GREEN
EUROPEAN
JOURNAL

Joseph Stiglitz: A Recipe for Green Growth

Article by Joseph Stiglitz, Wester van Gaal
May 15, 2023

As ordinary people face sacrifices and a higher cost of living, windfall corporate profits are breaking the social contract. The energy transition offers an opportunity for renewal, argues Nobel laureate Joseph E. Stiglitz, but we don’t need to break with growth.

***Wester van Gaal*: In a recent paper you co-wrote with professor Nicholas Stern, you argue that “at least in the coming two or three decades”, there does not have to be a trade-off between the green transition and the potential for growth. I can think of a few people in the EU Commission who will be relieved to hear it. Could you explain your thinking on this?**

Joseph Stiglitz: The point that Nicholas Stern and I made is that there is a good chance that the green transition will result in markedly lower energy costs. And if the energy cost is lower overall, that will stimulate growth.

We have inefficient cities and inefficient houses. We waste a lot of resources in a whole variety of ways. By going green, we will save money and be more productive. And as costs go down, we may even spend our leisure time differently. Green and rapid innovation will spill over benefits to other areas of human well-being, and it will prevent environmental destruction, which is already apparent. And because of the necessity of a Green Revolution, we will solve some of the other market failures, like access to credit which is too limited.

Some say growth should end completely, but this will not by itself solve the issue of high emissions and is politically not acceptable which could put climate policies at risk. Others suggest that investing a lot in preventing climate change will extract a high price from the economy – where doing too much will hurt economic growth and well-being, and therefore that it is ‘optimal’ to let temperatures increase by 3.5 degrees Celsius [an argument put forward by fellow Nobel-winning economist William Nordhaus in 2018, red]. But this is indefensible and dangerous.

When you say: “The issue of access to credit will be solved,” what do you mean exactly and how do you see it developing?

By creating green bonds and green community banks that provide low-interest rate loans for people and, crucially, developers to buy solar panels, cover the cost of insulating homes and buy electric vehicles. We’re doing that in the US with the Inflation Reduction Act [a €370bn in green subsidies and tax scheme], just not on the scale necessary to trigger the green revolution we need.

Central banks, in their fight against inflation, have increased borrowing costs at one of the fastest rates in the history of central banking, reducing economic activity and credit availability precisely when investments in clean technologies are needed most. Is that the right thing to do?

Inflation now is mainly supply-side oriented. And therefore, monetary policy, which is aimed at driving down demand, is not the appropriate instrument to fight inflation and may, in fact, be counterproductive because we want more investment to solve shortages and constraints on the supply side, not less. If you think there is a shortage of labour, then the right policy is to get more labour, for example, through childcare policies which would facilitate women's participation in the labour force.

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If energy is the problem, we should massively expand green energy. For this, you want to enhance the entry of new clean energy firms, not make it harder for them to compete with entrenched fossil fuel companies by increasing borrowing costs.

Raising interest rates makes it more difficult for firms, especially new ones, to access capital and enter the market.

You argue strong climate action could increase growth. Yet EU politicians have started talking about balancing their budget and not spending too much. French president Emmanuel Macron has pushed through an unpopular pension age increase. German finance minister Christian Lindner has been pushing for a return to strict budgetary rules in Europe. Are we entering a new phase of austerity?

I wouldn't call spending cuts austerity in the usual macroeconomic sense, but obviously, the cutbacks will be painful for ordinary people. On the other side, corporate shares have gone way up. We should be taxing windfall profits, either to tamp down prices or to protect those who are adversely affected by it.

People are faced with higher living costs. At the same time, we have to fight climate change. You can ask a lot from people if there is a sense of shared sacrifice. But you will destroy social solidarity if you ask one group to sacrifice while the other group enjoys a bonanza.

Macron's argument that we need social cutbacks to pay for these things is not persuasive. The political difficulties he's facing are because he appears to be breaking the social contract. I am shocked that there is not more sensitivity to this among politicians.

You mention profits. In recent months, central bankers have started to acknowledge that historically high corporate profits have been a dominant driver of inflation, but they have been somewhat reluctant to talk about it. What do you make of it?

Oh yeah, that's a lot of it. There was a real scarcity of fossil fuels which led to windfall profits. And the other aspect is the supply bottlenecks associated with the pandemic, which allowed big firms to take advantage of their market power by increasing prices.

And that won't be solved by raising interest rates. In fact, raising interest rates will exacerbate bottlenecks by encouraging firms to focus on short-term profits instead of expanding supply.

So they see corporate profits increasing, but market power is not part of their portfolio. And they lack an instrument to do anything about it, so they decide to live with the world as it is. But then, every time wages go up, central bankers say: 'Oh, we'll have to tighten the labour market and create more unemployment.' Clearly, that's the wrong model.

Why do they keep following that script?

The real flaw of central bankers is their excessive zeal for keeping inflation down. One of the things that has disturbed me is that some central bankers seem to think that what is driving inflation is wages. That’s obviously not the case.

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Real wages are lower in most countries now than before the crisis because prices have risen faster than nominal wages. Labour as a share of the economy has been going down for decades, and now it’s decreasing drastically.

Now, the profits have already been made. Corporations and shareholders will come out of this a lot wealthier. We have to accept that. Looking forward, we should institute a windfall tax and capital tax to prevent it from happening again. My worry is this excessive zeal to squash labour is not helping.

Explain how profits and wages relate.

The stagnation of wages is the flipside of the increase in profits. Wages don’t have to translate into higher prices if corporate markups come down. And markups are unusually high, so we should demand that they come down.

The EU implemented a windfall tax on fossil fuel companies last year. How do you rate its success?

It has simply been insufficient. The windfall tax has had too many exemptions. Some of the traders that made windfall profits were exempt. Some people bought gas contracts at low prices, then sold them at a high price and made a large profit.

They undertook some risk, and I think they should get some reward. But no one anticipated whathas happened with the war. If you add a tax of 70 percent of those windfall profits, they would still be well off.

Ordinary people face a higher cost of living or have to work for a large number of years. Again, this is an example of a violation of the social contract. Take France, for example: the reform of the retirement age especially affects blue-collar workers who enter the workforce when they are younger, while the wealthy enter the workforce later and are not affected as much.

And as these social cuts are happening, corporate profits are getting larger and larger. Many seem to find this arrangement unacceptable. I think rightly so.

Stiglitz will discuss economic policy that is future fit on Wednesday (17 May) at 09:30 am

Joseph Stiglitz is an American economist and public policy analyst, full professor at Columbia University. He was awarded the John Clark Bates Medal in 1979, and the Nobel Memorial Prize in Economic Sciences in 2001.

Wester van Gaal is a journalist from the Netherlands with a focus on the green economy. He joined EUobserver in September 2021. Previously he was editor-in-chief of Vice, Motherboard, a science-based website, and climate economy journalist for The Correspondent.

Published May 15, 2023
Article in English
Published in the *Green European Journal*
Downloaded from https://www.greeneuropeanjournal.eu/joseph-stiglitz-a-recipe-for-green-growth/

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