

The macroeconomics of an environmentally sustainable growth path

Giuseppe Fontana and Malcolm Sawyer
University of Leeds



Introduction

- Macroeconomic implications of a slower growth rate
- Aggregate demand, aggregate supply and the sustainable growth rate
- A circuitist view of the nature and role of the banking and financial systems
- Constructing a sustainable financial system

Introduction

- The analysis is firmly located in a post Keynesian cum Kaleckian macroeconomic analysis which stress:
- Fundamental uncertainty rather than risk: and hence path dependency;
- Economic activity is demand-driven in the short-run and the long-run with investment playing a crucial role

Introduction

- It is a monetary production economy in which there is no a 'classical dichotomy' and money is credit money endogenously created that is *ex nihilo* by the banking system
- Distribution of income and inequality are important for economic performance
- There are supply constraints, that is there is inadequate capital stock to secure full employment
- Environmental constraints matter in a more thorough way than has been done in PK literature

Macroeconomics of slower growth

- For convenience here analysis is in terms of a closed economy (such as the Earth)
- Start with simple observation from:
- Savings equals Investment plus Budget Deficit
- With slower growth investment will be lower (relative to GDP), implies need for some combination of lower savings, higher budget deficit if capacity utilisation and employment rates to be maintained

Macroeconomics of slower growth

- Consumption relative to income would be higher under slower growth.
- Savings would require budget deficits

Macroeconomics of slower growth

- Savings = $swW + spP$ (W wages, P profits)
- Hence $sw(Y - P) + spP = I + BD$
- $(P/Y).(sp - sw) = (I + BD)/Y$
- With causation running right to left
- Well-known classical case: $sp.P = I$, and hence $sp(P/K) = (I/K) = gk$
- Some obvious implications for the rate of profit (and that budget deficit in the interests of profits)

Macroeconomics of slower growth

- Investment based on a range of factors including 'state of technology', 'animal spirits', profitability and (changes in) capacity utilisation
- The end of 'accumulate, accumulate, that is the law of Moses and the prophets' ?

Aggregate supply and demand

- In another paper, put forward the idea of three growth paths and the adaption between them
- First: the growth of capital stock which arises from the interactions of investment and savings along the lines indicated above: this is a demand-led growth rate (not unlike the 'warranted rate of growth' in the Harrod-Domar model setting).

Aggregate supply and demand

- Second: the growth of the labour resource in 'efficiency units' which would result in a growth of output consistent with a constant rate of employment: supply-led growth rate based on the labour force.

Aggregate supply and demand

- Third: the 'ecological footprint' constrained rate of growth of output.

A circuitist view of the financial system

- A circuitist view of the nature and role of the banking and financial systems
- Distinguish between the financing (of investment) and the funding (of investment)
- Sources of financial fragility and instability in a circuitist framework from the manner in which banks create loans and from the manner in which financial asset markets operate

A financial system for sustainability

- Financial systems inherently unstable and prone to crisis; even apart from the power of the financial system, it is not possible to construct a financial system which will not be prone to 'booms and busts'
- The financial system should be designed for finance to serve the economy rather than the reverse

A financial system for sustainability

- The key roles of the financial system should be (in addition to providing a payments technology) the financing of investment, efficient linkage of savings and investment, and the appropriate direction of finance and funds (no presumption that the financial system is efficient nor that it allocate funds in a socially appropriate manner)

A financial system for sustainability

- Financial transactions taxes (and similar) to reduce the trade in existing financial assets, particularly high frequency trading and similar

A financial system for sustainability

- The development of a diverse banking system with alternative forms of ownership
- State development bank (operating on a rather larger scale than the Green Investment Bank)

A financial system for sustainability

- A 'green' Community Reinvestment Act: placing requirements on banks that a high proportion of their loans are directed to environmentally friendly investment (recognising the difficulties of monitoring such a scheme)