HELENE REY

Professor of Economics at London Business School, Member of the French National Economic Commission, Member of the High Council for Financial Stability

Jean-Claude TRICHET

Hélène, you have the last word.

Hélène REY

Merci Jean-Claude. As a macroeconomist, one underlying issue that has repeatedly come up and that is a very important issue right now is, why are the real rates so low? In a way, it underpins everything that most people have been saying. We do not understand exactly why they are so low. That constrains monetary policy massively. That is linked to the potential creation of bubble and financial instability. That puts huge financial risk, not just potentially on the banking sector, but also, people have not talked about the insurance sector and various types of asset managers, the pension funds etc.

This is a really big issue. What do we know about it? There are several theories out there. One very prominent advocate of secular stagnation is Larry Summers, and he relates the decline in real rates to trends. If he is right, then these trends are very persistent, because they have to do with demography and productivity growth. We cannot predict innovation. I happen to have done some research on this, and I would tend to disagree with Larry Summers and be much more on the Ken Rogoff side of things.

In order to understand long-term movements in real rates, one has to look at economic history. Then that is going to strike a chord with Jeff regarding the 1930s. However, if you look at the long-term patterns of movements in real rates, it turns out that you can link them quite closely to other macro-economic variables. This refers to consumption and wealth, consumption and wealth ratios.

What you see is that the only other episode that is similar to ours today is the 1930s, which was the big crisis. In both cases, you saw massive increases in wealth, in the 1920s. That was the irrational exuberance period. We saw that in the 1980s and 1990s, and in both cases, this was linked to financial deregulation. Then we saw a massive financial crisis. Then after the massive financial crisis, we saw a very long period of deleveraging, and people underestimate how long it takes to delever. We are still in that swing, in that period of deleveraging, and this is why the real rates tend to be quite low.

If this is correct, that also points to a fact. If this is correct, that points to that fact, but for other reasons, this is correct as well. Fiscal policy is the right tool right now. Fiscal policy is the right tool, because while the interest rates are low, fiscal policy is more effective. When interest rates are negative, if you have to do investments, it is the right time to do it. Do we have to do investments? We do. Everything we have said today and yesterday about climate change and having to do a transition requires a huge amount of private investment and public investment. We are in a situation where, from a cyclical point of view, it looks like we should be investing. From a survival point of view, it looks like we should be investing.

For everybody who says that having a lot of debt or having a deficit right now is not a prudent strategy, I would turn it on its head. It is the opposite which is not prudent. We should be investing a lot. How do we invest? In order to invest, we need certainty. We need to get rid of some uncertainty which is very detrimental to investment behavior. We have a case experiment with Brexit and I will not dwell on that, but in terms of climate change, there is a lot of uncertainty.

How do we go about that? What you want, and I think most economists who have worked on climate would agree with me here, is this. You want a carbon price and you want a deterministic price for a carbon price, with a long horizon. It is great that the chair here is Jean-Claude, because there is a great proposal out there by Christian Gollier and Jacques Delpla. They propose the creation of a carbon central bank, where the carbon central bank would sell permits, volumes of permits, in order to match them.

It requires the work of scientists in order to be able to do that properly, but it is possible. We want to match our target of volume of emissions with a deterministic path, between now and 2050. The central bank can intervene by selling these permits at auctions and hit this path. If you do that, and you also support it with public investment, you may unleash a whole lot of private investment. You may do something positive about what is needed for the energy transition. This is not without cost. The carbon price will be biting, so that requires a lot of accompanying distributive measures and we know that.

Energy transition is not going to be without cost, but this would be a way of doing it while dealing with the uncertainty and unleashing investment. This is something that would be worth considering. Starting it in Europe seems very natural, but with the appropriate mechanisms at the border to deal with the imported content of carbon, we could make progress and maybe increase the club of people adopting it down the road.

Jean-Claude TRICHET

Have you published a paper, Hélène, on this carbon central bank?

Hélène REY

The carbon central bank is not my idea. It is an idea from Christian Gollier. You might know that he is a very good academic and extremely good at finance and insurance. He is at the Toulouse School of Economics, along with Jacques Delpla. They published a short piece recently, where they detail exactly how things would work, and it is worth considering and reading.

Jean-Claude TRICHET

Ok, thank you very much, indeed. We have a very rich set of ideas, proposals and fears. I see many more fears and risks that could materialize than highly positive elements in what has been said. There will be only 2-3 remarks from me, which will be very short. I have to say that when I look at the picture from Planet March, I see populism and a level of frustration among the citizens, as you said very wisely, Jeff. This is in all the advanced economies without exception. Even if the modalities are different, it is the same in the US, the UK, continental Europe and Japan. That is one point, the immense frustration of the population.

Second, I see that inflation is extraordinarily low, and I cannot help making the connection. There is an anomaly in the functioning of our system which means that Phillips curve has not functioned since the crisis as it did in the past. Even when you have full employment, there is no real increase in the wages and salaries. The citizens prefer by far to protect their jobs instead of getting augmentations of wages and salaries, and that is because they have an immense competition constraint coming from globalization, the emerging countries, science and technology. This is not to speak, perhaps, of immigrants in their national economies.

All of this makes something which is abnormal. It is abnormal in my view that in Germany, you do not have this. It is starting a little bit now, but for a long period of time, you did not have what would have been expected from social partners in full employment. It is the same in the Netherlands, the same in Japan, the same in Switzerland and the same in a certain way in the US. This is with the paradox that the Republican president calls for the blue-collar workers to get more wages and salaries. This says a lot about the overall sentiment that there is something wrong there.

If they were even more demanding, I am not sure that the real wages and salaries would increase a lot, because you have other fundamental constraints that are underlying this, and we all know that. However, at least we would have unit level cost going higher, and with unit level cost going higher, inflation would be higher. We are in a Phillips curves which is Keynesian, which is more of a classic Phillips curve. Then perhaps the central bank would be without fear.

Right or wrong, they have the fear that the deflationary risk could materialize. This is the reason why, in this environment of very low inflation, they try to get out of this trap.

I dare myself, and I will be as daring as Hélène was. I know what happens when the system does not function very well and when wages and salaries are permanently fixed at too high a level. You engage with all partners in some kind of disinflation policy. This is what has been done in the Netherlands in Europe, in France after the Netherlands, and in many other countries. As a matter of fact, it is in all countries, in order to converge towards the euro.

It took social partners, government, public authorities, and the private sector, joint partnerships. These are to go from increases of 7-8% down to increases which would be more or less in line with the 2% of the inflation target, the implicit target. I am wondering whether we would not need to deliver the central banks from the trap, with all the consequences in terms of financial instability. These are associated with negative rates or very low rates. Should we not try to have the reverse consensus, if I may? It is not a disinflation policy, but other policies.

In a way, it is what Trump says when he said, ‘I am president of the US, and I want the blue-collar workers to get more wages and salaries.’ I see something which looks a little bit the reverse of what we did in the disinflation policy over 17 years in my own country. I participated in this myself. The euro would not exist, had we not introduced this policy.