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COMMENTARY

WHY MACROECONOMIC STRUCTURAL AND WAGE-PRICE INDICATORS ARE PUZZLING THE POLICY-MAKERS

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Policy makers are puzzled. Macroeconomic variables are indicating a strong economy, but the economy's price system is giving confusing signals. Some pieces of the puzzle, especially in the US economy, are:

- Growth has been robust, but the inflation rate is not reaching its target on a sustained basis.
- Unemployment rate is historically low, but inflation is not picking up (i.e. failing Phillips curve).
- Unemployment rate is at low levels, but rise in wage rate is not showing up.
- Why expansionary monetary policy (with unconventional methods of quantitative easing alongside ultra low policy rates) is neither able to increase inflation nor wages even when growth is robust and unemployment is low.
- Why are price indicators responding in the financial market but not in the real economy to the monetary policy expansionary stance? As the stock prices are continuously rising, and the real estate prices are also on the rise?

The US economy has been in the expansionary mode for more than a decade now and the unemployment rate is historically low being below 4 per cent for more than a year. But there is an increasing disconnect between the inflation and unemployment rates for recent couple of decades. It is almost assumed now that Phillips curve has no more relevance in the present times as it used to have 50 years ago. Also, the neutral rate of interest (i.e. neither stimulative nor restrictive rate as there is stable inflation at full employment and maximum output) has been continuously declining. One more piece of the puzzle is observed that natural rate of unemployment (i.e. noninflationary rate amid frictional, structural, and surplus unemployment) is also declining. Why are macro economic indicators not behaving as these are assumed to be? Why economy's price system (macro price level and wage rate) is not responding to the actions of policy makers, especially the stimulative monetary policy. However, the asset prices are responding well to all the stimulations whether accommodative monetary policy rates or fiscal tax cuts.

Whether the monetary policy is failing in the rich economies or these economies are behaving weird? This is an important inquiry with an implication for the future policy

framework in an era of monetarism. Especially, if recession approaches (as some observers are predicting) what will be the nature of stimulative policy discourse when neutral rate of interest is already that low. Also, how much slack will have to be removed in case of recession when the current natural unemployment rate has already been found lower than assumed previously. These are urgent questions to be answered for monetary policy to operate effectively in challenging times like ours. These answers become even more important especially when there are not many teeth left for the fiscal policy either due to fiscal deficit, public debt, falling revenues or prevailing sentiments against active government participation in the economy, or all the above.

This commentary attempts to solve the puzzles one by one and tries to answer the questions raised above with a different perspective than the official one. It highlights the need to integrate the social and economic realities in the economic data measurements. Inclusive macro indicators will not only represent structure of the economy better, but these will also have perhaps better predictability and applicability for the policy purposes.

An official version of the economic challenges and some of the answers may be summarized in following lines extracted from the speech of Mr. Jerome H. Powell, the Chair of the Board of Governors of the Federal Reserve System, on "Monetary Policy in the Post-Crisis Era" on July 16, 2019 at a conference "Bretton Woods: 75 Years Later - Thinking about the Next 75," organized by the Banque de France and the French Ministry for the Economy and Finance, Paris, France:

> "…the long-run normal levels of inflation, output, interest rates, and the unemployment rate are important structural features by which we guide policy. Standard estimates of the natural rate of unemployment—u*—and the neutral rate of interest—r*—have been declining for 2 decades, and particularly since the crisis.
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> Many factors are contributing to these changes—well-anchored inflation expectations in the context of improved monetary policy, demographics, globalization, slower productivity growth, greater demand for safe assets, and weaker links between unemployment and inflation. And these factors seem likely to persist. If that happens, the neutral rate of interest will remain low, and policymakers will continue to operate in an environment in which the risk of hitting the effective lower bound is much higher than before the crisis. This proximity to the lower bound poses new complications for central banks and calls for new ideas."

However, this commentary boldly points out to another aspect related with the economic data. Current data don't reflect the changing structural realities of the developed economies. For example, hyper-globalization, de-industrialization, inequality, jobs precariousness, gig economy, missing middle class, corporation power - especially of GAFA (Google, Apple, Facebook, Amazon), artificial intelligence, and robotization etc. have changed these economies drastically. These economies are structurally different now than some decades ago. Economic data should reflect such social and economic realities. But official data do not represent so, unfortunately. Therefore, there is a need to

make economic data more inclusive and relevant in consistence with the prevailing conditions.

Inflation Rate Puzzle

Let's take the case of inflation rate first. Inflation targeting focuses on the inflation rates based on the consumer price index constructed from the consumption basket of the representative consumers. But the concentration of wealth and income inequalities have made the official representative consumption basket non-representative for majority of the consumers. Majority of people even can't afford now many goods and services included in the basket. Middle class which used to represent the urban consumers is almost non-existent now. As average middle-class people have gone missing, so as the relevance/representation of an average consumption basket. Population is made of either the privileged or non-privileged, popularly known as 1% versus 99%. Clearly, the average has no meaning in this context. How many Americans are able to consult a doctor, how many Canadians are able to fill their prescriptions; perhaps they can't afford it. How many citizens are able to afford the college fee? How many of them can afford travel? Therefore, the average is hardly any representation of the majority now.

Another area that needs relook is linked with the recent disconnect of the inflation from the unemployment level, wage rate, and policy rate stance etc. Limited coverage of the total domestic economic activity by the inflation figures is at the root of such disconnect between the inflation and domestic economic indicators. Official inflation rates now represent only a limited sphere of the total domestic economic activity. First, inflation rate excludes a large chunk of economic activities from it by not including these in the consumption basket, which however impacts the economy and society profoundly. This is the financial sector inflation (ballooning assets, including real estate, prices). Second, it includes goods and services which don't involve any domestic economic activity at all. These are the imported goods and services (most manufactured goods and tradable services are imported now) which are, of course, way cheaper than the domestic ones. These, however, represent the foreign land's economic activities and has nothing to do with the domestic economy. How can then domestic inflation rate be assumed to react to the actual economic activity when – it excludes major inflationary part of the domestic activity (assets economy) on the one hand, and includes major deflationary part of the non-domestic (foreign) economic activity on the other.

Ask majority of the citizens how much they are benefited by the low rates of inflation. How much they are able to save for future out of their current income when things are that cheap for that long (low and stable inflation rates since the 1990s). In fact, they are able to save hardly anything after paying for ballooning rent/mortgage/bills/essential services out of their stagnant wages. Household debt figures tell loud the whole story. If the inflation rate is so low, where is income being spent then? Why are they compelled to

borrow then? So, a typical disconnect between inflation and other economic variables are not only felt by highly intelligent monetary economists or policy makers, but this is also felt by the majority of common people too who never see any net benefit coming home from the low inflation!

Puzzling Response of Expansionary Monetary Policy

When policy-makers talk about increasing the economic activity with expansionary or accommodative monetary policy – what do they talk about? And which wage-price would go up without any major impact on the actual real economic activity? Most of the real economy's activities are now out of the realm of domestic interest and wage sensitivity. Hyper-globalization and de-industrialization have made most rich economies depending on a limited number of big industries like, auto (declining as well), weapons, military vehicles/items, medical instrumentation, construction machinery, planes, and trains etc. These big industries hardly wait for changes in the policy-rates. Also, being highly technical (robots have already substituted most labor) or strategic, these are hardly sensitive to the wage changes. When interest-elastic and wage-elastic industrial sector (e.g. the semi-durable goods producing) has disappeared with the de-industrialization, and the remaining industries (large and/or highly technical/strategic) are neither interest-elastic nor wage-elastic; the policy rate changes will not have the effect, in a big way, obviously on the economic activity and wages.

Who does react to the interest rate changes? The players (mostly speculators) in the assets (Stock/commodity/real estate) markets and the foreign exchange markets who have to make their portfolio decisions to take profit from the monetary policy-stance. So, the asset markets and assets holders welcome the accommodative policy stance which increases the value of their assets at one stroke of the monetary authority.

Have common people ever heard applauding or criticizing the policy stance? Why do they feel neutral? Without job quality, job security, future security (no pension or savings), and all these alongside the debt-loads; they feel not only intergenerationally (as compared to their baby-boomer parents or grandparents) under-privileged, but they feel absolutely deprived as well. They are already too overburdened with their demanding one/two/three job/s to make their ends meet. Lowering policy rate make their life perhaps even harder by making the rentals and mortgages (for the potential buyers) higher on ever rising real estate or by making any other assets out of their reach. Lost investment opportunities led by de-industrialization and also increasing the rental/value of the commercial space have converted the potential small entrepreneurs into traders (of imported goods) at amazon or similar platforms in the gig economy. This is what a transformed economic structure is providing the small entrepreneurs the only platform to be creative and innovative; and then on the top of that they are asked to compete with the direct manufacturers of China or even amazon, the market-place owner (who knows the pricing/ sourcing/ advertising

and all other business information about the traders). Going through such harsh realities, the common people have nothing to feel happy or grudge about the policy rate changes. Their struggle is not going to change anyway, as the changing structure of the economy gives no hope to them!

Neutral Interest Rate Puzzle

Let's now concentrate on the official confusion on the neutral rate of interest which has been on a declining trajectory for quite sometime now. Policy-makers have to remind themselves of the lost economic activities and opportunities which their economies once had. Hyper-globalization, de-industrialization, digitalization, artificial intelligence, and robotization have changed the total structure of the economy. With the stagnant and contracted real economic opportunities and the jobless economic growth as well, policy-makers can lower interest rate as much as they like without any fears of the product price inflation (having left the assets inflation aside) and wage rate increase! If policy-makers' human eyes can't see the declining absorptive capacity and falling investment opportunities of the real economy; how a model or computer can do so which gives results on what the data being fed into it. May be GIGO (garbage in, garbage out) effect! Once a model/computer starts diagnosing this major human err of feeding the limited data, policy makers will soon be obsolete as well; the way intelligent (driverless) cars are going to do with the taxi/uber drivers!

Unemployment Rate Puzzle

Another contentious issue bothering the policy makers is the declining natural rate of unemployment. Since unemployment rate is at the historically low rate and still neither pushing up the wage rate nor the inflation rate – perhaps this is motivating policy-makers to reach the conclusion that the natural rate is lower than previously thought. It means there is more slack (in the labor market) than thought, that is why wages and prices are not rising as these should otherwise.

Changing economic landscape has also changed the employment structure in the rich nations. Labor shortages and high wage/benefits/pension jobs of the industrial economies have been replaced by joblessness and outsourcing/precariousness/gig employment in the post-industrial phase of the same economies. Three main culprits, for these changes in the employment structure, are considered to be – globalization, de-industrialization, and technological advancement.

Sustained joblessness is not an exception, it has become rather a rule now. That is why, in the US, now U3 (official unemployment rate) measure is less preferred than the relatively inclusive U6 (that also covers part-timers and marginally attached to the workforce, including discouraged ones). However, many other aspects of joblessness might be excluded from the U6 measurement too. For example, long-term jobless people

(especially, neither working nor looking for more than an official one-year definition), jobless-turned self-employed (gig entrepreneurs for survival), students in studies because of no suitable job opportunities, forced (involuntary) retirement, joblessness on account of ill-health (mental and physical) caused by un/under-employment at first place and then driving people out of active force. Declining participation rate reveals a lot in itself too. When there is a sustained structural stagnation in the labor demand, the supply of labor will respond in different ways one of which will be 'no active participation' in the labor market. (Note: working age population= actively participating labor force [i.e. working or looking for work] + non-active population [out of labor market, however *many of them are still interested actually*])

Long-term joblessness makes unemployed people hopeless. Since a job is not only a source of livelihood; it is much more than that as it provides identity, dignity, the purpose of and fulfillment in life. One is out of the job market because of hopelessness is not equal to one's inability and unwillingness. Such joblessness is not natural; it is policy-driven or broadly system-driven. The economic system has made them jobless and caused this hopelessness; and now the same system excludes these people from the unemployment head-count. People's hopelessness is not an individual problem; because they observe happening the same with their peers, community members and many others in the society – this makes it a social problem. At every point system has failed them. De-industrialization came the first causality on the quantity of jobs, next casualization and precariousness came as the second causality on the quality of jobs. Then came the computer and now coming the intelligent computer (machine learning and artificial intelligence etc.) and robotization. Mass human resource has been on the verge of becoming redundant at the hands of the technology advancement as once livestock (animals) was made by it. Once machines substituted the animals and now intelligent machines are substituting the human beings. People are out of the job market not because they want to be; they are forced out of job market because of the consequences of the anti-labor and/or pro-capital bias of the policy and polity. Capitalists are making labor redundant with their anti-labor technology advancements, and politics and policy-makers are accepting these as if they are subservient to the capitalists instead of the wider society.

When unemployment rate narrows its coverage, excluding most of the unemployed people, due to one definitional constraint or the other. Constrained conceptualization might help make economic modeling easier or let the politicians/policy-makers out of public pressure. But neither the data collected on such indicators (as these exclude more than what these include) represent the realities of the economic structure nor can achieve broader socio-economic results which the society/economy expects from the policy-makers to achieve who use such structural indicators as a base in their policy-formulation.

Wage Rate Puzzle

Now turn to the wage rate puzzle. Why has wage rate become unresponsive to the low unemployment rate and strength in the economy the way it is expected otherwise? Why is expansionary monetary policy unable to push the wages up? This is again perhaps not a problem related with the wage rate or unemployment rate. This is related with the same conceptualization-deficit problem. When an official unemployment rate does not reflect the actual unemployment rate – this is an obvious outcome. In simple words, wage is a price of labor determined by its demand and supply; and in case of excess supply of labor, the wage rate will obviously not rise. And official unemployment figures do not correspond to the actual unemployed labor force. Perhaps that is why news headlines sometimes read that thousands have got jobs but the unemployment rate remains the same or the wage rate remains stagnant; because more people have joined the job market (meaning participation rate has increased). Actually, there is an army of the labor force not considered in the official unemployment rate – e.g. part-timers (waiting for full time jobs), underemployed, gig-employed, gig-entrepreneurs, discouraged, hopeless, etc. – that keeps pressure away from the wage gear. It also highlights a discrepancy between the official and actual figures of the slack in the economy.

Another reason, for wages not rising, lies in the loosened bargaining power of the employees. Forget about unionization etc., these have become now things of the long past in the current economic landscape. This is either because of enough slack or job precariousness or contractual/ sub-contractual jobs (second/third party – when first party contracts out to the second or second to the third), or all. Employees are working at the terms of the employers because they are left with no say or bargaining power. In simple words, they face – this job or no job scenario. If they leave the current job, they will land up with a similar job elsewhere with the similar conditions, if lucky enough to get another job; otherwise joblessness is the only next best alternative. How can one expect such employees to ask for a wage raise? Or can they? There may be many hopeless and voiceless people (most probably unaccounted in the official unemployed labor force), who are waiting to take over. Neither the official natural rate of unemployment nor the low wage rate puzzle can see the hopelessness and voicelessness of those people. Human eyes are needed to see those things. That is why central banks are accepting it that the natural rate of unemployment is lower than what it was thought to be. And intuitively they are accepting that because of the lower natural rate of unemployment, there is no pressure felt on the wage rate to increase at this official low rate of unemployment.

To conclude: either refine the existing macroeconomic indicators to become representative or introduce new ones to reflect the economic realities. Structure of the economy has undergone too many changes for the same old conceptualization to remain relevant. That is why current data don't reflect the economic structural realities. If existing macroeconomic indicators don't reflect the structural realities of the economy these are

bound to give weird results such as the broken relationship between inflation and unemployment, unemployment rate and wage rate, policy rate stance and real economy, economic buoyancy and price-wage indicators. And when weird theoretical/modeling results would deviate from the factual realities, assumed values would need more and more revisions (to match the realities). The way neutral rate of interest and natural rate of unemployment have been undergoing revisions, for instance.

When the political economy is disconnected with the society, authoritarians win with their divisive tactics and illusive promises of making their countries great again. When the data on the macroeconomic indicators are dis-associated with the economic and social structural realities, valuations will need continuous revisions and readjustments on the policy-makers' bafflement. Partial equilibrium is perhaps good for an intellectual exercise, it can hardly serve any economic and social purpose in a complex nation! The same way, if economic indicators exclude too much and become unrepresentative of the structure of an economy; such conceptualization-deficit and measurement-deficit will lead to the outcome-deficit. These may be good for the modeling exercises but tend to lose the predictability and applicability in the policy formulation. Economics is applicable if it is based on the facts of the economy, it becomes confusing and baffling when it excludes more than what it includes!