

## **Monetary Policy and Neoliberalism**

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### **Abstract**

This chapter reviews the monetary policies associated with neoliberalism. It starts from the monetary policy problems emerging in the transition from Keynesianism to neoliberalism, to argue, first, that monetary policy and exchange rate regimes are irreducibly *political*. They do not simply offer alternative approaches to macroeconomic management; they also discipline the nation states and the social actors in specific ways. Second, the neoliberal transition was the contingent outcome of the search for solutions to specific problems of accumulation that surfaced, in part, through inflation and other symptoms of monetary instability. Third, the monetary and exchange rate policy regime that emerged under neoliberalism is the 'new monetary policy consensus' (NMPC), including inflation targeting (IT), Central Bank independence (CBI) and floating exchange rates. The NMPC is examined in detail, and criticised from a political economy angle. Fourth, the chapter reviews the implications of the global crisis starting in 2007 for the NMPC.

**Keywords:** Monetary policy, neoliberalism, inflation targeting, Central Bank independence.

## **Introduction**

This chapter critically reviews the monetary policy framework associated with neoliberalism, including inflation targeting (IT) and Central Bank independence (CBI). Together, they are the component parts of the so-called New Monetary Policy Consensus (NMPC).<sup>1</sup> Since the late 1980s, the NMPC has become the dominant ('best practice') monetary policy paradigm in several advanced, middle-income and, increasingly, poor countries.<sup>2</sup> Its popularity among mainstream economists and policymakers is based on the theoretical strengths of the NMPC (from the point of view of neoclassical economics), and the alleged successes of countries implementing this policy compact. From this point of view, the NMPC addresses successfully an important policy problem: how to anchor domestic monetary systems in the age of neoliberalism, that is, in economies with inconvertible credit money and bloated and liberalised financial systems, and in societies split by incompatible political and economic demands. In this sense, the NMPC helps to underpin neoliberalism. The manner in which it does so, discussed in detail below, makes the NMPC the most appropriate monetary policy strategy for the age of neoliberalism. In this sense, then, the NMPC is hegemonic: it incorporates the most refined practical conclusions drawing upon mainstream economic theory; it is attractively packaged, and its policy recommendations draw upon the 'common sense' of the neoliberal age; consequently, they are easy to understand and defend. These policies also promote powerful interests that are presented as the expression of the 'common good'.

The global success of this monetary policy paradigm is not simply due to reasoned academic debate and enlightened policymaking. It is, to a much greater extent, the outcome of the reorganisation of social relations and transformation of economic policies in several countries under neoliberalism. It is only in this context that the mainstream could address important shortcomings of the anti-inflation strategies attempted after the collapse of the Bretton Woods System, that were generally based either on 'social accords', or money supply or exchange rate targeting. Despite the achievements of the NMPC in policy practice, this chapter shows that the theoretical foundations of IT and CBI are both eclectic (including insights from the monetarist, new classical and new Keynesian schools of thought) and faulty. They cannot represent reality adequately, and fail to deploy policy instruments consistently in order to maintain economic stability, especially in challenging times when policy anchors are most needed. At these times, countries must resort to pragmatic solutions outside the NMPC.

The chapter includes six sections. This introduction is the first. The second reviews the development of the mainstream theory and policy practice of inflation control, focusing on IT and CBI. The third outlines the costs of the NMPC, including high interest rates, conflicts between IT and balance of payments equilibrium, financial instability and the costs of CBI. The fourth briefly summarises studies of the performance of IT and CBI. The fifth examines the implications of the global crisis starting in 2007 for the NMPC. The sixth concludes this chapter.

### **The NMPC in Theory and Policy Practice**

In the postwar (Keynesian-social democratic) 'golden age' of capitalism, inflation was generally assumed to be due to cost pressures, especially rising wages and balance of payments difficulties. Mainstream policy recommendations included incomes policies and exchange rate adjustments within the Bretton Woods System, to allow persistent differences in rates of productivity growth to be absorbed through the exchange rate rather than through unemployment. Perceptions shifted between the late 1960s and the early 1980s, when inflationary pressures were assumed to result from adverse supply shocks, excess money supply growth and unreasonably optimistic assumptions about the stability of the Phillips curve. In this period, many mainstream economists turned towards monetarism, and advised governments to control inflation through labour market reforms to increase 'flexibility' and cut employment costs, and impose money supply (or, alternatively, exchange rate) targets in order to secure fiscal discipline and anchor private sector expectations.

The monetarist experiences in Germany, Switzerland, the UK, the US and elsewhere during the 1980s did not vindicate the claims that money supply targeting was either feasible or conducive to inflation stabilisation (at the same time, exchange rate anchors failed with dreadful consequences in Argentina, Chile and Uruguay) (Diaz-Alejandro, 1985). In addition to these practical difficulties, monetarist theory was badly damaged by the severe criticisms inflicted by new classical, Keynesian and radical political economists.<sup>3</sup> Briefly, Keynesians and radical political economists argued, first, that since the velocity of money and the money demand function are unstable, the relationship between money supply and nominal income is unpredictable. Therefore, even if money supply targeting were feasible (which it is not), it would be insufficient to control inflation. Second, although there is always some relationship between changes in the stock of money and changes in the price level, this does not imply that the growth of the money stock *determines* the rate of inflation. Therefore, even if money supply targeting can help to squeeze inflation out of the economy, it does so slowly and unreliably, and

potentially at a high cost. Third, government attempts in the 1970s and 1980s to control the money supply while, at the same time, liberalising the financial system and the capital account of the balance of payments were self-defeating. Liberalisation modified the monetary transmission process and the linkages between money, finance and output. It also created incentives for the development of a host of financial instruments that blurred the definition of the monetary aggregates and bypassed existing controls over the supply of money, throwing the entire exercise into confusion. The (radically mainstream) new classical economists also criticised the monetarist experiment. In spite of their general agreement with the monetarist analysis of inflation, the new classicals claimed that the policy shift towards money supply targeting induced changes in private sector behaviour that invalidated the predictions of existing econometric models. Consequently, the monetarist policy recommendations were doubtful analytically, as well as potentially unhelpful in practice.

The shortcomings of monetarism and heavy criticisms levelled by its opponents contributed to the development of a vast literature on inflation and stabilisation during the 1980s. In the absence of significant wage pressures or major supply shocks during this period of consolidation of neoliberalism in leading economies, inflation was associated with fiscal deficits and, especially, lack of government policy credibility. This diagnosis lent itself to recommendations for increasing credibility, supported by some kind of nominal anchor. These policies were followed by pressures for CBI and trade and capital account liberalisation, in order to dismantle selected features of the Welfare State, further increase labour market flexibility, curtail the remaining sources of labour unrest, and impose finance-friendly policy discipline on presumably reluctant governments (Gowan, 1999; Panitch and Gindin, 2005; Rude, 2005).

By the mid-1990s, the NMPC had already become the hegemonic framework for anti-inflation policy. This policy regime was perceived to be the most conducive to the consolidation of the low inflation regime achieved in rich countries, and it spread rapidly from New Zealand in 1989. The NMPC also seemed to have something to offer to the middle-income and poor countries, even though their Central Banks generally lack experience supervising complex, liberalised and internationally integrated financial systems (which, nevertheless, were imposed by external as well as internal pressure, as part of the neoliberal transitions in these countries). There, the NMPC could allegedly deliver greater economic stability, institutional transparency, objective monetary policy rules, standardised channels for the diffusion of information and, hopefully, lower costs of international financial integration.

## Inflation Targeting and Central Bank Independence

For mainstream economic theory, the most important contribution that monetary policy can give to social welfare is price stability. Attempts to use monetary policy to achieve other goals, such as higher output or employment, should be avoided because they tend to introduce an inflationary bias in the economy. Instead, the government should signal its 'explicit acknowledgement that low and stable inflation is the overriding goal of monetary policy' (Bernanke and Mishkin, 1997: 97), by setting a legally-binding numerical IT to be pursued by the Central Bank. The IT can be either an interval or a point, with or without tolerance margins. Finally, the IT should be the *only* nominal anchor in the economy, as it cannot be pursued simultaneously with money supply, wages, employment, exchange rate or any other targets.

CBI is an essential component part of the inflation targeting regime (ITR). The distinguishing features of CBI are the institutionalisation of the primary responsibility of the Central Bank for achieving the IT, the appointment of its directors for fixed terms (preferably not coinciding with the mandate of the country's president or legislators, in order to ensure policy continuity), and the regular assessment of the Bank's performance through the trajectory of inflation and reports formally submitted to the government, legislators and the media. Potential differences between countries and over time can include the precise duties of the Bank, its policy instruments and degree of autonomy, the relationship between the Central Bank and other government departments, the procedure for appointing Bank directors, and limits on government borrowing from the Bank. In sum, it is assumed that CBI limits the influence of politicians over economic policymaking, which should reduce uncertainty, moderate the political business cycle and largely eliminate the inflation bias of monetary policy.

The ITR operates at multiple levels. At the level of government, it allegedly secures 'good' (i.e., neoliberal) monetary policies, increases the transparency and accountability of Central Bank actions, and provides guidelines for other policies, especially fiscal, employment and exchange rate policy. From the point of view of the private sector, ITR provides guidance for inflation expectations and strong indications of future government policy. This should reduce uncertainty and facilitate economic co-ordination across markets, lowering adjustment costs and assisting the consolidation of a low inflation regime. If implemented competently, ITR can be highly successful, even 'deliver[ing] as much price level stability as a commodity [gold] standard' (Bordo et al., 2003: 1).

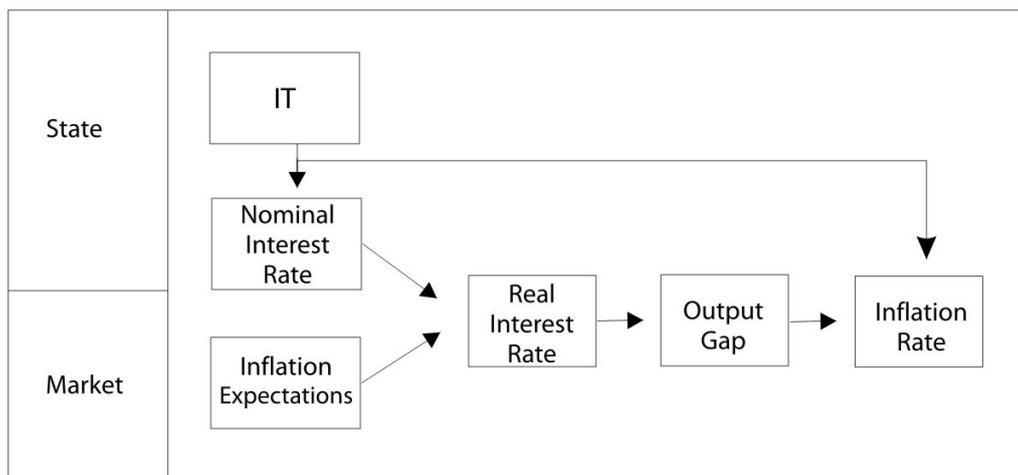
The transition costs to the new policy regime presumably depend on the credibility of the government's commitment to the ITR and reputation of the Central Bank. The more credible the government's commitment and the better the Central Bank's reputation, the faster expectations will converge to the IT and the lower will be the output costs of reducing inflation towards the target (the 'sacrifice ratio'). Once established, the ITR should bring lower and more stable inflation rates, faster economic growth, and a permanently lower sacrifice ratio. These potential benefits support the view that other government policy goals, such as employment generation, economic growth and income distribution, should be subordinated to IT.

Despite these significant advantages, even the mainstream cautions that IT is not appropriate for all countries and circumstances, and that five conditions must be satisfied to secure the viability of this policy regime. First, the monetary authorities need effective policy tools and autonomy to deploy them. Second, the absence of fiscal dominance; that is, fiscal policy considerations cannot play a determining role in macroeconomic policy decisions. This requires strict limits on government borrowing from the Central Bank, while public sector funding should rely on a broad tax base and efficient tax system, rather than seignorage. Third, the rate of inflation should be low enough at the start to ensure a reasonable degree of Central Bank control of the monetary aggregates (therefore, IT is *not* a stabilisation policy). Fourth, the financial markets must be sufficiently developed, deep and efficient to absorb placements of public debt, such as treasury bills or bonds, which could otherwise sidetrack monetary and fiscal policy. Fifth, the absence of external dominance – in other words, the country's balance of payments should be sufficiently solid to allow monetary policy to focus on inflation control, rather than being constantly diverted by the need to respond to adverse external shocks.

### **The NMPC in Practice**

The economic model underpinning the NMPC is very simple (see Figure 1). It includes two key parameters: the IT and the inflation expectations; the former is set by the government and the latter by 'the market'. The model also includes one discretionary policy instrument, the nominal interest rate.

#### **Figure 1: Inflation targeting**



The government policy objective is to eliminate the inflation gap (the difference between the rate of inflation and the IT) at a specific point in the future (the policy horizon). The model presumes that inflation is jointly determined by inflation expectations and the output gap, with the latter fluctuating around a supply-side equilibrium. Alternatively, unemployment fluctuates around either the natural rate of unemployment (NRU) or the non-accelerating inflation rate of unemployment (NAIRU), such that unemployment below (above) the NRU/NAIRU would lead to higher (lower) rates of inflation. The output gap (the difference between the rate of unemployment and NRU/NAIRU) is determined by the real interest rate. Finally, the real interest rate is, by definition, equal to nominal interest rates minus expected inflation.

In this model, the Central Bank attempts to hit the IT through manipulation of the nominal interest rate in order to influence the state of expectations and, at a further remove, fine-tune aggregate demand. If the Central Bank forecasts a positive inflation gap during the policy horizon, either because aggregate demand is too high or because the market expects that inflation will rise in the future for whatever reason, the Bank will adjust monetary policy, usually by raising nominal (and, *ceteris paribus*, real) interest rates.

The model implies that inflation control is achieved through fluctuations in the output gap. The lower is the government's tolerance to an inflation gap, the shorter is the time-span available to achieve IT. Similarly, the more open is the economy, the larger will be the fluctuations of the output gap and, therefore, the variance of the unemployment rate. Finally, although a wide variety of instruments can be used to achieve IT, in practice Central Banks tend to focus on manipulation of nominal interest rates. This instrument is especially convenient because it is simple to use; it is also supposedly non-

distortionary, because it does not systematically discriminate between economic sectors and, therefore, does not lead to resource misallocation.

In contrast with money supply or exchange rate targeting regimes, the NMPC is flexible at three levels. First, the IT is normally low and positive, rather than zero, and the targets are usually bands, rather than points. Bands are used because of the possibility of misspecification, parameter uncertainty or structural breaks in the Central Bank economic model, because of the uncertainty surrounding the monetary transmission process and links between the policy levers and inflation outcomes, and because of the possibility of shocks. All this would make it difficult to continuously hit a single point target for inflation. Even trying to do so would increase the volatility of the interest rates which, in turn, would have destabilising effects. Second, in exchange rate targeting regimes it is impossible to depart temporarily from the peg without a severe loss of credibility or a currency crisis. In contrast, in ITR the Central Bank normally targets inflation over a policy horizon of one to three years in the future, so it can ignore transitory disturbances that, in and of themselves, would not trigger long-term variations in the rate of inflation. In order to make the ITR even more robust, inflation is usually measured by a 'core' (rather than headline) price index, usually the CPI. This is to minimise the impact of adverse supply shocks, natural disasters, sudden fluctuations in the exchange rate or terms of trade, seasonal variations of food and energy prices, changes in indirect taxes, regulated prices, subsidies and mortgage payments, and even the direct (first-round) impact of interest rate changes. Third, although interest rate manipulation is the favoured monetary policy instrument under ITR, the Central Bank should ideally deploy all relevant information and a wide variety of tools in order to pursue IT. These tools depend on the institutional structure of the Central Bank, the country's political system and the policymaker's conviction about how best to operate. They could include, for example, changes in banking regulations or the required reserve ratios, the imposition of differential asset requirements, or anything else, as long as it contributes to achieving IT within the policy horizon.

In sum, the NMPC allegedly offers the optimal combination of instruments to lock in low inflation and create conditions for sustainable growth, bringing together the virtues of policy simplicity, credibility, legitimacy, sustainability and flexibility. Claims such as these have contributed to the rapid growth of the appeal of the NMPC around the world.

### **Costs of the NMPC**

This section examines the potential economic costs of the inflation policies associated with the NMPC. Four types of costs are considered: the cost of using interest rates as the main tool to control inflation, the cost of conflicts between IT and balance of payments equilibrium, the cost of financial instability, and the costs of CBI.

### **The Cost of High Interest Rates**

It was shown in the previous section that, in the NMPC, inflation control is achieved primarily through manipulation of interest rates. This implies that real interest rates will tend to be higher under this policy regime than under an alternative arrangement in which a wider set of instruments plays a more significant role in (non-targeted) inflation control.

There is no question that high interest rates can reduce inflation, since they increase the costs of production, investment and consumption, and may trigger government spending cuts because of the higher cost of servicing domestic public debt. Weaker aggregate demand tends to compress profit margins at least in the competitive sector of the economy (oligopolistic firms may be able to increase prices in order to defend their profits, but this will be ignored here). In turn, higher financial costs can force highly leveraged or financially weaker firms into bankruptcy, regardless of their economic prospects, technical efficiency or strategic importance. The remaining firms could respond to these cost and demand pressures by reducing variable costs in different ways. For example, they could evade tax or social security payments, increase the intensity of work, the number of unpaid hours or labour turnover, delay bill payments, and so on. High interest rates also change the relationship between the tradable and non-tradable sectors, industry and agriculture, and the sub-sectors within them. The sectoral and distributional impact of higher interest rates cannot be anticipated precisely, since it depends on the structure of the economy, pattern of demand, response of the exchange rates and export and import sectors, and other variables. However, it is widely accepted that higher interest rates tend to bring gains to finance, both in terms of policy influence and through additional shares of national income (Argitis and Pitelis, 2001; Mann, 2013; Rochon, 2007).<sup>4</sup>

Higher interest rates also increase the risks associated with financial sector activity. This is not only because of the adverse impact of higher interest payments on indebted agents, but also because of the larger size of the liability mismatches in the economy, emergence of new financial assets and markets requiring distinct (and, inevitably, more risky) investment strategies, and a more volatile economic

environment. In extreme cases, rigid inflation rates (due to cost or balance of payments pressures, or deep social divisions), or excessively ambitious IT, can lead the Central Bank to impose very high real interest rates, which can push the economy into a stabilisation trap: a 'bad' equilibrium with low growth, high unemployment and intractable problems of poverty and inequality.

### **The Cost of Conflicts between IT and Balance of Payments Equilibrium**

ITR may conflict with the achievement of intertemporal balance of payments equilibrium at two levels. First, there may be conflicting pressures on the rate of interest. In any small, open economy with relatively developed currency and financial markets, there is a close relationship between interest rates, rate of inflation, fiscal deficit, rate of unemployment, exchange rate, and level and direction of international capital flows. There is *a priori* no guarantee that a single interest rate can deliver, simultaneously, IT, a sustainable fiscal balance, exchange rate stability, balance of payments equilibrium and low unemployment. Achieving these goals requires a combination of policies in which interest rates play an important but not necessarily decisive role.

In other words, attributing unwarranted priority to the manipulation of interest rates in economic policymaking implies that these rates will tend to be determined by the higher of two levels: those required to achieve IT, and those needed to close the balance of payments, with the rate of unemployment being a residual. If the balance of payments constraint is binding, the exchange rate may be stable but aggregate demand will tend to be too low, potentially leading to a stabilisation trap. Alternatively, if the IT is binding, the interest rate will be too high for balance of payments equilibrium, leading to excessive inflows of foreign capital, especially if international capital flows have been liberalised, as is often the case in countries moving towards neoliberalism. The ensuing increase in external liabilities will tend to be sterilised by a swelling domestic public debt, potentially exposing the economy to a financial crisis, a balance of payments crisis, a fiscal crisis, or all three.

Second, it may be difficult to pursue IT if the private sector has large liabilities in foreign currency. In this case the financial institutions and their customers will be burdened with currency mismatches, which could become costly should the exchange rate depreciate. These mismatches will create pressures for the Central Bank to provide hedging instruments and maintain exchange rate stability, even though this is incompatible with ITR. In these circumstances, IT may be an inappropriate choice

of policy regime, and a hard exchange rate peg may be more desirable, especially for very small economies.

### **The Cost of Financial Instability**

Although the Central Bank is primarily responsible for achieving IT, it must also be the charge of banks and the institution responsible for preserving domestic financial stability (see below). These mandates may occasionally clash, especially if asset and product markets give contradictory signals about inflation, asset prices are very volatile, or asset values rise rapidly as a proportion of GDP. For example, if price inflation threatens to escalate, the Central Bank may be compelled to raise interest rates, which could undermine financial system stability and trigger a costly crisis. Alternatively, if deflation looms, the Central Bank may be forced to lower interest rates, although this may fuel destabilising shifts in asset prices or debt and consumption bubbles.

The close relationship between price inflation, personal and company debt, financial system stability and asset price inflation, and the potentially large cost of financial crises, suggest that the Central Bank ought to monitor asset prices and levels of debt as part of its duty to maintain economic stability. It follows that the excessive focus of the NMPC on inflation control tends to distract attention from the financial sector as a major source of *instability*. This is misguided, because the output and employment costs of financial crises can easily exceed the costs of moderate inflation – as was dramatically demonstrated by the global crisis starting in 2007.

### **The Cost of Central Bank 'Independence'**

Arguments for CBI are based on the presumably greater transparency, legitimacy and accountability of monetary policy under this institutional arrangement. However, this claim veils the greater scope for (asymmetric) *discretion* in the conduct of monetary policy under CBI. In this policy regime, the board of the Central Bank ought to consult 'the markets' in order to set interest rates. In contrast, in previous monetary policy regimes, claims for interest rate changes would be the subject of political argumentation at several levels of government, especially at the Ministry of Finance. There, counter-claims expressing the interests of different social groups could (at least in principle) be heard, and there might be scope for reaching a more balanced decision. This debate should be welcomed, for how 'could it be thought reprehensible for the elected representatives of the people to seek to influence –

by persuasive argument perhaps – the central aspects of [economic] policy?' (Forder n.d.; Forder 2003). In this sense, CBI is *undemocratic* by definition: the insulation of monetary policy from public debate reduces the accountability of the Central Bank, and undermines the legitimacy of monetary policy.

It follows that the 'credibility' and 'reputation' of the Central Bank are misnomers. The improved indicators of credibility that usually follow CBI reflect the sentiment of a narrow circle of powerful individuals, whose material interests are directly affected by the monetary policy stance adopted. In this sense, 'improved expectations' are a reflection of the closer relationship between the Central Bank and financial markets under CBI, as well as financial operators' appreciation of the Central Bank's performance and their confidence that monetary policy will be subordinate to their narrow interests: in other words, 'credibility' measures the *takeover* of monetary policy by the interests of finance.

### **The Performance of IT and CBI**

There is a vast literature assessing the performance of IT and CBI. These studies tend to be substantively similar in their scope, approach and conclusions. This section focuses on the former for reasons of space.

Several studies have identified gains stemming from IT in such areas as lower inflation rates, volatility and inertia, improved expectations, faster absorption of adverse shocks, lower sacrifice ratio, output stabilisation, and the convergence of poorly performing countries toward well performing country standards.<sup>5</sup> Similar gains have been attributed to CBI.<sup>6</sup> However, other studies have been less supportive, claiming that there is no evidence that IT and CBI improve economic performance.<sup>7</sup>

These conflicting views are partly due to the use of distinct approaches, datasets and econometric methodologies; as such, they are no different from the contradictory views in other areas of macroeconomics. However, there may be three additional reasons for these diverging views of the efficacy and efficiency of IT and CBI. First, it is difficult to classify policy regimes rigorously. Countries can be grouped in different ways according to whether they follow 'explicit' or 'implicit' IT policies, or the extent to which their Central Banks have administrative and/or instrument independence. If one also controls for the structural differences between the economies being

examined, the available samples tend to become vanishingly small, making it impossible to make meaningful before-after or with-without comparisons of policy performance.

Second, even its committed supporters admit that IT is not an inflation stabilisation strategy. Consequently, although high inflation countries may be more inclined to adopt IT, they can do so only *after* a successful disinflation programme that is, itself, unrelated to IT. On adoption, the ITR will almost invariably inherit falling inflation rates, growing monetary policy credibility and, quite possibly (if their economies have been in the doldrums for long periods), above-trend growth rates. These favourable developments are *conditions* for IT rather than outcomes of this policy regime, and they should be factored into the assessment of the performance of ITR.

Third, even when the economic performance of IT countries improves *more* than that of non-IT countries by whatever criteria, it cannot be assumed that the difference was *due* to IT. For example, Ball and Sheridan (2003) find evidence that the countries showing the greatest performance improvements during their period of analysis were those with the worst performance in the previous period, and these tend to be IT countries (possibly because underperforming economies are more likely to change policy regimes). However, those improvements could be due simply to their regression to the mean, which helps to explain why performance *also* improved in the non-IT countries. Therefore, the apparent success of IT countries may be due to their having 'high initial inflation and large decreases, but the decrease for a given initial level looks similar for targeters and non-targeters' (Ball and Sheridan, 2003: 16). Once they control for regression towards the mean, Ball and Sheridan find no evidence that IT improves any aspect of economic performance.

### **The Impact of the Global Crisis**

The NMPC established itself as the typical monetary policy for neoliberalism during the 1990s and the early 2000s. The consolidation of neoliberal economic policies and the NMPC in a growing number of countries supported a fundamental transformation of the role of finance. 'Liberalised' financial systems gained increasing control over economic resources and their allocation, and the scope to develop an increasingly autonomous sphere of speculation based on the trading of titles of fictitious capital. These developments were fully supported by presumably 'independent' Central Banks.<sup>8</sup>

Because of its strategic position at the hub of social reproduction, including control of the key sources of capital, foreign exchange and state finance, the financial institutions could appropriate a growing share of surplus value. For example, in the USA, the profits of financial companies (that is, excluding profits due to the financial activities of non-financial firms) jumped from below 5 per cent of after-tax corporate profits in 1982, to well over 40 per cent in the early 2000s.<sup>9</sup> Since finance is directly unproductive of value, these profits can only be transfers from the non-financial corporate sector and wage-earners. Their expansion has contributed greatly to the concentration of income under neoliberalism (e.g. Mohun, 2015; Piketty, 2014; UNCTAD, 2013).

This period was dubbed 'the great moderation' by mainstream economists and policymakers (e.g. Bernanke 2004). That presumably blissful age of rapid and stable GDP growth and low inflation, at least in comparison with the erratic performance of most advanced economies since the late 1960s, is now long-forgotten. The sobriquet serves only as a reminder of the hubris of the spokespeople for neoliberalism, who claimed ownership of a modality of global growth drawing on a conventional set of macroeconomic policies including IT, CBI, and liberalization of domestic finance and international capital flows. These policies sustained the rapid accumulation of private debt and rising current account deficits in the US, UK, the Eurozone periphery and in leading middle-income countries, and growing current account surpluses and currency reserves in China, Japan, Germany and several East Asian and oil exporting countries. Both sides were brought together by misaligned currencies supported by enormous currency flows channeled by a bloated and short-termist financial system.

The dysfunctionality of this model of growth was missed by neoliberal academics, ministers of finance, academics, journalists, and the all-important independent Central Bankers. Their self-congratulatory mood was rudely dislodged by the onset of the greatest crisis of capitalism since the Great Depression in 2007. The crisis remains unresolved at the time of writing, one decade later. It has revealed that, under neoliberalism and the NMPC, global growth has become structurally unbalanced, consisting of speculative bubble-like episodes taking place *between* increasingly severe finance-driven crises: the neoliberal 'great moderation' was a myth driven by unsustainable policies backed up by finance-friendly economic dogma. Remarkably, the trajectory of the distribution of income and wealth in most countries shows that neoliberal economies tend to generate inequality when they grow, and to distribute losses inequitably when they contract (Arestis and Sawyer, 2010; Saad-Filho, 2008, 2011; Tcherneva, 2015).

The strategy of crisis management since 2008 demonstrates the depth and extent of the hegemony of neoliberalism over ideology as well as state policy. First, neoclassical economics dominates the discipline almost entirely, to the extent of treating Keynesian anti-cyclical policies as a set of tools that can be deployed selectively in emergencies, especially to support finance itself, but otherwise beyond the pale as suggesting unacceptable tolerance of inflation and the interests of the poor. Second, the astonishingly skewed finance-friendly strategy of containment of the global crisis received almost universal applause, even though it amounted to a barefaced socialisation of losses in order to salvage the largest financial institutions specifically, and the neoliberal system of accumulation in general. Third, even though the crisis imposed significant changes in the practice of monetary policy in several countries, primarily through the generalisation of ZIRP (zero interest rate policies) in most advanced economies as part of the strategy to salvage finance, it did not lead to the formal abandonment of IT or CBI anywhere. In this sense, both neoliberalism and the NMPC remain unchallenged, while policy implementation has retained as much flexibility as necessary in order to help salvage the system of accumulation by any means necessary.

Despite its success in further consolidating the hegemony of neoliberalism, the attempt to address the crisis in the advanced economies through relaxation of monetary policy, provision of virtually unlimited public support for finance, and fiscal 'austerity' has failed to sustain the economic recovery anywhere. In essence, Central Banks in the USA, UK, Japan, Switzerland and the Eurozone reduced interest rates virtually to zero, sometimes even straying into negative territory, which was previously thought to be impossible. Those Central Banks also purchased vast quantities of worthless assets from large financial institutions through 'quantitative easing' programmes, in order to buttress private balance sheets (Kregel, 2009: 6-7).

In practice, those policies required the temporary abandonment of IT, with outcomes ranging from inflation much above the official target for extended periods, as in the UK, or significantly below this target, as in the Eurozone, without *any* analytical, practical or institutional consequences. Given the overwhelming need to save neoliberalism from itself, the supposedly all-important inflation targets became entirely irrelevant. CBI similarly vanished without a trace, as bankers confabulated overtly with governments and the largest financial institutions whenever this became convenient in order to find the best way to stabilise the economy. The *political* roots of the NMPC, and the practical irrelevance of its grandiose principles and institutional framework, became evident. As former Fed chairman Paul Volcker (2008: 1-2) colourfully summarised it:

[W]e have moved from a commercial bank centered, highly regulated financial system, to an enormously more complicated and highly engineered system. Today, much of the financial intermediation takes place in markets beyond effective official oversight and supervision, all enveloped in unknown trillions of derivative instruments. It has been a highly profitable business, with finance accounting recently for 35 to 40 percent of all corporate profits ... It is hard to argue that the new system has brought exceptional benefits to the economy generally ... Simply stated, the bright new financial system – for all its talented participants, for all its rich rewards – has failed the test of the market place. To meet the challenge, the Federal Reserve judged it necessary to take actions that extend to the very edge of its lawful and implied powers, transcending certain long embedded central banking principles and practices.

Regardless of those contortions, the neoliberal crisis resolution strategy failed at another level too. Pumping large quantities of money into a dangerously unstable financial system, while offering near-zero interest rates at home, triggered a stampede of capital from advanced economies into the 'emerging' world, where the economic prospects were much healthier. This took place through carry trade and the 'currency war' in the late 2000s, which led exchange rates to respond pro-cyclically: rising unsustainably in the 'South' and declining in the 'North'. That torrent of taxpayer-funded financial capital was eventually absorbed by the rapid growth of corporate debt in developing countries:

The corporate debt of nonfinancial firms across major emerging market economies [has] increased from about US\$ 4 trillion in 2004 to well over US\$ 18 trillion in 2014. The average emerging market corporate debt-to-GDP ratio has also grown by 26 percentage points in the same period (IMF, 2015: 84).

Those resource flows, initiated by the attempt to save the banking system in the advanced countries, have destabilised exchange rates, current accounts and growth prospects in numerous countries, so far without a plausible form of resolution, and suggesting that the current crisis may remain unresolved for some time.

## Conclusion

This chapter has shown that the NMPC is limited in four important ways. Firstly, it is based on doubtful assumptions, unwarranted generalisations, overly optimistic expectations about convergence to a virtuous circle of prosperity, and the questionable ability of neoliberal policies to extricate the economy from finance-driven crises. Secondly, the NMPC imposes low inflation targets that can lock the economy into a pattern of low growth, high unemployment and potentially intractable problems of poverty and inequality. Thirdly, it offers only blunt and inefficient policies against inflation, grinding it down through potentially long periods of high unemployment that reduce the economy's growth potential while increasing its financial fragility. Fourthly, hyper-vigilance against inflation, which is built into IT and CBI, is incompatible with rapid and equitable growth, because it fosters the interests of finance at the expense of the majority of the population and locks countries into economic development strategies that are inimical to the achievement of democratic outcomes (Ayers and Saad-Filho, 2014).

Given these limitations, why does the mainstream place so much emphasis on IT and CBI, as is demonstrated even by a cursory perusal of IMF publications and the writings of most mainstream macroeconomists? Several contributing factors can be readily identified. First, mainstream theory is structurally predisposed to see value in IT and CBI, since they share the same methodological foundations (real-monetary dichotomy, quantitativism, abhorrence of state intervention, and so on) (e.g. Mishkin and Posen, 1997). Second, IT and CBI are hegemonic under neoliberalism. They have become part of the 'common sense' of the age, and these policy recommendations tend to creep unthinkingly into even heterodox discourse. Third, IT and CBI can appear to contribute to inflation control because governments will always set targets that they believe can be achieved, and because demand control through the manipulation of interest rates can normally reduce inflation regardless of its causes, especially in an open economy. Fourth, neoliberalism has restructured the economy, class relations and legal system in order to minimise the scope for distributional conflicts to spill into higher inflation, making it easier to control inflation under any reasonable macroeconomic circumstances. Finally, IT and CBI promote the interests of domestic and international finance, ensuring that they will be supported by a powerful constituency.

IT and CBI are not merely technical matters: *monetary policy is political*. Monetary policy regulates and disciplines the process of accumulation in each country and internationally, and helps to

perpetuate the inequities associated with the neoliberal system of accumulation. In other words, IT and CBI are primarily political rather than 'technical' choices, and they have profound implications for the economy, society and political system. They support the reorganisation of society and economy that is set in train by the transition to neoliberalism, including the takeover of the state's legitimacy, resources and policymaking capacity by finance. These are deployed to strengthen minority power and promote the interests of finance, dressed up as the general good. These goals are disguised by the veil of 'technical objectivity', 'rules' and 'policy neutrality' that is provided by mainstream economics.

In summary, the NMPC *may* have succeeded in maintaining marginally lower rates of inflation than alternative policy frameworks (although this is debatable). In contrast, the NMPC *certainly* excludes inconvenient political dilemmas from public scrutiny, entrenches the current finance-friendly balance of social forces into the institutional fabric, and creates rigidities preventing the consideration of alternative economic policy tools and goals. In all these senses, the NMPC is intrinsically *neoliberal* and inimical to political democracy and economic equality. The NMPC has also helped to fuel financial asset bubbles, did not contribute to the global recovery, and contributed to the generation of potentially explosive imbalances in several countries. This is hardly a record to be proud of.

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## Notes:

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<sup>1</sup> The term NMPC is suggested by Arestis and Sawyer (2005) and Fontana (2006); for a review, see Saad-Filho (2007).

<sup>2</sup> An incomplete list includes Australia, Brazil, Canada, Chile, Colombia, Czech Republic, Ghana, Guatemala, Hungary, Iceland, Indonesia, Israel, Mexico, New Zealand, Norway, Peru, Philippines, Poland, Serbia, South Africa, South Korea, Sweden, Thailand, Turkey and the United Kingdom (see Hammond, 2012 and Roger, 2010). Countries following similar strategies include Argentina, Japan, Singapore, Switzerland and the United States plus the Eurozone.

<sup>3</sup> For an overview of these debates, see Carlin and Soskice (1990), Levacic and Rebmann (1982) and Sawyer (1989).

<sup>4</sup> For alternative views, see Brancaccio and Fontana (2013) and Knibbe (2015).

<sup>5</sup> See, for example, Bernanke et al (1999), Carvalho-Filho (2010), Debelle et al (1998), Dotsey (2006), Landerretche et al (2001), Mishkin (1999), Mishkin and Schmidt-Hebbel (2002), Roger (2010) and Svensson (1997a, 1997b, 2007).

<sup>6</sup> See, for example, Alesina (1989), Alesina and Summers (1993), Cukierman (1992), Grilli et al (1991) and Hammond (2012).

<sup>7</sup> See, for example, Agénor (2001: 43-44), Bibow (2010), Carare et al (2002), Carare and Stone (2003), Cecchetti and Ehrmann (1999), Chang and Gabel (2004: 183-184), Debelle et al (1998), Neumann and von Hagen (2002) and Wray (2014).

<sup>8</sup> For a detailed analysis, from slightly different viewpoints, see Gowan (1999), Lanchester (2010), Norfield (2016), Panitch and Konings (2008), Panitch and Gindin (2012) and Tett (2009).

<sup>9</sup> See 'Financial Sector Profits as a % of All Domestic Corporate Profits', US National Income and Product Accounts, table 6.16A, <http://www.bea.gov/iTable/iTable.cfm?ReqID=9#reqid=9&step=3&isuri=1&903=236>.