Interview: L. Randall Wray

L. Randall Wray is one of the most important exponents within post-Keynesian economics. He is a Professor of Economics at the University of Missouri-Kansas City, a Senior Research Associate at the Center for Full Employment and Price Stability, as well as a visiting Senior Scholar at the Jerome Levy Economics Institute of Bard College. He is a past president of the Association for Institutionalist Thought (AFIT) and has served on the board of directors of the Association for Evolutionary Economics (AFEE). He is the author of innumerable articles and a number of books such as the acclaimed *Credit and State Theory of Money* (ELGAR, 2004) and *Understanding Modern Money: the Key to Full Employment and Price Stability* (ELGAR, 1998). His work on monetary theory, public finance and policies of employment generation are referential for academics and policy makers all over the world. In Argentina, his proposed Employer of Last Resort program inspired the implementation of the *Jefes de Hogar* program which employed over two million people at one point in response to the economic collapse of 2001. On September 26th of 2007 Wray gave this interview for *OIKOS* Review.

*OIKOS* – You were a student of Hyman Minsky and one of the first economists to effectively incorporate his ideas into your own contributions to macroeconomic theory. Currently, as the effects of the bursting of the real estate bubble spread through financial markets worldwide, Minsky’s work has become a frequent reference on major media outlets and comments by mainstream economists. Is it somewhat frustrating that mainstream economists and policy makers seem to have just “discovered” the “novel” Minskyan ideas about financial cycles even though his theories have been exhaustively discussed and expanded by heterodox economists like yourself? After all, while orthodox economists seemed to have been caught by surprise by the recent financial crisis, economists at the Levy institute familiar with Minsky’s ideas, yourself included, have been warning for years about the imminence of a severe financial crisis as a result of irresponsible practices in the market for mortgages.

Wray – Well, Minsky had students in his Berkeley days that did incorporate his ideas into their works: Vicky Chick for example, and Peter Gray. He also taught Tom Sargent, as well as Robert Hall, though it is hard to tell what influence he had on them. There were famous economists from more than twenty years before I had Minsky who were influenced by Minsky. On the mainstream discovery of Minsky, it is true that he is all over the financial press right now, probably to a greater extent than he ever was before, but every time the US goes through a period like this he is discovered again.

During the S&L crisis, Minsky was sought after by the mainstream economists and mainstream press, in a way similar to now, but to a slightly lesser degree. I think it is inevitable that when you have a crisis people try to find some economist who studied crises. Whenever financial crises occur, they rediscover Minsky. This is not the first time and it will probably not be the last…However, even though orthodox economists and press are referring to Minsky and
they understand some of what he argued, I think they still don’t really get Minsky’s ideas because they present what is going on now as something that is unusual, a random bubble or something like that, that just sort of appeared suddenly, maybe in the last couple of years. That is about as far back as they go: the start of the real estate bubble. A few of them also say: “well, maybe it is somewhat linked to the Nasdaq bubble seven years ago”.

However, I think Minsky would argue, and in fact he did argue, that what’s happening now really began in 1980 or 1974 and to really understand what’s going on you have to go back that far. You can’t even go back to 2000, because it all began a long time ago. It began with the deregulation of the American financial sector, around 1974. That was when we started deregulating the thrift sector and then in 1980 there was a major deregulation act that came during a recession and was a reaction to what was perceived to be the problem causing the recession then. The deregulation became necessary because monetary policy had changed its direction in the 1960s when the Fed became mainly responsible for trying to fight inflation. So I believe the problem goes back to that: the Fed taking on the responsibility of fighting inflation by raising interest rates. Well, our whole financial system had been based on an implicit guarantee that interest rates would not be raised too high. Because our financial institutions tended to hold long-term assets and shorter-term liabilities, high interest rates made them insolvent.

Well, let’s look at 1980. What did we have? Volker pushed the short-term overnight interest rate to 21%. The thrifts held assets that earned only 6%. Instantly the whole thrift sector was made insolvent. So they said, “Well what do we have to do? We’ve got to deregulate them and allow them to pay market rates on their liabilities and earn market rates on their assets. This way they will get involved on a wider range of assets, not just home mortgages.” Well, the thrifts did what was expected and then what happened? We had the thrift crisis. Of course! So we deregulated them and essentially killed them. But what banks and thrifts learned from that experience is: you don’t want to hold mortgages. So they invented securitized mortgages in the early 80s. In 1987 Minsky wrote a memo on securitization. Already in 1987 Minsky understood how banks and thrifts were going to react. Fast forward things to the current time and what do we find? Subprime lending, securitized mortgages... No banks or thrifts held the securitized mortgages. They were all divided up and sold off to pension funds, insurance companies and hedge funds. Nobody ever really looked at the credit worthiness of the mortgages that had been securitized because there was never any point in doing that. The banks and thrifts knew they would not hold them. The problem did not suddenly appear with an irrational exuberance in the real estate market. Still, this is the way people are presenting it now: people just started paying crazy amounts for properties that they could not afford. But that is not the basis of the problem at all. It all goes way back...

OIKOS - Would you say then that a way to deal with the inherent instability of financial markets is to bring back some stronger regulation?

Wray – Well, you need regulations, you need supervision and you need guarantees. The problem is that for the most part we kept guarantees, but we reduced supervision and regulation. So you get the worst of all possible worlds. You have got government guarantees on a lot of financial sector liabilities. Everyone knows of the FDIC, which is the insurance on bank deposits up to 100,000 dollars. But you have implicit guarantees on home mortgages too. For instance, we have Fannie Mae (Federal National Mortgage Association – FNMA), which is a huge loan originator and everyone believes that, if push comes to shove, the government will guarantee its liabilities. We kept guarantees. In fact we expanded them and we continue to expand it. We now let Fannie Mae do things that it couldn’t do before. We still have guarantees but we are no longer supervising and regulating. And even regulations are not enough. The problem is that things just change too fast. You would have to rewrite regulations every couple of months. Hence, you need
regulations but you also need supervision because the supervisor, you would hope, can keep up with changes.

There is one fundamental problem. Supervisors will likely never be as well paid and intelligent as the people they are trying to supervise. All the incentives are on the private side to innovate and get around regulation and supervision so they are probably going to be able to hire the smarter people. Still, you have to do the best that you can do.

OIKOS – Financial crisis have apparently become more frequent in recent days. However, despite of these financial crises, severe depressions have been a lot less frequent than before. Can we say that the presence of Big Government and Big Bank institutions have avoided severe economic depressions to result from these financial crisis?

Wray – Mostly, the presence of governments prevents financial crisis from escalating into severe economic crisis. In reality, the increasing number and frequency of financial crisis is the flip side of not having great depressions. In other words, the financial sector tends to get increasingly fragile [as the economy avoids severe downturns] so you have more crises and they tend to get worse. What you do not have is a great depression that, as Minsky said, simplifies the financial system, that is gets rid of the innovations that were too risky because you never have an economic crisis that wipes all of them out [and reduces financial fragility]. Why don’t we have a great depression, then? I think a big part of the answer is the size of the government in the economy. In the US about 1/3 of the economy is government. I know this is bigger than in the typical country in Latin America, but it is still very small compared to other developed economies. This factor helps to stabilize the economy because the government’s budget will always move countercyclically, even if the fiscal authorities are not trying to set fiscal policy with that goal in mind. We also have purposeful intervention in the financial markets by the Central Bank and other financial regulators. In the US there are a number of such institutions, not just the Fed. Those also intervene to prevent an asset price deflation from spreading too far. It sets a floor to how low the stock market will go, how low real estate prices will go and it also helps to contain it to one sector at a time.

OIKOS – You have just mentioned the importance of big bank and big government institutions for the stable functioning of a capitalist economy. As you have mentioned, while developed countries such as the US have made use of large government budgets as a way of preventing severe recessions with relative success, developing nations, such as the ones in Latin America, have adopted much more modest fiscal activism. As a result, unemployment rates have been considerably higher in many Latin American countries than in developed countries. Is it justifiable that these countries’ governments maintain a policy of reduction of public spending while unemployment remains high?

Wray - Yes, it is true that Latin American countries typically have much smaller governments compared to developed countries. Latin American countries will usually rely more on the external sector to be the thing that sets a floor and a ceiling for aggregate demand. In a way, they can do that while the US cannot. The US is too big and tends to be the driver of the performance of the rest of the world’s economy. When the US economy collapses, for the most part it cannot rely on the rest of the world’s demand to bring it out of recession. Brazil and Argentina can. To some extent your exports will set a floor to how low aggregate demand goes. However, I don’t think that is a very good policy. By adopting that strategy you rely on foreigners. However, how do you know that the US is going to ramp up its demand to bring you out of a recession? It might work. Then again, it may happen that the US goes into a recession and pulls you down. It is much better
to have domestic policy to try to stabilize your economy rather than relying on foreign economies.

OIKOS – For years you have advocated for an Employer of Last Resort program where the government would offer jobs to all citizens willing and able to work as an effective stabilizing use of fiscal policy. How does such a program help stabilize the economy and how is it different from traditional public spending policies that focus on increasing aggregate income and stimulating economic activity?

Wray- It makes sense to try to build in automatic stabilizers into your own economy. The Employer of Last Resort program is a powerful stabilizer that you can use. Whether Brazil is able to do it or not, I think the answer is really simple. Brazil can certainly implement Employer of Last Resort programs. It is technically feasible and it is financially affordable. The constraints are only political and, possibly in the beginning, there may be some issues with regard to the ability of organizing what could be a very large program on short notice. There are two answers that can be given to that. First, there’s the recent example of Argentina where a huge program had to be implemented in a very short period of time because they were in a crisis. In a matter of four months they went from 0 to 2 million employees. This shows that even a country that was experiencing about as bad a social, political and economic crisis as you can imagine was able to come up with a program that was huge relative to the size of the economy and that operated fairly well. The second answer that one can give is that you don’t have to implement it all at once. You can implement it as your capability to manage the program increases. For example, you can start with a program of 25,000 and then gradually increase it until you have provided a job to everyone who wants a job at the program wage.

OIKOS – Brazil’s government spends significantly on basic income guarantee (BIG) programs. How do BIG programs differ from job guarantee programs such as ELR?

Wray – First, the programs are not necessarily antagonistic. You could have both kinds of programs. In fact, even if you have an employment guarantee, you need some kind of support for people who can’t or won’t work. You will still need some kind of transfer or welfare income guarantee program. They can be complementary programs. The question is whether you can implement a BIG without an employment guarantee. In capitalist societies in which it is expected that people are responsible up to some point for earning their incomes, than you have to, at a minimum, provide them with an opportunity to do that. BIG does not provide any direct opportunity for people to earn their incomes. People who want to work may be able to find a job or they may not. Only an ELR program can guarantee that they will get a job if they want to work. The United Nations charter of human rights recognizes the right to a job as a fundamental human right. BIG does not provide that nor does it claim that it will. By itself, BIG will never solve the problem of unemployment, of people who can’t find jobs and want to work. Additionally, I think it is questionable whether a BIG, which guarantees an income to people who are able to work but who are not working, will have the same political support as a program that provides a job to people who want to work and hence allows them to get their income through work. It seems to me that, at least in the United States, voters expect that people who can work will work. I think that politically a job guarantee program is more feasible and once it is provided Americans would be much more willing to support welfare than they are now if they can see that it is providing an income to the people who, for whatever reason, don’t want to work or can’t work.

With regards to promoting macroeconomic stability, the ELR program definitely contributes positively in a number of ways. First, the spending on the program is counter-cyclical
whereas the spending on the BIG program is not. The ELR spending will go up in a recession automatically because people laid off by the private sector will move into the public employment program and the government will start paying more wages. That will automatically increase government spending in recessions. During an expansion things are just the reverse. People are hired out of the employer of last resort program into the private sector so that private firms can gear up production. Public employment will be reduced and therefore in an expansion public spending will automatically go down. The budget will automatically move counter-cyclically and I think even the “sound finance” supporters would support counter cyclical budget movements. Certainly, in the US they do.

Even those who argue that over the long run we should run a balanced budget agree that in recessions budgets should move towards deficits and during expansions towards a surplus. An ELR program will move the budget in those directions and, therefore, it will help to stabilize aggregate demand. The other thing an ELR program does that BIG programs do not is that it provides an anchor for wages. By the way, it is important to clarify that there are different versions of ELR. The one that Minsky advocated, which is also the version I support, pays the same wage to everyone in the program. It is a basic ELR wage. Everyone in the program receives that wage. That wage will become the effective minimum wage in the economy as a whole because any private employer is going to have to offer at least that wage to hire workers out of the ELR program—or compensate them in some other way so that their job becomes more appealing than the one offered by the ELR program. As long as you hold that ELR wage steady, firms can always recruit people out of the pool by paying a mark up above the ELR wage. That mark up should be reasonably steady through time. If you keep the ELR basic wage constant, effectively you are stabilizing the wage at the very low end. There can still be some increase at the upper end and in economic booms maybe firms will have a problem finding skilled workers. They might bid up the price of highly skilled workers a bit. However, the ELR pool will always help to dampen that because the alternative to hiring skilled workers in a highly competitive market is to hire less skilled workers from the ELR pool and then train them or change the method of production so that you can use the less skilled workers. An ELR program will certainly not increase wage pressures in a boom and it will probably dampen them because you always have the alternative to hire out of the ELR pool. Also, it reduces downward pressures on wages in a recession. Wages can never fall below the ELR wage. Therefore, it stabilizes things on the down side too if that is ever a concern.

While ELR stabilizes wages, BIG will not do that at all. All it does is provide an income, which could actually be inflationary if the supply side of the economy is not able to increase production sufficiently to match the increased demand that comes from the BIG income. It will be more inflationary than providing income through wages in an ELR program because ELR can provide some goods and services to the economy directly, whereas BIG does not provide anything directly. BIG programs may stimulate the production, but it does not directly provide any production. Finally, on the wage side BIG can also be inflationary because it allows an income without working which reduces the incentive to work, reduces the supply of labor. Depending on where you set the BIG payment, you could have a significant effect on the supply of labor. Of course, if you keep BIG extremely low that effect will be very small. On the other hand, if BIG is extremely low; you are not really helping people. If BIG is a living income, sufficient to provide a decent standard of living, then the effect on labor supply will be pretty large, therefore inflationary.

OIKOS – The usual criticism against ELR is that the portion of the government budget necessary to finance such a program would be just too great, which would significantly reduce the country’s ability of maintaining a balanced budget. Certainly, a country where the federal
government is committed to maintaining a balanced budget might find it extremely difficult to implement such a grandiose program. How would you address these critics?

Wray – First let me just say something about the argument that an ELR program will be too big and will cause a massive increase in government spending. I don’t think that this is correct. Certainly out in the real world, when countries have implemented employment programs they have not led to massive increases of government spending, and also the economists who have looked at implementing programs for the US do not find that to be true. In Argentina, the cost of implementing a significantly large job guarantee program was only 1% of GDP. Estimates for the US are on a similar range: around 1%. India has an experience in one of its provinces with an employment guarantee that goes back to the 1960s and again it is in the 1% range. These numbers, if anything, are high because they are not taking account of cost savings in the rest of the budget. Almost everyone who studies unemployment comes to the conclusion that crime rates go up, family problems go up and health problems increase as a result of unemployment. Governments will almost certainly have a reduction of spending on crime, taking care of families, health care costs and so on if people are provided jobs and income. Therefore, the net costs are probably a lot less than 1% of GDP. So I do not think that it is correct that the budget is going to be blown up by implementing this program. And again, you can implement the program slowly. You don’t have to start with a universal job guarantee. You can gradually implement a direct job creation program. That way you can keep control over the cost of the program and gain the experience to implement a successful program more slowly. You can do it that way.

OIKOS - However, your position is that no sovereign nation should find its government’s ability to spend constrained by its inability to collect taxes unless needless monetary and fiscal rules are imposed on the fiscal and monetary authorities. Why is the practice of sound finance an unsound idea?

Wray – It could well be true that overall government spending in Brazil is already big enough. I could not really comment on that. It is possible that it is big enough. Then it comes down to priorities. Does it make sense to spend 8% of GDP to service debt rather than to have full employment? I don’t think anyone in their right mind would say that this gets the priorities right: to spend 8% of GDP to service your debt but keep 20% of your population unemployed. This is a crazy ranking of priorities. It could be that you want to implement the program while cutting government spending in some areas if the amount of government spending is already the correct amount. Implementing an ELR program does not mean necessarily that you are going to increase government spending. It means that you are going to make government spending more counter-cyclical, which is probably a good thing. Maybe you want to reduce spending that is not counter-cyclical -- maybe spending that is on low priority things, maybe spending that is actually causing inflation -- and implement ELR at the same time. I just want to make clear that people that advocate implementing ELR are not necessarily saying you should spend more than you are spending now. Maybe you are spending the right amount, maybe you are spending too much, and maybe you are spending too little. ELR can be implemented in any of those cases.

Now the question is... Can governments afford to spend more? Let’s say you can’t find any place where you are not spending in priority areas. All the spending you are undertaking now, you want to retain. The government can always financially afford to implement another program as long as it uses its own currency and has a floating exchange rate. If you have those things, you have the sovereign ability to implement the program and pay for the program in the same way you pay for other programs: by crediting bank accounts. That is what government spending always comes down to. In a sovereign nation with its own floating currency the government effectively spends by crediting bank accounts. They can create really complicated procedures to
allow them to do that or they can do it extremely simply by doing it directly. In Brazil I am sure they do not do it directly and neither do we in the US but it all amounts to the same thing anyway. Governments tax by debiting bank accounts. The spending and the taxing are completely unconnected. The government does not need to do one before it does the other. Once we have gotten the economy underway and there are bank accounts out there, the government can increase spending without increasing taxes, it can increase taxes without increasing spending. One is crediting bank accounts and the other is debiting them. Over any given span of time we can look at the government’s crediting of accounts and the government’s debiting of accounts, take the difference between those two and we could find out that the spending equaled the taxing, or the spending was less than the taxing or that spending was greater than taxing. In other words, over any given period there could be a government deficit, balanced budget or budget surplus. None of that makes any difference to the government’s ability to credit a bank account and to pay somebody a wage. As long as there is someone willing to work for the wage, the government can always credit the account. That does not mean that a budget deficit or surplus may not have implications for the economy and we may want to consider that. However, that is a separate issue from whether the government can financially afford to credit some worker’s account. They can always do that. It is financially affordable and the government has the procedures in place to make sure that it can do it. A sovereign government can always credit a bank account and pay wages.

OIKOS – Does that mean that the governments do not need to tax or borrow from the public in order to finance its spending? What do taxes do in this context?

Wray – It is important to keep in mind: governments spend by crediting accounts and taxes by debiting them. If the government is spending more than it taxes, that means it is running a budget deficit, and that means it is net crediting bank accounts. If it is net crediting bank accounts, then bank reserves are going up. Normally, an increase of bank reserves will put downward pressure on the overnight interest rate. Once that happens, the Central Bank will notice that the overnight rate is falling below its target so it will automatically intervene. This is not a discretionary thing. The Central Bank wants to keep the overnight rate close to the target rate so it will intervene. The way it intervenes is by selling bonds. The immediate impact of a budget deficit is that the Central Bank will sell bonds in order to drain excess reserves so that it can keep the interest rate on target. Eventually the Central Bank would run out of things to sell if the government continued to run a budget deficit. Because the Central Bank is selling Treasury bonds it is not the source of the bonds. It can only sell the bonds that it has previously accumulated. Therefore, the Treasury and the Central Bank must coordinate their actions and the Treasury will start to sell bonds, instead of the Central Bank, over a longer period instead. The Treasury cannot run out of bonds because the Treasury is the one who creates the bonds. The purpose of those bond sales by the Treasury is to relieve the Central Bank: to drain reserves from the banking system so that the Central Bank can hit its interest rate target. I do not know how it works in Brazil, but in the US the Fed and the Treasury talk every single day. They coordinate their activities to ensure that some combination of sales of bonds by the Fed and the Treasury will occur in order to drain excess reserves. From this perspective, the purpose of bond sales is to drain reserves, and that is true whether it is bond sales by the Fed or by the Treasury. The effect of bond sales is always to drain reserves.

Economists call bond sales by the Fed monetary policy, but they call bond sales by the Treasury fiscal policy. It is believed to be a borrowing operation and it is probable that even people at the Treasury view it that way. They think that what they are doing is borrowing. But as economists we should step back and get below the superficial and see a bond sale for what it really is: a reserve draining operation. This is the effect of it in the economy. The bond sale occurs to drain reserves that were created by deficit spending. Logically it is not possible to see
this as the “Treasury borrowed in order to get something so that it was able to deficit spend”. It has to be the other way around. It has to be “the Treasury net credited bank accounts through deficit spending so that excess reserves were generated and had to be drained”. These are drained by the Fed and Treasury selling bonds. The deficit spending occurs first. The logical sequence has to be that. All of this actually can occur completely simultaneously if the Fed and Treasury are able to perfectly coordinate their activities and be perfectly able to forecast when Treasury checks will be cashed, these being the payments made by the Federal Government, and when taxpayers will pay their taxes, which is really determined by very complex procedures in the economy, really outside the control of the Treasury. If these things could all be matched perfectly, than everything would occur simultaneously. We would have the bond sale and the deficit spending occurring exactly at the same point in time. However, it is impossible to coordinate these things perfectly because we cannot control when a social security recipient will cash the check, we cannot control exactly when the bank will present the check for payment, we cannot control when a firm will make its quarterly tax payment and so on. There are a lot of time gaps involved here and the Fed and the Treasury have to create very complicated procedures for selling bonds, for buying bonds, for moving Treasury accounts from private banks to the Central Bank and vice versa in order to ensure that there is the right amount of reserves in the banking system at all times. For economic theory that stuff is just procedural and can all be left to the side. For the economist, the sequence is really clear: deficit spending first, bonds sales later. Bond sales are part of monetary operations and have nothing to do with the Treasury’s ability to spend.

OIKOS – What is the effect of an increasing public debt on the private sector? Do government debt assets that are held internationally change the analysis?

Wray – The government debt, no matter where it is held, is going to be a private sector asset. When the government deficit spends, it adds to the non-government sector’s income. That is then accumulated as net savings by the non-government sector and it takes the form of either currency – actually high-powered money, which is a currency plus reserves – or as government bonds. The exact proportion of the net financial savings of the non-government sector divided between high-powered money and bonds will depend on the private sector’s preferences. The high-powered money pays no interest while government bonds pay interest. When the non-government sector has too much of its portfolio in noninterest paying government debt – that is, high-powered money – it offers it in the overnight market, pushes the interest rate down and the government knows it needs to sell bonds. In other words, it is the private sector that determines that division. The outstanding government debt (bonds plus high powered money) is the net wealth of the non-government sector accumulated as a result of deficit spending. When the government runs a surplus, the non-government sector effectively has to offer some of that net wealth to pay for the taxes in excess of government spending. Therefore, budget surpluses always reduce the income and the wealth of the non-government sector. If the government sector always ran a balanced budget the non-government sector would never have any net financial wealth.

People who argue for a balanced budget are at the same time saying that the private sector should not have any net financial wealth. I think it is impossible to come up with any good explanation as to why that would be a good policy. In the US we have only been in that situation in one year: 1837. This was the only time the Federal government was not in debt. Was that a good thing? Well, probably not. The economy went into a great depression. I don’t see any plausible economic arguments for the government not to be in debt to the private sector. Public debt is the source of the private sector’s net wealth, which generally should be thought of as being a good thing. Now... some of that government debt will be held domestically and some of it will be held outside the country. Does that make any difference? I can’t see that it makes any difference at all. It is still just a claim in the sovereign government’s currency. A sovereign
government can always service that debt. It just does that by crediting bank accounts in its own currency. It is always able to do that whether it is domestic or foreign.

OIKOS – Is there any implication of deficit spending for the foreign exchange market?

Wray – It is extremely hard to say what impact, if any, this will have on the exchange rate. Japan has run huge budget deficits and has had an appreciating currency. The US budget deficit has been relatively lower as a percentage of the economy under Bush Jr. and we have had the dollar depreciating against the yen and the Euro. What implication the budget balance has on the exchange rate is very hard to determine. It certainly has no implication for the government’s ability to deficit spend and to service its debt. It is always able to do both of those whether the debt is held by foreigners or domestically. I would not even call the purchase of Brazilian government debt as a capital inflow. It is not really flowing. What is really happening is that the name of the holder of the government debt is now outside of the country. The capital flow seems to indicate that something is flowing that allows the government to do something that it would not be able to do otherwise. That is not true at all. It does not increase the government’s ability to spend and it does not increase the government’s ability to pay interest on its debt.

OIKOS – Some Latin American countries have issued dollar denominated debt. That cannot be good policy, right?

Wray – That is a completely different issue. I would suspect it is always bad policy to do that but I could be wrong about that. A Latin American government’s ability to pay interest in dollars is going to be limited. It cannot just credit bank accounts in dollars because ultimately it could be called on to actually deliver the dollars and it is either going to have to borrow those or exchange domestic currency for dollars, in which case it is going to be subject to the exchange rates in order to do that. A government’s ability to spend and service its debt is only unlimited if the payments are made in the government’s own sovereign currency. Once you get into dollar denominated debt, then you are going to need to somehow get a hold of dollars which really comes down to having an account at the Fed.

OIKOS – Many Central Banks around the world have adopted inflation targeting as their monetary policy framework. In Brazil, inflation targeting was adopted in 1999 after the collapse of the fixed exchange rate, adopted then as the effective nominal anchor. Advocates argue that inflation targeting is more effective than other ways of fighting inflation because it leads inflation expectations to converge to a clear value: the announced target. You have presented strong arguments against the adoption of inflation targeting by Central Banks. Why do you think inflation targeting is not good monetary policy?

Wray – First of all, I do not think that trying to reduce inflation and maybe even to target inflation is necessarily a bad idea. If you had 20, 30% rate of inflation it could be a good idea to try to reduce inflation and even to announce some targets. The problem is that inflation targeting among orthodox economists means you use monetary policy to hit an inflation target. However, monetary policy has virtually no leverage on the inflation rate. There is no mechanism for using monetary policy to hit an inflation target. At best let’s say it is foolish hope, but probably it is just an outright fraud. The Central Bank cannot do what it claims it is able to do under inflation targeting. All they can do is set the overnight rate. We are not even sure which way you should move it if you want to lower the inflation rate. I know orthodox economists think that raising the overnight rate will lower inflation.
However, there is very little empirical evidence or even strong theoretical reasons to believe that to be the case. Raising the overnight rate could very well increase inflation since interest is in some ways like any cost of production. You do not hear people advocating raising wages or oil prices to fight inflation. Why would you believe that raising the cost of credit would fight inflation? This assumes first that there is a very strong interest elasticity of spending and we know that is just not true. Investment is certainly not influenced much by interest rates. As far as I can tell, at least in the US, consumer borrowing is not influenced by interest rates. Thirty years ago no one would have thought that consumers would borrow at 18 to 21% interest. Now we know that they do. They use their credit cards. It is possible that the home mortgage market is somewhat interest sensitive but even that is doubtful. What we see is that when interest rates are lower, home prices are just higher and what people seem to focus on when taking a mortgage is the total monthly payment and not the interest payment. In any case we just don’t see strong interest rate elasticity of spending.

The other thing that you have to do to make that argument is you have to ignore that the interest payments are received by someone as income. For every private debtor there is a private creditor. Therefore, you have to make a strong assumption that the marginal propensities to spend of the debtors are a lot higher than the marginal propensity to spend of the creditors so that when you redistribute income towards creditors they do not spend it. There is no empirical work that demonstrates that. I believe that, at least in aging economies, it is very doubtful that such is true. In the US, when we have so many retirees living on interest income it is doubtful that you would have that expected effect on the propensity to spend. The other thing one would have to ignore is the fact that in virtually all countries the government is a huge net debtor, probably the biggest net debtor in the economy typically with a debt that is 50% of GDP and in some cases even 100% or more. When interest rates rise there is a huge increase in government spending which provides income to the private sector and probably stimulates private consumption. Under not implausible assumptions about what the government debt ratio is, what the marginal propensity to spend out of government interest receipts, raising interest rates might actually stimulate the economy rather than slow it down. Not only for cost reasons, but also for these income reasons, there is no reason to believe that raising interest rates will be anti-inflationary. Monetary policy just is not the right way to target inflation. A much better way is to use fiscal policy. The government should try to identify government programs that lend an inflationary bias to the economy. Indexation of wages and pensions and prices that government pays are probably far more important than monetary policy in affecting inflation. If you want to reduce inflation, you reduce indexing; you reduce the rate of increase of the prices government pays. That will do a lot more to fight inflation than monetary policy will.

OIKOS – Changing the subject a little since we are approaching the end of this interview, how do you see the recent tendency of governments in Latin America, such as Chaves’ in Venezuela, which have clearly chosen policies significantly different from those of the Washington Consensus?

Wray – I certainly think that abandoning the sorts of policies advocated by the Washington Consensus is the first step for any government that wishes to produce any kind of economic development. Those policies of the Washington Consensus were all just completely wrong: they were policies against growth, against a more equal distribution of income; they did not promote employment, and they increased foreign indebtedness. Governments should instead try to reduce inequality, provide jobs, raise wages at the bottom, abandon any links to the dollar, float the currency, and use their own sovereign currencies, not borrow in dollars… It seems that these are policies that Latin American countries have started to implement and I think it is the right way to go.
OIKOS – Finally, let’s go back to the issue of job guarantee programs. The Ministry of Labor in Argentina was able to implement in the beginning of 2002 the Jefes de Hogar program admittedly inspired in your ELR idea in response to the economic collapse of 2001. What have we learned from the Argentinean experience with the program?

Wray – We have learned a lot from the Argentinean experience. We have learned that you can implement a very big program very quickly in a Latin American country, which, though more developed than most, shares a lot of the similarities with other countries in the continent. Argentina could do it successfully. They were able to provide lots of jobs that provided useful goods and services for the community. They came up with experiments on how to run the program that identified which kinds of organizations may create the jobs, and what kinds of jobs can and should be created. Certainly, a lot of useful things can be learned from studying their program. Also, some non-obvious benefits were generated by the implementation of the program that no one had really thought about before and that could be important in other Latin American countries, such as raising the status of women, getting women involved in the life of the community and improving their lives. I think that is probably the most beneficial thing out of the Jefes Program.

Unfortunately, government officials seem not to recognize those kinds of benefits. They don’t really seem to recognize the benefit of having women in the labor force and they never really saw the program as permanent. As a result, they will be phasing the Jefes Program out replacing it with welfare for women and limited term unemployment compensation for men. Both of those are problematic. The women did not want to just go back into the household and collect welfare, and the men are going to run out of unemployment compensation pretty quickly. If the US goes into a recession, as I think it will, and if the world economy slows down, Argentina is going to face a big unemployment problem. A major lesson from the Argentinean experience is that it is fundamental, as part of the development of an ELR program, to develop the understanding of, in addition to all beneficial effects of an ELR program on the economy – the stabilizing features, etc – the human right to employment. India, for example, has had a very big program since the 1960s and it is absolutely recognized that there is a human right to a job and that if the private sector is not able to guarantee that right, the government must. I think we need to go beyond the economic arguments and develop a greater common awareness of the human right aspect of job guarantee. Recognizing this right will effectively counter a push to end the program when times get better and it looks like most people have gotten private sector jobs. Because when the people who remain in the ELR pool are mostly women, as in the case of Argentina, you must counter the argument that the ELR program is no longer necessary. The ELR program needs to be kept not only for the stability that it provides to the economy, but also to guarantee the human right to a job.