Note on current research

I am currently working along two axes.

In a major way, I work on monetary macroeconomics. I am currently writing a paper called “An Essay on the Genesis of Growth: Credit, Capital and the Transition to a Capitalist Economy.” It aims to present growth as a change of regime phenomenon, which occurs when a certain part of the productive resources of the economy starts to be devoted to the production of capital goods\(^1\). It fails to happen in one regime because there is some intertemporal inefficiency in the overlapping-generations framework we employ; namely, the deviation from the first best is due to the difference between the productive value of capital\(^2\) and its financial value, embodied in stock prices which are partly determined by gross savings from the young. The growth regime is likely to arise when the productivity of the capital-producing sector increases and/or when “credit-creating institutions”, i.e. a financial sector whose balance sheet is allowed to grow via auto-leveraging, arise, inciting the young of all cohorts to become a debtor instead of a saver. We also plan to analyze, in this framework, the fundamental difference at the macro level of stocks and loans, and revisit the traditional paradox of why there is so little equity on the markets, and so much debt. This brings us to the nature of the firm as a debt-vehicle: people associate themselves in institutions called firms, not because of their organizational superiority, but because it allows them to raise debt, which they would be unable to do alone.

I propose an interpretation of the post-World War II US economic history based on such a framework in another project: “1980 as a Watershed: Patterns of Growth, Finance and Inflation in the USA, 1947—2009”. I first note that until precisely at the time of the Volker stabilization, the consumer price index and the investment price index\(^3\) have evolved quite the same way in the medium term, both being systematically related to the evolution of the monetary aggregates: money and inflation behaved the monetarist way and every increase in the size of the balance sheet of the financial sector was “canceled” by the consequent increase in prices in the medium term. Financial crises were rare, and activity was relatively volatile. The high interest rates due to the Volker policy in 1980—1982, have amazingly, been compatible with a sharp growth of the money stock. Since that date, monetary aggregates are insignificant determinants of the inflation rate in most econometric regressions. Simultaneously, the investment price index began decreasing steadily\(^4\), while the consumption price index increased at about 4 percent per annum. But still, despite this seemingly

\(^1\) In the model with two goods, the emergence of a capital goods industry is an absolute prerequisite for growth because technical progress is supposed to be completely embodied. The obstacle to the emergence of growth lies in the condition that the young’s savings must equal the market value of available capital at each period.

\(^2\) That is, its productivity of today and of tomorrow.

\(^3\) That is, the price index for the goods and services exchanged during a period of time that corresponds to an investment under national accounts conventions.

\(^4\) At a rate around -1 percent per annum between 1982 (peak) and 2004 (Penn World Tables).
unfavorable pattern of relative prices, the capital industry flourished relative to the consumption-goods industry during these three decades of boom\(^5\): higher wage growth, higher employment growth and higher investment\(^6\). During the crisis episodes, the capital industry has also been hurt harder. The ongoing regime, starting in 1980—82 is marked by frequent financial crises but few recessions and low overall real volatility. In the up phase of each cycle\(^7\), stock prices – and more especially the capital sector’s stock prices – sharply increase, while the underlying dividends increase much less. Indebtedness and the balance sheet of the financial sector increase altogether, and money does not create inflation. This is the bubbly economy path. Furthermore, because financial capital is incited to flow towards the capital goods’ industry, physical investment concentrates (at the margin) in the investment sector. Once the crisis occurs, a change of regime takes place, where those past investments will prove not to be *economically* profitable anymore: the only way to revive growth is to reanimate the bubble\(^8\). In the early 30’s, this is how the Great Depression ultimately happened: the Federal Reserve did not react aggressively enough to the perturbations on the financial markets. Today, and regularly since 1987, busting bubbles are each time reflated by easy monetary policy\(^9\): when the expectations of the private sector of the economy slide away from what needs the bubbly path to be sustained, official intervention always managed to reload another upward cycle, steeper than the previous one. The question is left opened as whether this “perpetual reflate” will work forever or whether the real consequent distortions, crystallized in a too high real size of the investment sector, will one day become too heavy a burden to bear.

Secondly, I work on international economics. I have written the first draft of a paper about the last oil boom and the international adjustment. I first show that the correlation between the US current account deficit and the top 15 oil exporters’ surplus is almost equal to -100% over the period from 1998 to 2008\(^10\). This suggests that the oil exporting countries have been the most important ‘periphery’ of the international economy during the first (1998—2001) and second (2003—2008) oil booms, because it is the one whose surplus has adjusted in response to the variations of the US deficit, which has overwhelmingly dominated the pattern of global imbalances in these years and especially since 2003. Conversely, those surpluses have been derived on the basis of a dramatic rise in the price of the barrel, and the boom is best understandable in the broader context of deep global

\(^5\) The boom has been interrupted several times (1987, 1998, 2002, 2008).

\(^6\) Which means that the relative boom of the capital firms rested on a demand emanating, to some extent, precisely from the other firms of the capital sector. This explains the structural break between the time series of real consumption and real investment: since 1980, more investment has not generated as much consumption as it did before, because much physical capital was being contained in the capital industry itself.


\(^8\) Otherwise, those excess capacities in the capital industry constitute “white elephants”: costly capacities devoted to something unprofitable.

\(^9\) And maybe also public deficits.

\(^10\) The same is not true for the Asian countries as a whole.
imbalances. To account for the observed facts, we suppose that, everything else equal\textsuperscript{11}, credit creation in one country tends to make its current account more in deficit\textsuperscript{12}. We pose a three regions model, with (1) the USA, (2) the oil exporting countries and (3) a flexible exchange rate regime zone. The oil exporting countries export to both regions, but invest predominantly their receipts in the USA. This has the consequence that credit is quasi-subsidized in the United States, as the oil exporting countries voluntarily provide the needed savings, in response to the increased credit to the US nonfinancial sector. The exorbitant privilege of the USA, that Europe does not own, rests on that it manages to externalize its saving activity, via a current account deficit that is easily or automatically financed, during its phases of ascending phases of leverage cycles. The oil exporting countries finance, via its surplus with Europe, the increase in the US non-oil deficit. It also finances automatically a good part of its oil deficit. This makes us revisit the well-known strong link between the dollar exchange rate and the oil price as different manifestations of a same pattern.

In another project with two coauthors\textsuperscript{13}, we look at those “US deficit and leverage cycles” and their evolution through time. Starting in 1980, the American current account deficit has closely followed the country’s leverage cycles, each time supported by a well-identified periphery: Japan for the 1980’s, Asia and Europe\textsuperscript{14} in the 1990’s and the oil exporting countries in the 2000’s. We plan to employ VAR techniques to study for each cycle the patterns of international financial adjustment to a credit shock in the USA.

\textsuperscript{11} And especially the exchange rate.

\textsuperscript{12} I thus take a monetarist approach to the balance of payments.

\textsuperscript{13} Hamouda Chekir (Lazard Frères, Paris) and Mouhamadou Sy (PSE).

\textsuperscript{14} Europe at this time contributed to the financing of the US current account deficit more by accident than because it was a ‘natural’ periphery, simply because before the adoption of the euro many countries implemented relatively restrictive policy to satisfy the convergence criteria.