Monetary and Fiscal Policy in the future

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- Likely to live for a while in a low r (safe interest rate), low g (growth rate) environment
- With substantial uncertainty about both r and g. We do not have iron-clad explanations for past evolutions

- Short run: Rebalancing from monetary policy to fiscal policy
- Longer run: Same. Less room for monetary policy, more room for fiscal policy
- Focus on the longer run. 30,000 feet.

In general, low g makes everything harder... Higher probability of recession, more need for macro policy.

Low r and ZLB create problems for monetary policy

- Conventional m policy works (mostly) through general level of rates.

  Undoing a distortion (nominal rigidities)

- Unconventional m policy works (mostly) through risk spreads. Comes by nature with more risk taking.

  Undoing or creating distortions?

- Not easy to eliminate the ZLB constraint.
- Revisiting the case for higher inflation. Salience and the Phillips curve?
- Revisiting the case for negative nominal rates and in a cashless (less cash) economy. A more flexible instrument.

Low $r - g$ creates opportunities for fiscal policy

Implications of $r - g < 0$? It depends on why (and how long). (Did not think Blanchard-Weil would be that relevant...)

- Could reflect dynamic inefficiency. $g > MPK > r$.

  If so, debt sustainable, and desirable. Unlikely: MPK still high.

- Could just reflect risk and risk aversion, so $MPK > g > r$.

  If so, debt not sustainable without later primary surplus, and displaces capital

- Could reflect more (and I think it does): Incomplete markets, and safe debt can help. Or liquidity of public debt.

  If so, debt sustainable without later primary surpluses. But is it desirable?

Implications for fiscal policy. An example

- Suppose $MPK - r$ reflects liquidity (maybe size and depth of public debt market)
- Think fixed liquidity premium x. so $r = MPK - x < g$
- Then, debt is sustainable without later primary surpluses, but displaces private capital
- Clearly debt should be used to finance public investment, if MPK higher than private. (no distortion cost)
- Clearly deficit finance should be used to fight negative output gaps. Need not be public investment
- Gross and net debt: Should the government be in the intermediation business? Or the central bank? Or both?