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With one word economics lurched into fantasy

Steve Keen



"Adam Smith" by Bernt Rostad is licenced by CC BY 2.0 DEED. A statue of Adam Smith, the man behind "the invisible hand", standing in the Royal Mile (Edinburgh) near St Giles Cathedral.

Human society is energy blind. Like a fish in water, it takes for granted the existence of that without which it could not survive.

As with so many of humanity's problems, this conceptual failure can be traced back to an economist. But the guilty party is not one of "the usual suspects" - Neoclassical economists - but the person virtually all economists describe as "the Father of Economics", Adam Smith.

Smith led economics astray on the vital issue of energy in the very first sentence of *The Wealth of Nations*, when he stated that:

"The annual **labour** of every nation is

the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes..." (Smith 1776, p10). (my emphasis added)

I emphasize "labour" in that sentence because, apart from that word, it is virtually identical to the opening sentence of Richard Cantillon's *Essay on Economic Theory*, which was published two decades before *The Wealth of Nations*:

"**Land** is the source or matter from which all wealth is drawn; man's labor provides the form for its production, and wealth in itself is nothing but the food, conveniences, and pleasures of life" (Cantillon 1755, p21). (my emphasis added)

With that one word altered, economics took a terrible lurch away from realism and into fantasy. Cantillon's insight was that what existed before Man and outside human society - let alone outside "the economy" - was the source of the material wealth we generate within the economy. Smith's substitution saw an action within the economy itself - the work of the labourer - as the source of value, and the division of labour over time as the source of its growth.

Cantillon's perspective, that wealth originated from outside the economy - though the form that wealth took was shaped within it - was correct, according to the incontrovertible Laws of Thermodynamics (Ulgiati and Bianciardi 2004; Eddington 1928, p37). Smith's perspective happened to be wrong, because he contemplated that

the closed system of the economy could produce more outputs than inputs over time. This wasn't known to be false until a century after The Wealth of Nations appeared, when the Laws of Thermodynamics were developed, so Smith cannot be criticised for that mistake. But economists today should not persist with using models of

production that violate the Laws of Thermodynamics.

Source:

Real World Econ Rev Blogs, 9 Jan 2024
<https://rwer.wordpress.com/2024/01/09/with-one-word-economics-lurched-into-fantasy/>

Extracted by Prof Steve Keen from his paper published in RWER issue 106.

**As Australia's net zero transition threatens to stall,
rooftop solar could help provide the power we need**
Anna Bruce, Baran Yildiz, Dani Alexander and Mike Roberts

Australia is not rolling out clean energy projects nearly fast enough to reach the Australian government's target of 82% renewable electricity by 2030. A huge build of solar and wind farms, transmission lines and big batteries is needed. But progress is challenged by the scale required, in addition to community resistance to new infrastructure and connecting all that new renewable electricity to the grid.

In the latest obstacle to expanding renewable energy capacity in the longer term, federal Environment Minister Tanya Plibersek knocked back a plan by the Victorian government to build a sea terminal to service offshore wind farms, saying it posed "clearly unacceptable" environmental risks.

The roadblocks facing large projects present an opportunity to ramp up the contribution of small-scale technologies in the energy transition. Recently, federal and state energy ministers agreed on the need to have a national roadmap and a co-ordinated approach to integrating into the grid what they call "consumer energy resources" (CER), which include batteries, electric vehicles and rooftop solar.

More than one in three Australian

houses have solar panels on their roof. Australia leads the world in rooftop solar per head. During the past year these systems generated close to 10% of our electricity. Several times over the past few months, they even provided enough electricity to briefly meet all of South Australia's electricity demand.

And the technology still has great potential to grow: although installed capacity has doubled in the last four years, these systems cover only about 10% of Australia's estimated usable roof area. So, how large a share of our electricity needs might rooftop solar provide? The answers are not simple.

Why rooftop solar presents a challenge for the grid

In electricity systems, demand and supply must be balanced at all times. The Australian Energy Market Operator (AEMO) runs the grid and keeps it secure to avoid blackouts in case of unexpected events such as the sudden disconnection of a transmission line.

To meet demand, every five minutes AEMO dispatches electricity from large-scale generators, such as coal-



Grid operators dispatch power from electricity generators, but not from rooftop solar. “Transmission Tower” by Nupur Shah is licenced by CC BY-NC 2.0 DEED.

fired power stations or large solar farms. As the grid operator, AEMO must also procure reserve capacity to balance any differences in demand and maintain security.

But AEMO does not dispatch power from rooftop solar, which is either used on site, or flows into the grid independently of AEMO’s control. This isn’t usually a problem, since AEMO keeps the grid balanced by forecasting how much rooftop solar is being generated.

However, if rooftop solar generates the majority of power in a particular region, there may not be enough dispatchable generation and reserves online to keep the grid balanced and secure. Grid security can also be challenged when unexpected events trigger the safety settings of rooftop solar systems and cause them to disconnect.

The other big issue for grid balance is that the network businesses that man-

age the poles, wires and other infrastructure connecting generators to homes and businesses need to ensure that voltages remain within defined technical limits to avoid damaging equipment or appliances. When solar generates a lot of power at a time of low electricity demand, voltage can exceed the upper operational limit. Voltage can also fall below the lower operational limit whenever too many people connect big appliances like air-conditioners.

So how are we managing the three challenges of rooftop solar: lack of controllability by the market operator, uncertain behaviour during unexpected grid events and impact on network voltage?

Ways to manage and expand rooftop solar

Current Australian standards require solar to automatically disconnect when voltage gets too high. Network businesses also pre-emptively manage this



PM Anthony Albanese and Energy Minister Chris Bowen visit NSW company SunDrive, Australia's production facility for solar panels (extracted from SunDrive Facebook page).

problem by preventing customers in areas where voltage is an issue from connecting solar to the grid, or by limiting the size of solar systems they can connect or the amount of electricity they can export to the grid at any time. But this approach is potentially unfair to those customers who can't connect or export.

The good news is that standards introduced in 2020 provide more sophisticated ways of managing solar power through more gradual voltage response, and by requiring systems to ride through major disturbances rather than disconnecting. Some networks have also developed solar-friendly ways to cut off surplus output "dynamically", meaning only at times when they have to.

Owing to these measures, solar customers face less constraint on exporting power to the grid. However, since

solar sometimes now supplies most of the generation in South Australia, AEMO has also tested disconnection of solar to increase its control of the grid in case of threats to system security.

Some of these solar power management tools are still quite blunt, and some commentators worry that they will be overused. While necessary in the short-term, if unchecked they will reduce our ability to realise our rooftop solar potential.

Getting smarter about when we use power

There is another way to use our solar systems more effectively: we can shift energy use to times when the sun is shining, and store energy – in batteries, electric vehicles and hot water tanks – to use when it is not.

To make such a change, consumer

electricity prices are a potential lever. Solar customers already have an incentive to use electricity from their own rooftop systems, because they pay more for grid electricity than they are paid to sell solar back to the grid.

South Australia and some of the other network areas are introducing low

“solar soak” rates to encourage all customers to use electricity during the high solar times, such as the middle of the day. Times of plentiful solar power also tend to be the cheapest times to buy wholesale electricity from the grid, and innovative retailers are passing through these price signals to customers.



Customers will be rewarded for operating their EVs in ways that reduce pressure on the grid. “EV Charging” by DDOT DC is licenced by CC BY-NC 2.0 DEED

However, typical retail plans offered to customers don’t provide much incentive to change patterns of electricity use, especially since many customers are understandably not focused on their electricity bills or cannot easily shift their power use.

In these cases orchestration schemes, often called “virtual power plants,” are an option. Under the schemes, a business will reward household customers that allow it to operate their rooftop solar, batteries, appliances, electric vehicles and hot water systems in

ways that reduce overall costs or grid impacts. Better management of electricity use through these schemes can allow the grid to take on more solar.

Recent trials in Western Australia (Project Symphony) and Victoria (Project EDGE) show that orchestration can work. Nevertheless, people will need good reasons to hand over control of their solar system, batteries and appliances, particularly if they bought expensive equipment such as batteries for back-up power or to increase their energy independence.

It would be a major setback to the net zero transition if AEMO and network businesses, lacking better options for managing the grid, continue to cut back and switch off solar systems until people find it unattractive to purchase them.

The new CER roadmap needs to provide clear guidance on how AEMO and network businesses can manage rooftop solar, and other technologies such as batteries and EVs. Good governance arrangements and meaningful stakeholder consultation are essential if Australia is to maintain the momentum of its people-powered energy transition.

Source: The Conversation, 9 Jan 2024
<https://theconversation.com/as-australias-net-zero-transition-threatens-to-stall-rooftop-solar-could-help-provide-the-power-we-need-220050>



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Ecological economics and modern monetary economics need each other

Steven Hail

Here are three things that ecological economists often do not get quite right about money, and I am talking about those who engage positively with modern monetary theory (MMT), so understand MMT basics (i.e. not people who believe we operate fractional reserve banking, or that banks which create money then lend it to their own central banks, or anything like that).

1) You often see people who claim that MMT neglects private bank money. Some people who may have said this a decade ago have since read the literature and know this is incorrect now, but it is still commonly said by some of the most brilliant ecological economists and others.

It is of course not true. As emphasised by one of the originators of MMT, Prof Randall Wray, who was before MMT a leading Post-Keynesian. MMT incorporates the horizontal/endogenous money perspective of Kaldor, Moore and other Post-Keynesians, which is basically the realistic description of how loans create deposits. However, it adds to this a proper description of the role of the government and its central bank.

2) You also often hear people say that 97% of the money supply is created by bank lending. The mistake here is to conflate bank IOUs/deposits with bank lending to customers (the loan is an asset for the bank and the deposit is a



"bank deposit" by Mike Lawrence (Credit Debit PRO) is licenced by CC BY 2.0 DEED

liability, and the loan creates the deposit out of nothing when banks lend).

Yes, 97% of some monetary aggregates consists of bank deposits, with the rest being physical currency tokens (notes and coins, while we still have them).

But no, this was not all created by bank lending. Only (a very substantial) part of it. The main other contribution, in most cases, is federal government spending not matched by taxation or bond sales to the non-bank private sector.

If the central government spends \$100 and taxes \$80, it leaves \$20 as bank deposits/IOUs to customers, and at the same time \$20 of reserves at the central bank as the offsetting asset for the private banks. If the \$20 is then matched by bond sales to non-banks, these deposits and reserves are deleted again. But if the bond sales are to the banks, then while bank reserves fall by \$20, to pay for the bonds, bank deposits/bank IOUs DO NOT fall.

In other words, central government deficit spending increases the official money supply in this case, and the

97% of the money supply which is bank deposits has not been wholly created as a result of bank lending. It is a bit more complicated.

As a minimum, I believe bank lending should be much more highly regulated, and I believe in macroprudential and micro/ecological prudential regulation. I would go further and argue that people should be able now to hold their transaction deposits at the central bank itself, and if banks remain in the private sector, they should be largely funded by and closely regulated as to what they are allowed to do by the central bank.

3) There are some people who claim that the existence of compound interest somehow necessitates continuous economic growth. However this is not so, because interest does not normally compound on loans, but is instead a transfer of wealth from those who have to pay interest to those who receive it. The first group might have to create output to make interest payments, but the second group can cut back on what they produce. It is a distributional/social justice issue, but

not one which necessarily has to drive limitless expansion.

That said, I am in favour of low - or even zero - official interest rates, led by the USA and copied internationally, but for distributional reasons.

MMT and ecological economics, in my opinion, very much need each other, which is why I am grateful to Professor Philip Lawn for introducing me to ecological economics over the years, and for introducing so many ecological economists to MMT.

Comments from Prof Philip Lawn

Steven's last point is important. I used to fall into a trap that I no longer do, thanks to Steven. Most people understand that the repayment of the loan principal destroys credit money. The payment of interest does not. It constitutes a redistribution of spending power from the borrower to the lender.

A lot of people think that the money used to pay the interest on a loan is 'new' money and therefore there is always more money in the system following the full repayment of a loan. One can borrow money to pay off any debt owed on an existing loan ('refinancing'), which might include a little bit of interest owed and a penalty for extinguishing the debt early, which would marginally increase the money supply, however most people who are indebted use their disposable income to repay the principal and any interest charged. If they do the latter, the borrower may partake in activities to increase real output to earn additional income so they can pay off the loan without having to reduce their overall spending, but most people do not do that. They either reduce their fortnightly spending on other stuff (by an amount equal to fortnightly loan repayments) or, if they were previously saving \$X out of their fortnightly disposable income (perhaps to build up a deposit on an expensive item), they cease saving \$X each fortnight and instead use it to grad-

ually repay the loan principal and pay any interest owed. If they do either of these, they don't earn additional income and therefore do not engage in activities that increase GDP. The point here is that repayments of loans (where the borrower pays more to the lender over the duration of the loan than they borrow from the lender - that is, the borrower receives the principal from the lender but pays back the principal plus interest) do not have to be matched by increases in real output. And consequently it is wrong to say that interest payments on loans necessitates the growth of GDP. It is true that more loans can lead to more spending, which can promote increases in GDP. But we would then be referring to spending levels, not the effect of having to pay interest on a given loan. Interest rates have distributional effects.

One might say that since the payment of interest on loans can lead to some increases in GDP (if the borrower chooses to earn more income to maintain their fortnightly spending and saving levels), then interest payments do promote some growth. And I would respond by saying that it would only promote a desire for more spending. But if natural resource extraction and waste generation are restricted to rates, via caps (as Ecological Economists recommend), that are within the ecosphere's regenerative and waste assimilative capacities, then without a reduction in the throughput intensity of GDP, the increased desire to spend would manifest as inflation, not as an increase in GDP. If we don't like the inflation caused by an increased desire to spend beyond sustainable productive capacity, then we can use taxation to reduce the spending power of currency users. In fact, we wouldn't need to do this if cap-auction-trade systems were introduced to access natural resources and generate wastes (also recommended by Ecological Economists) because rising permit prices (i.e., permits to access resources and generate wastes) would rise as spending desires rise. The higher permit prices would act like rising taxes by destroying some of the

spending power of resource buyers and waste generators.

Caps on the rate of throughput (resource extraction/waste generation) are the only means of guaranteeing throughput targets (simple, not complicated) and, for a given level of government spending, taxation is a simple means of ensuring total spending does not exceed sustainable productive capacity enforced and guaranteed by the caps. Both caps and a form of taxation is part and parcel of well-designed cap-auction-trade systems.

The inflation issue is important because there is massive cost-push inflationary pressure simmering within the real economy. That pressure is not being reflected in the prices of goods and services because policy makers refuse to impose taxes or introduce cap-auction-trade systems so that natural resource prices better reflect the true value of natural resources and the true costs of waste generation.

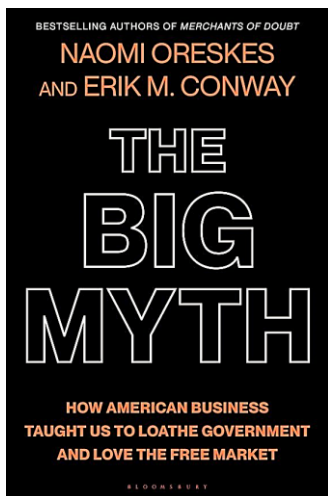
Many MMT economists are unaware of this simmering inflationary pressure.

How do I know that this pressure exists? Well, apart from the fact that depletion/pollution taxes are eschewed, the USA, for example, has an ecological footprint that is twice its biocapacity. Sustainability requires the EF to be no greater than biocapacity. Imagine introducing cap-auction-trade systems in the USA with caps to reduce the USA's rate of throughput to half its current level (necessary to achieve sustainability). The prices of natural resources and the cost of polluting would go through the roof, as would then the prices of newly produced goods and services. Transitioning to sustainability will not be the smooth ride that many people believe. Redistribution is going to be critical, in particular, dramatically reducing the income and wealth of the rich. Without it, we simply won't be able to fit everyone equitably into a sustainable economy.

Assoc Prof Steven Hail and Prof Philip Lawn are associated with Modern Money Lab, Torrens University, Australia. Steven is a member of the ERA editorial committee and Philip is an ERA patron.

Recommended book: The Big Myth

How American business taught us to loathe government and love the free market, by Naomi Oreskes and Erik Conway (Bloomsbury, 2023)



The great enemy of truth is very often not the lie - deliberate, contrived, and dishonest - but the myth - persistent, persuasive, and unrealistic. [John F. Kennedy, Commencement Address, Yale University 1962]

The bestselling authors of *Merchants of Doubt* offer a profound, startling history of one of the United States' most tenacious - and destructive - false ideas: the myth of the "free market."

In the early 20th century, business elites, trade associations, wealthy powerbrokers, and media allies set out to build a new American orthodoxy – i.e. down with "big government" and up with unfettered markets. With startling archival evidence, Oreskes and Conway document campaigns to rewrite textbooks, combat unions, and

defend child labour. They detail the ploys that turned hardline economists Friedrich von Hayek and Milton Friedman into household names; recount the libertarian roots of the Little House on the Prairie books; and tune into the General Electric-sponsored TV show that beamed free-market doctrine to millions and launched the career of Ronald Reagan. By the 1970s, this

propaganda was succeeding. Free market ideology would define the next half-century across Republican and Democratic administrations, giving us a housing crisis, the opioid scourge, climate destruction, and a baleful response to the Covid-19 pandemic. Only by understanding this history can we imagine a future where markets will serve, not stifle, democracy.

Rethinking banking as a public franchise Offering economists a more accurate metaphor Tom Foster

Australians are very familiar with the concept of a franchise business, having the second highest number of franchising outlets per capita than any other country (ITA, 2022). When we think of franchises, some popular retail brands immediately come to mind; Jim's Mowing, McDonalds and Harvey Norman to name several. So, what is meant by rethinking banking as a public franchise - are we thinking about setting up a new franchise called Jim's Banking? Not quite.

In their 2017 Cornell Law School paper *The Finance Franchise*, authors Robert C. Hockett and Saule T. Omarova (Hockett & Omarova, 2017) "map a new vision" (Ibid, 2017, p1211) of a nation's financial system by asking for "re-conceptualization of modern finance as a hybrid public-private franchise system" (Ibid, 2017, p1149).

The authors commence by setting out the "three ways in which finance can originate and flow" (Ibid, 2017, p1143), the first two ways being:

1. The Credit-Intermediation (or one-to-one) Model where bank deposits of private saver's pre-accumulated funds

are 'recycled' -- one-to-one -- in order to create loans for the bank's lending customers. "This is the essence of the so-called "loanable funds" model of banking, pursuant to which "deposits make loans"" (Ibid, 2017, p1159); and 2. The Credit-Multiplication (known as one-to-many) Model, also commonly known as "fractional reserve banking" (Ibid, 2017, p1152), where funds lent out or invested by banks "constitute a multiple of (pre-accumulated) funds originally supplied by private savers" (Ibid, 2017, p1153).

As illustrated in Figure 1 the above two models reflect the "orthodox" (Ibid, 2017, p1151) view of a financial system operating independently to the public sector in which finance sector entities "compete" (Ibid, 2017, p1143) for a finite and "unavoidably scarce" (Ibid, 2017, p1145) amount of money "first accumulated in private hands" (Ibid, 2017, p1145).

The third model the authors set out is:

3. The Credit-Generation (or none-to-many) Model where money is not recycled or multiplied from pre-accumulated sources but instead, in the form-

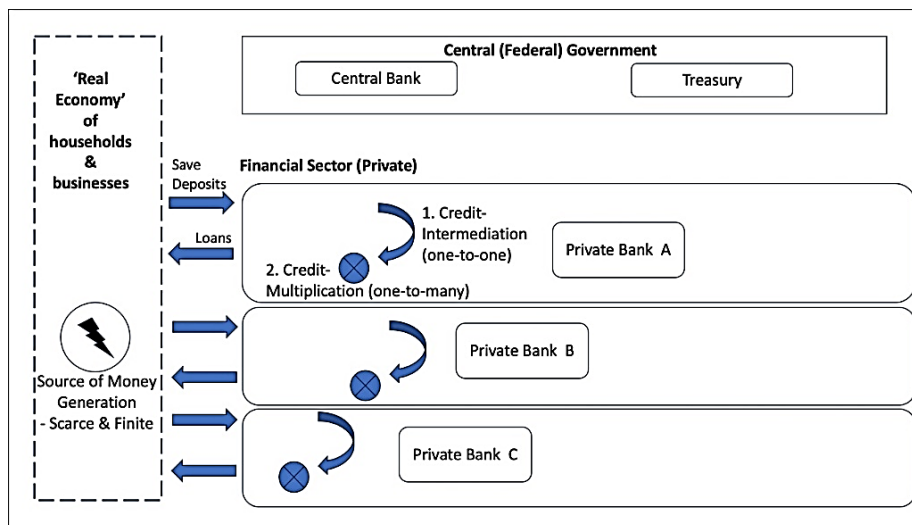


Fig 1: Conceptual illustration of orthodox view of banking system.

ation of a debt, is created from 'nothing' as a form of credit-money. This model reflects the "credit theory of money" where "money is credit and nothing but credit" (Mitchell Innes, 1913) and becomes, not a scarce and finite "creation" of the private sector, but an abundant and (potentially) infinite resource of the "state" (Keynes, 1930, p4).

To identify which of these models are used by banking in practice, some authors examine bank's assets and liabilities reflected in their balance sheets, and "as a matter of accounting" are able to show (Hockett & Omarova, 2017, p1160):

1. The credit-intermediation (the loanable funds theory) model "to be false" (Ibid, 2017, p1158); instead "deposits do not make loans, but loans make deposits" (Ibid, 2017, p1161); and
2. The credit-multiplication (fractional reserve banking) model as "not necessary" (Ibid, 2017, p1160). In other words, the authors establish the way

finance originates and flows throughout banking is that of credit-money produced by the credit-generation model. From this evidence the authors then use the credit nature of money to explain how "the public enters the realm of finance" (Ibid, 2017, p1155) through the public underwriting of these credit-generation operations by the private banks.

Replicating a function otherwise solely reserved for the sovereign government, (government-licensed) private banks are authorised to conduct credit-generation operations in the nation's sovereign (national) currency, creating credit-money in "immediately spendable form" (Ibid, 2017, p1156) for its clients to use. Credit-money is inherently two-sided: when a bank generates credit-money, it simultaneously creates a deposit asset for its client and a corresponding liability on its own balance sheet. It is through this structure of privately generated credit-money that the authors identify the two mechanisms by which the government underwrites it:

Accommodation – the government's central bank ensuring that bank-created credit-money can be used throughout the economy by standing behind the payments system; and

Monetisation – the government recognising the “spendability” at par of the credit-money it licenses private banks to generate.

Through these “twin acts” (Ibid, 2017, p1156) of accommodation and monetisation, the sovereign public extends its full faith and credit to privately generated credit-money. This establishes the essential role played by the public sector in enabling that credit-money to function and flow throughout the economy.

Comparing this now established hybrid public-private relationship to existing business models, the authors identify strong parallels with the franchise business model, observing the government acts as “de-facto” (Ibid, 2017, p1156) franchisor and government licensed private banks the franchisees.

In a typical franchise agreement, the franchisor takes on the risk of licencing franchise businesses (accommodates) to replicate the franchisor's brand and ‘proven’ business system, which by following, the franchisor can confidently provide its imprimatur that the franchisee clients are purchasing and consuming the franchisor brand of quality product or service. In doing so franchisees should be able to replicate business results of the franchisor's ‘promise’ of profits.

For example, McDonald Inc accommodates McDonald store franchisees who - by following the McDonalds

‘prescribed’ system – cook and sell replicable Big Mac hamburgers which are already proven to be popular and profitable. By the franchisee following its proven system, McDonalds Inc can assure store customers they are consuming a Big Mac to McDonalds Inc specifications (i.e. consuming Big Mac Burgers made to MacDonald Inc's patented Big Mac burger recipe). Also, the franchise owner by following the prescribed system is more likely to be rewarded with a profitable McDonald's franchise business. Refer to Figure 2.

Using the public franchise lens to view banking, the sovereign government's central bank and Treasury (typically) combined (Ibid, 2017, p1157) act as franchisor by issuing banking licences (aka franchise agreements) to the privately owned banks (franchisees), authorising those private banks to replicate the credit-generation of the nation's credit-money. With franchisee banks acting according to the licensing process, the sovereign government is then able to guarantee accommodating the debit (liability) and the ‘spendability’ by these bank's customers of the credit-money the banks create (monetisation). Refer to Figure 3.

In this way, backed by the sovereign public's “full faith and credit”, and with the government in an oversight and credit modulator role, a nation's credit-money is propagated and allocated by the private banks to where the credit is needed by the ‘real’ economy (represented by businesses and households) (Ibid, 2017, p1211). The intended purpose of having this public-private hybrid, given that the licensed private banks compete between each other, is that the private banking sector will perform the tasks of issuing, circulating and distributing money more effectively and efficiently than the public

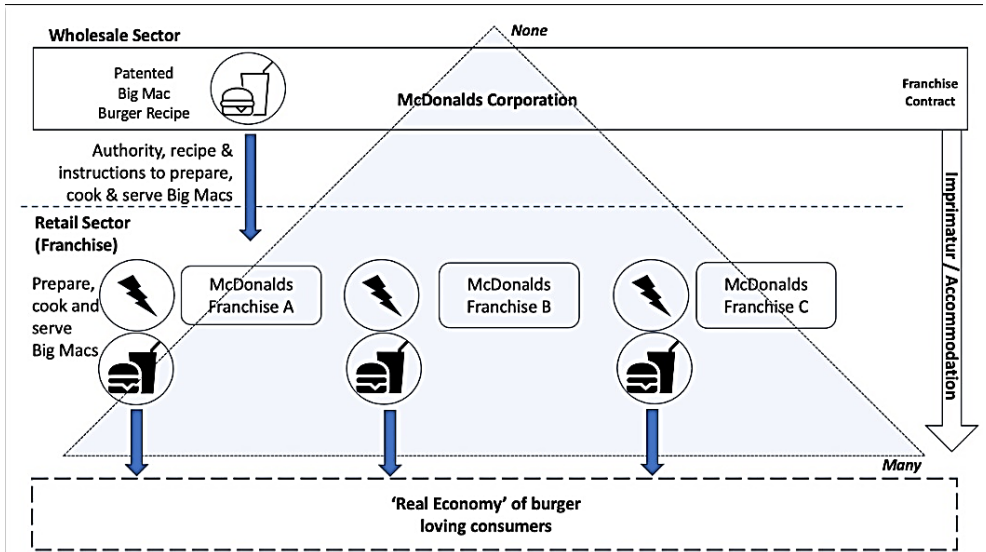


Fig 2: Conceptual illustration by author of franchise business model.

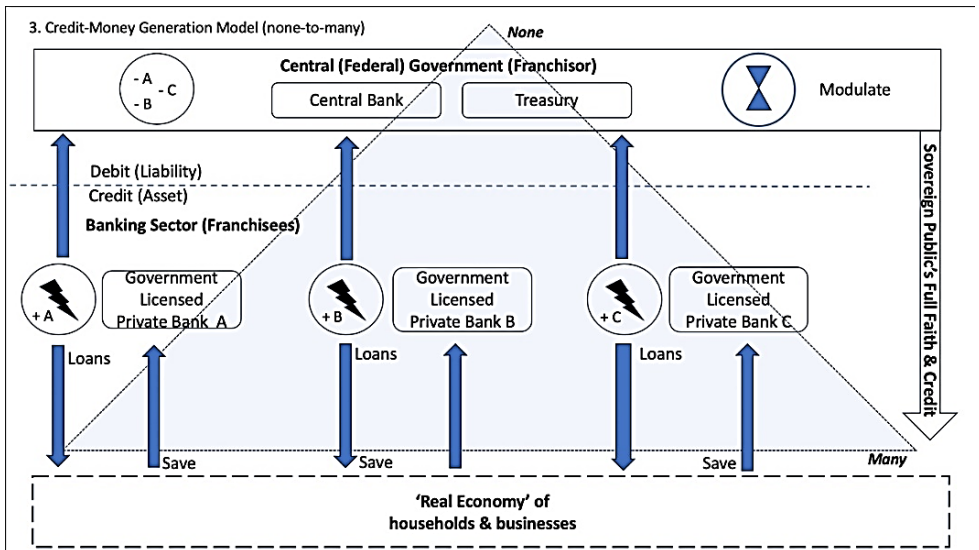


Fig 3: Conceptual illustration by author of banking as a public franchise.

sector could achieve.

Rethinking banking in this way as a public franchise has profound implications for public policy development. Of particular significance is the choice of macroeconomic theory for determining national policies, as a public franchise model exposes as inaccurate numerous aspects of the orthodox economic theory of banking and money. A contending replacement is Modern Monetary Theory (MMT), which incorporates within its foundations the credit theory of money (Mitchell et al., 2019, pp154-155).

Another implication is that the private banking system is now recognised as a tool for public - rather than for purely private - purpose. To illustrate, the authors Hockett & Omarova use the example of 'dysfunction' (Hockett & Omarova, 2017, p1213) and financialisation' (Ibid, 2017, p1211) within many modern economies - creating a capital 'glut' (Ibid, 2017, p1214) for the financial sector at the expense of the real economy. The authors argue the "attitudinal shift" (Ibid, 2017, p1216), created by viewing banking as a public franchise, would ensure efficient prop-

agation and fairer allocation of the public's credit-money towards supporting more productive uses across society.

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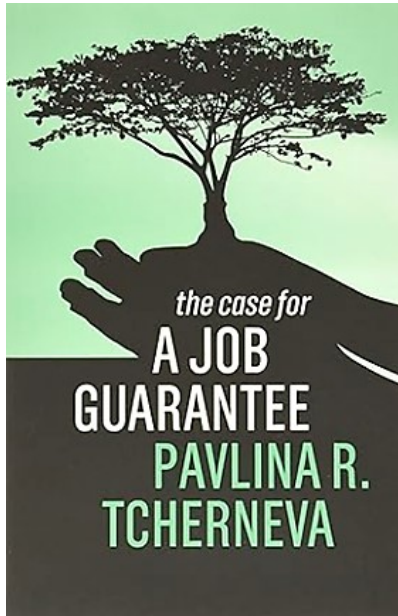
Tom Foster holds a Bachelor of Engineering (Electrical) Honours degree from the University of NSW, a Post Graduate Diploma in Management from MGSM and is currently studying for the Master of Economics of Sustainability degree at Torrens University.

Book recommendation: **A proposal for achieving full employment** **The Case for a Job Guarantee (Polity Press, 2020)** **Pavlina R. Tcherneva**

One of the earliest discussions of work relief was by the great Indian economist Kautilya (375–283 B.C.E.). In his treatise *Arthashastra*, he recommended public works projects that are aimed at alleviating poverty. Work relief programs of a more recent origin include the Civilian Conservation Corps

and the Works Progress Administration of the 1930s-1940s within the U.S., South Africa's Expanded Public Works Programme which started in 2004, and the Mahatma Gandhi National Rural Employment Guarantee Act enacted in India in 2005. In *The Case for a Job Guarantee*, Pavlina R. Tcherneva

discusses job guarantees as recent policy iterations of work relief. Job-guarantee proposals are distinctive because they assume that full employment is achievable only if there is a public employment opportunity for all people who seek paid work.



In *The Case for a Job Guarantee*, Tcherneva makes five main arguments. First, involuntary unemployment is commonplace and correlated with detriments for the unemployed and others. Second, the prevailing theory of full employment is not supported by empirical research. Third, full employment can only be maintained with the use of a job guarantee. Fourth, a job guarantee provides goods and services not currently produced by the private and public sectors, and a job guarantee would reduce the detriments correlated with involuntary unemployment. Fifth, a job guarantee can

contribute to price stability by expanding the supply of experienced workers and by minimizing wage fluctuations.

Tcherneva reviews research that documents the existence of involuntary unemployment even during times of low unemployment rates. This area of research, which covers employment before the COVID-19 pandemic, was able to show that the number of involuntarily employed people had exceeded the number of available jobs. And based on the evidence presented in her review, Tcherneva has concluded that traditional employment policies have failed to achieve full employment.

Tcherneva's research indicates that involuntary unemployment harms the unemployed and others. Unemployment is correlated with reduced mortality, reduced lifetime earnings, increased poverty rates, higher rates of alcoholism, a greater incidence of depression, and an overall decline in physical health. Children in families with unemployed adults are more likely to suffer from malnutrition, mental health problems, stunted growth, and reduced educational success. Unemployment is associated with the social ills of urban blight, crime, inequality, and reduced technological innovation, and its consequences include higher income transfers, prison costs, and healthcare costs. Finally, because the unemployed are not working, there is forgone productive output.

Tcherneva argues that these individual and social costs of unemployment call into question the cogency of the prevailing theory of full employment structured around the assumption of a natural rate of unemployment. The nat-

ural rate of unemployment is commonly called the nonaccelerating inflation rate of unemployment. This rate is a hypothesized amount of unemployment corresponding to a stable price level that economies tend toward in the long run. Tcherneva argues that the existence of a natural rate of unemployment is not substantiated by empirical research. If the natural rate is not a supported hypothesis and if unemployment has detrimental effects, a new definition of full employment is needed.



"Stickynotes - Find a Job" by Fazingo Photos is licenced by CC BY-SA 2.0 DEED

A job guarantee produces full employment because its purpose is to employ all people who wish to work. Using research on past direct public employment programs, Tcherneva shows the promise of a job guarantee, noting that job-guarantee work would complement work that is already being performed by private firms and government agencies. The author finds that job-guarantee work can be performed in the general areas of care services, environmental conservation services, and in community services. These areas have been recommended on the basis of research that identifies unmet public needs. In particular, a job guarantee can be situated as part of a broader policy aiming to move the economy

toward environmental sustainability. The positions created by a job guarantee would be offered at a fixed wage set above the official poverty threshold and also would provide the benefits of health insurance, paid leave, and childcare.

Tcherneva further argues that, besides providing a defined form of full employment, a job guarantee would help stabilize prices. First, it would increase the pool of trained workers, reducing wage pressures in labour markets. Second, the set wage of the job guarantee would act as a price buffer stock. Buffer stocks stabilize the price of a given commodity by ensuring that the commodity is bought and sold in any amount at a publicized price. A job guarantee acts as a buffer stock for labour by employing all people who wish to do job-guarantee work at the set wage. Also, this wage would not be indexed to any price series, which would minimize its inflationary or disinflationary effects. The number of people employed through a job guarantee would increase (decrease) during economic contractions (expansions). This changing number would help minimize price fluctuations, all else held equal.



"Employment" by Jeremy Sternberg is licenced by CC BY-NC 2.0 DEED

The job guarantee scheme proposed by Tcherneva would be financed by a central or federal state. Local governments and nonprofits would submit proposals for employment projects. Tcherneva argues that the funding of a job guarantee should be considered in real terms (i.e. increased number of people employed, reduced detrimental effects of unemployment, tempered price fluctuations) and not as a financial cost. Thereby, she argues that the outcomes of a job guarantee are a net social benefit. In support of her view, Tcherneva cites a research paper she coauthored that uses macroeconomic modelling and finds that a job guarantee would create private-sector jobs, increase state-level revenue, and reduce poverty (in addition to providing a form of full employment). Although she argues that it is best to consider a job guarantee in real rather than financial terms, she does provide a financial estimate of the cost of a job guarantee scheme. She finds that such a scheme would cost approximately one percent of gross domestic product in the United States, but this estimate does not consider any reductions in

other government social spending due to unemployment.

The Case for a Job Guarantee has been written for a general audience. It can be an appropriate reading in introductory courses on employment, as well as macroeconomics, and public policy. Social scientists who are interested in the theoretical assumptions and research that underpin proposals for a job guarantee will find the book to be useful. The book is short, so the amount of space devoted to the presentation and appraisal of different economic theories, social statistics, and other employment policies is limited.

Source:

Monthly Labor Review, November 2023
<https://www.bls.gov/opub/mlr/2023/book-review/a-proposal-for-achieving-full-employment.htm>

This publication has creative commons status.

Dr Pavlina R. Tcherneva is a Professor of Economics at Bard College, the Director of OSUN's Economic Democracy Initiative, and a Research Scholar at the Levy Economics Institute, NY. She is a macroeconomist specializing in monetary economics and stabilization policy.

A future threat has become a present reality and time is against us

Jamie Morgan

This short article is extracted from, and summarises, much of the author's larger article in *Real World Economic Review*, issue 106, entitled "Against the clock: Economics 101 and the concept of time".

"How can we construct an economics consistent with the biophysical limits to economic growth?". As any ecological economist is aware, this is a foundational issue not an afterthought chapter tacked on to the end of a textbook or

delegated to a sub-disciplinary specialist who can 'deal with that for us'. Doing either of those has been part of the problem. Mainstream economics takes as its primary focus the micro-economics of price signalling in systems of market exchange and assumes efficiencies in dynamic market processes are sufficient to ensure best use of resources and eventual development of alternative ways of achieving

what we want and need (through a combination of behavioural change, investment and technology). At the same time, the macroeconomy is conceived through a circular flow of income, and targets continual economic growth. This implicitly equates health of an economic system (as a source of both progress and wealth) with continual economic growth (bigger is better rather than different can be good) and this growth is conflated with the possibility of solving problems created within the system, including environmental ones. Thus economic growth implicitly becomes the basis of solutions rather than merely source of the problems we see around us. This mirrors the basic socio-economic drivers of our dominant ways of living (i.e. the apex which others aspire to and which 'development' assumes is the way to go). Capital-accumulating industrial-consumption economies presuppose growth and, government stabiliser policies notwithstanding, if growth fails to occur this is deemed to be a signal of crisis (and this remains the case despite the proliferation of alternative indexes of human development and wellbeing).

"What is very obviously not foundational is the basic fact that an economy is a material-energy process on a finite planet involving metabolic flow and waste, and that a bigger global economy observably outstrips any 'efficiency savings' to the extent that the biosphere has been profoundly altered and polluted.

"Environmental economics has taken

its cue from mainstream economics. Its main focus being relative scarcity rather than absolute scarcity, addressing market failures (taxes, subsidies and regulation to get the price right, altering behaviour while also working to induce market processes that promote technological transitions), and if there is no market, creating property rights and securitisable assets to essentially create synthetic markets (trading pollution and valuing nature for its preservation). All of this simply ignores the basic problem of socio-economic drivers, implicitly assumes technology will mainly solve problems and underplays the need to rethink how society and economy are organised – around a concept of 'a good life within planetary boundaries' and a concept of 'enough' (a different concept of 'abundance'). These are just not questions and issues either a mainstream economist or an environmental economist can meaningfully address within their skillset and framework of thinking (and this remains the case despite growing concern among world scientists regarding trends and despite some limited progress at the annual COP meetings – in which issues like financing, just transition and so on have become legitimate subjects of discussion).

"A future threat has become a present reality and ecological breakdown, climate change and erratic and extreme weather events are now all around us. We are only at 1.1-1.2°C of heating. Worse is yet to come and an avalanche of statistics makes it very clear



"Climate Angels outside the Australian Government offices - Extinction Rebellion Melbourne - IMG_4443" by John Englart is licenced by CC BY-SA 2.0 DEED

that rhetoric has not yet translated into action with sufficient urgency. We are on the clock and time is against us."

Original paper:

<https://www.paecon.net/PAEReview/issue106/whole106.pdf>

Source:

Real World Econ Rev blogs, 31 Jan 2024
<https://rwer.wordpress.com/2024/01/31/a-future-threat-has-become-a-present-reality-and-time-is-against-us/>

Prof Jamie Morgan is attached to Leeds Beckett University Business School, UK.

"Complexity" in economics

Maria Alejandra Madi

This blog has been extracted by the author from her longer article which appeared in Real World Economic Review, issue 106.

"Anthropogenic climate change and ecological breakdown are now major threats to human life and other species. It is now widely acknowledged that mainstream economic theory and especially neoclassical theory lack adequate concepts to address these problems and arguably have contributed to them through misdirection and delay.

"Complexity" sciences, however, are now widely adopted but have as yet made little impact on economics. In this short article I advocate the widespread adoption of 'complexity' in the field of economics. Complexity means more than just acknowledgement that 'it's complicated'. Its greatest attraction in our current 'climate emergency' is that it is capable of dealing with the interconnection and interdependence between the biosphere and economic

systems. I draw attention to several significant aspects of complex systems for economics:

- a. The lack of homogeneity among the elements of the system in terms of the characterization of agents (attributes, rules of behaviour, cognitive rules, strategies, learning capacity) and the environment where patterns of interaction occur;
- b. The adaptive nature of an agent's behaviour in interaction with their environment;
- c. The concept of emergence as the property of novelty, change, and innovation of complex systems that exhibit a wide range of aggregate patterns.

“ Theory and policy that fail to consider a) to c) in the context of the impacts of economic systems on the biosphere are deficient and as Winkelmann et al argue, there is a need to ‘close this loop’ (Winkelmann et al., 2017)

Incorporation of complex economic and biophysical systems in Eco 001

“ While founding economists such as the physiocrats and John Stuart Mill had some concept of the material impact of economic activity, mainstream economics has since become divorced from the physical world. Its main focus is exchange valuations including at the macroeconomic, national accounting, circular income flow and trade balances levels (for discussion of the issues see Naredo, 2012; Green 2012).

“ Mainstream economics exemplifies a mechanistic cause-and-effect perspective which was prevalent in the 19th century. Simple linear cause-effect relations and recourse to *ceteris paribus* clauses don't allow for realistic representation of the economic system

(Madi, 2020). Mainstream economics has attempted to adapt itself through ‘environmental economics’, but as ‘ecological economists’ argue, this remains incapable of appropriately incorporating material flows and energy use in ways liable to lead to a rational conception of ‘biophysical limits’. Moreover, Econ 001 courses and textbooks still treat the environment as a specialist issue rather than a subject of basic concern. This state of affairs reflects a deeper problem of unrealistic knowledge, mainly predicated on *homo economicus* (with a few modifications) and Cartesian reductionism (Fullbrook, 2016). Worse, a mainstream economics education imposes implicit norms that prevent students cultivating a critical mindset. In a time of ‘climate emergency’ this is a major problem (Reardon and Madi, 2020).

“ Earth systems scientists have developed a ‘planetary boundaries’ framework which seeks to model the interactions between human activity and different systems – of which climate is only one (Steffen et al. 2015a, 2015b). Earth system scientists work with a concept of ‘safe operating space’ and report that multiple systems have now exceeded this (Steffen and Morgan, 2021). It is partly because of such changes that Earth systems scientists have also coined the term ‘Anthropocene’ (though others, such as Jason Moore, prefer the term ‘capitalocene’) (Donges et al., 2017).

“ It seems clear that economics needs to adopt an appropriate variation of the kind of complex systems approaches that are now available. “

Comments from Dr Geoff Davies

There is plenty of observable evidence that modern economies are far from equilibrium

with strong positive and negative feedbacks operating. They are therefore sensibly regarded as complex systems.

In fact large parts of modern economies are living (people, food sources ...) and living systems are complex.

A complex economy must be approached differently, with different questions. See more in Economy, Society, Nature – green cover in the right-hand-column.

Source: <https://rwer.wordpress.com/2024/02/06/complexity-in-economics-2/>

Dr Maria Alejandra Madi has outstanding research and publication records, and she specialises in the financial and social challenges of globalization, as well as realism in economics and the methodology of economics within the wider context of the philosophy of science. She is currently visiting professor at the Green Economics Institute

Letters

From Dr Ted Trainer

What is sustainable development?

Mark Diesendorf's answer to this question in the previous issue of ERA Review provided useful information on the concept and its history but did not deal with the magnitude of the problem. He did note that "...consumption of goods and services in rich countries must be reduced substantially..." however that does not convey the seriousness of the predicament or the extremely radical nature of the changes that would have to be made.

In Degrowth and Green New Deal etc. literature the predominant assumption, usually implicit, is that the big global problems threatening us can be solved without too much inconvenience and without major change in lifestyles and social systems. This would be correct if the required reductions in resource and environmental impacts were not very big and/or were largely achievable by technical advance, more diligent recycling and tighter regulation. However it should be recognised that the reductions required are enormous, and cannot be achieved without the adoption of new and extremely radical settlement for our economic, political and cultural systems. Simple Footprint analysis using World Wildlife Fund findings indicates that the amount of productive land being used

now to provide for each Australian is around 8-10 times the available amount in 2050 if two-thirds of the world's productive land was shared equally by the estimated 10 billion likely to be on earth by then. If consideration of rates of use of other resources along with their declining availability is added, the picture is worse.

In other words, if one is serious about achieving a sustainable and just world order then one must face up to degrowth in rich world levels of resource consumption to levels that are a small proportion of present levels. This cannot be done while retaining present lifestyles and systems. It can only be done if there is transition to very different lifestyles.

Most obviously it cannot be done in/by the current capitalist economic system. The nature of the capitalist economic system we are obliged to work within involves constant and limitless growth in production, consumption and GDP. It is also a system which allows the few who own most of the capital to invest it in, not what is needed by society, but what will maximise their wealth. The inevitable result is skyrocketing inequality, grossly inappropriate development and most people on Earth being deprived of necessities. Most green people, and indeed

most within the Degrowth movement, do not seem to confront the necessity to radically change the economic system.

Moreover, the sustainability goal cannot be achieved unless there is also extreme change in other social arrangements. Thus, most people would be obliged to live in small, highly self-sufficient and self-governing communities and would have to be happy to live very frugally without any desire to become wealthier. My studies (for instance of egg supply and the remaking of suburbs) detail the way these arrangements would enable the necessary huge reductions to be made in throughput, while improving the quality of life.

The Degrowth movement, let alone the Green New Dealers and most Green people, reveals little or no grasp of the magnitude and significance of the changes that would be required to achieve their goals. Sufficient degrowth requires scrapping, eliminating most production, consumption, investment, trade and GDP. How are you going to do that in a society that craves increasing wealth and has structures that must have growth or there is chaos? This is the unrecognised "Degrowth Conundrum".

Central to my Simpler Way Transition Theory is the firm conviction that this society is totally incapable of solving its problems. It fails/refuses to understand their nature, the way capitalism has driven us through the limits to growth. It is dominated by the capital owning class which will not tolerate any transition

involving their elimination. It is fiercely committed to affluence and getting richer, precisely the things now causing all our big problems.

The system is now well into self-destruction. There is no way of avoiding this now. The main causes are probably not the increasing resource and environmental difficulties and costs, including the need for resource wars, but the deterioration of social cohesion. The accelerating inequality is generating intense anger among the deplorables and thus increasing support for authoritarian leaders promising to "drain the swamps".

The coming time of great troubles could bring the end of us, but it will open the possibility of transition to sustainable development as it forces communities to try to build local, self-sufficient, cooperative, simpler systems. This is happening especially in poor countries. What is to be done is to work at raising awareness of the magnitude of the predicament, the need to abandon many current systems, and of transition to simpler lifestyles and systems as the only hope of eventually getting through.

The required revolution is actually going remarkably well. In recent years there has been rapid increase in discontent with capitalism and in the strength of the degrowth movement. We urgently need more effort going into explaining the existence and benefits of local, cooperative, self-sufficient and simpler ways. My video attempts to do this.

The master-economist must possess a rare combination of gifts. He must reach a high standard in several different directions and must combine talents not often found together. He must be mathematician, historian, statesman, philosopher - in some degree. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician. — John Maynard Keynes

Battery prices are falling again And that's a good thing Dan Gearino

Cheaper batteries add to the economic case for electric vehicles, even if some U.S. auto dealers are still figuring out how to sell the models.



"EV Charging Station" by Duncan Rawlinson s licensed by **CC BY-NC 2.0 DEED**

Optimists about the transition to clean transportation often talk about a double benefit: Electric vehicles have close to zero emissions and soon they also will be less expensive than their gasoline counterparts.

However the idea of the inevitability of cheaper EVs took some hits last year as the average price of lithium-ion batteries increased. Analysts reassured us that the price surge was due to short-term factors, and that the long-term trend of price decreases would likely resume in 2023.

They were right.

Bloomberg NEF issued its annual battery price report this week, showing a global average price of US\$139 per

kilowatt-hour for a lithium-ion battery pack, which is down from US\$161 in 2022 and lower than any year on record.

The report predicts prices will continue to decline, reaching an average of US\$113 in 2025 and US\$80 in 2030.

The average would fall below US\$100 for the first time in 2027. That value is important because it's the level the auto and battery industries have long identified as the approximate point at which an electric vehicle will cost the same as an equivalent gasoline vehicle.

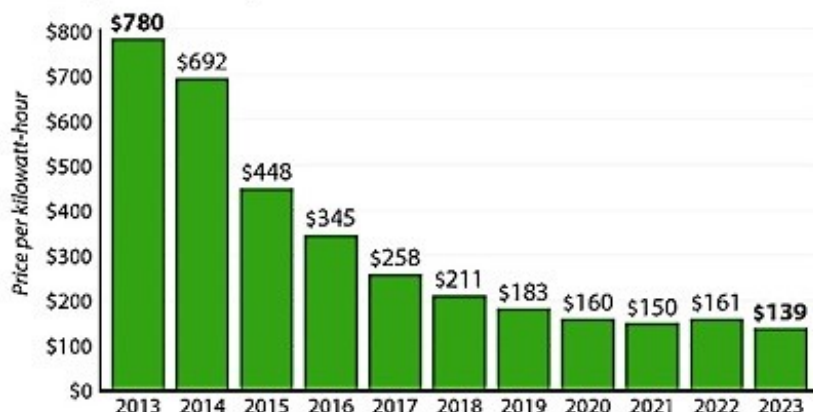
The reality is more complicated as pricing varies by country, vehicle style and many decisions that automakers

Lithium-ion battery prices fall to new low

After a one-year outlier, lithium-ion battery pack prices have fallen in 2023, continuing what has been a near steady decrease due to improvements in technology and economies of scale.

U.S. LITHIUM-ION BATTERY PACK PRICES

In dollars per kilowatt-hour, 2013-2023



SOURCE: BloombergNEF

PAUL HORN / Inside Climate News

make. But it is accurate to say that the market is quickly moving toward a point at which EVs are less expensive than equivalent gasoline vehicles.

I spoke about the report with Evelina Stoikou, an energy storage analyst for BloombergNEF and the report's lead author. "It's an interesting year," she said. "Historically, battery price reductions were largely attributed to technological innovation. And this year, it's not that this is not the case, it's just that it's not the biggest factor. The biggest factor that drove the price decline is dropping raw material costs."

Lithium is among the raw materials whose costs have fallen by a lot in 2023. Another factor is that the demand for batteries has been less than some companies' expectations, even

though that appetite has grown, she said.

She is hinting at the malaise among some automakers who have said that their EV sales are growing too slowly. I wrote a few weeks ago about how General Motors and Ford plan to slow the pace of their EV ramp-up because of concerns that demand is not high enough to justify the previous plans. Tesla also has raised some financial concerns as it prepares to release the Cybertruck.

But Stoikou emphasizes the need to appreciate nuance in this market. For example, even with the headwinds described by some automakers, EV sales are on pace to meet BloombergNEF's forecast, which called for substantial growth in 2023. (Cox Automotive has a breakdown of U.S. sales for the

first nine months of this year, showing major growth.)

The problems do not relate to overall sales numbers, globally or in the U.S., but to specific automakers and their models. Some automakers are not selling certain models fast enough, leading to an oversupply on dealer lots. In other cases, price competition has harmed the profitability of some models.

One of the big challenges is that many car dealers are not committed to selling EVs. They face a loss of revenue from the shift to EVs because customers will no longer need oil changes and other basic service, which is a key component of dealer profit.

Last November 2023 a group of about 4,000 dealers sent an open letter to President Joe Biden urging him to “tap the brakes” on emissions regulations that would require that EVs comprise about two-thirds of the market by the early 2032. (The dealers represent about one-fifth of all new car franchises in the country.)

“Last year, there was a lot of hope and hype about EVs,” the letter says. “Early adopters formed an initial line and were ready to buy these vehicles as soon as we had them to sell. But that enthusiasm has stalled.”

I don't want to dismiss the dealers' concerns, which in many cases reflect a lack of enthusiasm for EVs in their regions. But it's important to remember that the harm will be much greater if the U.S. slows down its transition to EVs.

Transportation is the leading source of greenhouse gas emissions in the U.S. Therefore a shift to EVs is a matter of national health and security.

The future of the U.S. as a leader in transportation manufacturing is closely tied to the transition to EVs. China leads the world in EV manufacturing and Europe is ahead of the U.S. in levels of consumer adoption. The U.S. needs to catch up, not slow down.

The BloombergNEF report covers lithium-ion batteries across multiple end uses, including transportation and stationary energy storage, among others. Stoikou and her co-authors found that the prices for various end uses are continuing to converge. For example, lithium-ion batteries used in buses and commercial vehicles used to be significantly more expensive than the batteries used in light cars and trucks, but now the differences are much smaller.

She views this convergence as a sign of the battery industry's growth and maturation. It shows that the sub-categories within the market are now large enough to benefit from economies of scale to a larger extent than before.

One of the major changes happening to battery companies is their shift to manufacturing products close to the place where the cars will be built and sold. The Inflation Reduction Act has accelerated this change with incentives to encourage battery makers to build factories in this country. As a result, companies have committed to spend tens of billions of dollars on new U.S. factories.

In the short run, the ramp-up of new battery factories will likely increase the costs of batteries from those plants compared to existing plants in Asia.

Stoikou doesn't expect this cost disadvantage to last for long, and she notes

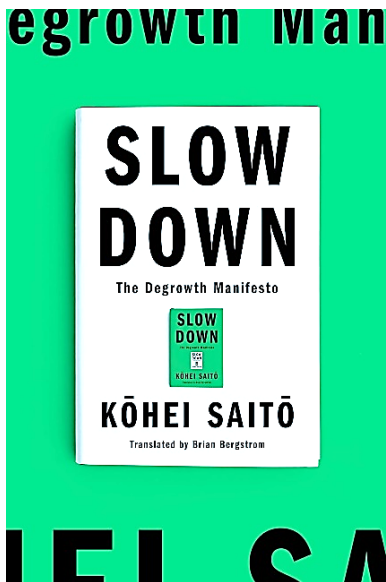
that IRA incentives should cancel out much of the difference.

Source: Inside Climate News, 30 Nov 23.
<https://insideclimatenews.org/news/30112023/inside-clean-energy-battery-prices-are-falling/>



Dan Gearino is Clean Energy Reporter, in the U.S. Midwest, National Environment Reporting Network.

Recommended book: Slow Down: The Degrowth Manifesto
by Kohei Saito (translator Brian Bergstrom; Astra House, 2024)



Why, in our affluent society, do many people live in poverty, without access to health care, working multiple jobs and are nevertheless unable to make ends meet, with no future prospects, while the planet is burning?

In his bestseller book, Kohei Saito has argued that while unfettered capitalism is often blamed for inequality and climate change, subsequent calls for “sust-

ainable growth” and a “Green New Deal” are a dangerous compromise. Capitalism creates artificial scarcity by pursuing profit based on the value of products rather than their usefulness and by putting perpetual growth above all else. It is therefore impossible to reverse climate change in a capitalist society -- more: the system that caused the problem in the first place cannot be an integral part of the solution.

Instead, Saito advocates for degrowth and de-celeration, which he conceives as the slowing of economic activity through the democratic reform of labour and production. In practical terms, he argues for:

1. the end of mass production and mass consumption;
2. decarbonization through shorter working hours;
3. the prioritization of essential labour over corporate profits

By returning to a system of social ownership, he argues, we can restore abundance and focus on those activities that are essential for human life, effectively reversing climate change and saving the planet.

They (economists) must set aside their contempt for other disciplines and their absurd claim to greater scientific legitimacy, despite the fact that they know almost nothing about anything. — Thomas Piketty, *Capital in the Twenty First Century*

Lessons from Australia in solving Argentina's economic crisis

Steven Hail

With Argentina facing dire economic challenges, Steven Hail offers recommendations for recovery based on lessons learnt from Australia's fiscal mistakes.



Argentinian President Milei plans to dollarise the nation's economy (Screenshot via YouTube)

Ten years ago, frustrated with economic policy debates in Australia and many other countries, I gave a public talk entitled 'Exposing the Myth of a Commonwealth Budget Emergency'. It used insights from modern monetary theory (MMT) to attack not only the budget of the Abbott/Hockey Administration but also the broken and badly misinformed promise of a budget surplus that both Kevin Rudd and Julia Gillard had made in earlier years.

Since then, I have been campaigning for the wider use of an MMT frame for thinking about public policy, and the culmination of this will be touring with an award-winning documentary entitled *Finding the Money* and renowned MMT economist Stephanie Kelton in March 2024.

I said that Australia's government is a full monetary sovereign. This means that it issues the currency in which our tax liabilities are denominated, that currency is not convertible at a fixed rate into gold or U.S. dollars or anything else and that it has no significant foreign-currency-denominated debt.

That also means that the only constraints on its spending relate to our productive capacity. In other words, whatever we can do, it can pay for. There exists an inflation risk relating to federal spending, but no insolvency risk.

After years of being ignored, the Modern Monetary Theory (MMT) school of economic thought is escaping its controversial reputation and is growing in popularity.



Modern monetary theory opens range of economic possibilities (credit: source)

I also pointed out that government surpluses are non-government deficits, so in the absence of a persistent trade surplus (which we have now but didn't have then), any government surplus must either force the private sector into more debt (as under the Howard-Costello government) or alternatively drive the entire economy into recession (think Hawke/Keating).

We should not be aiming to run a fiscal surplus, or see it as a great achievement if we happen to do so, as that is not a guide to a responsible fiscal policy. In the absence of supply shocks, a responsible fiscal policy is aimed at non-inflationary full employment. The federal government budget will normally be in deficit for the simple reason that the private sector normally needs to run a surplus, but no specific budget outcome should be seen out of context as an appropriate target.

The cost of getting this wrong under all the above administrations, and then under the Turnbull and Morrison gov-

ernments was unnecessary unemployment and insecure employment, as well as under-funded public services and missed opportunities.

Way back in 2014, one of the questions I received was "What about Argentina?" With a few seconds to respond at the time, I said it was hard enough talking about Australia and had to avoid the question. But what about Argentina? What about Turkey or Sri Lanka? What about Zimbabwe in 2008, or so many other cases of financial crises?

If you want a general answer, it is that these countries are not full monetary sovereigns. But looking for a general one-size-fits-all answer would be a mistake – one that International Monetary Fund and World Bank economists have made down the years at great cost. Every country has its own economic and political history, social institutions, endowments and vulnerabilities.

In the case of Argentina, it has exper-

experienced a return to hyperinflation since 2022 – the seeds for which were sown in 2016 – and last October elected a president with more extreme economic shock policy proposals than any in recent Latin American history. President Javier Milei has recently passed a law marking the stripping away of workers' rights, further privatisations, eliminating remaining controls on foreign investment and seems proud to oppose social justice.

With more people heading to the polls in 2024 than any year before, elections in the world's largest democracies will shape the future of the world for years to come.

Milei apparently intends to scrap Argentina's currency and adopt the U.S. dollar as Argentina's legal tender currency. Such dollarisation already exists in Ecuador and El Salvador, but not in such a large economy as Argentina or one for whom the U.S. is far from its largest trading partner. It is a policy widely regarded as suicidal but may be impracticable anyway, as it requires the government to buy up pesos in circulation with U.S. dollars and Argentina has hardly any official U.S. dollar reserves to accomplish it.

There is a chance that Milei might have some short-term success, barring a revolution, if he doesn't dollarize and if foreign investors can be tempted to buy cheap Argentine assets, which will prop up the peso for a while. But it will end in tears sooner or later.

Argentina has had hyperinflation in the past - in the late 1980s, after the fall of its military regime. Back then, in the early '90s, they tried "convertibility" against the U.S. dollar, under what is called a currency board system. The

issuance of pesos was limited to central bank reserves of U.S. dollars, for the sake of credibility. People started to think of the peso and the dollar as the same thing. It brought inflation down, but at the expense of austerity, rising inequality and eventually an over-valued currency which made it impossible to compete against Brazilian firms and others. There followed a banking collapse and mass unemployment, as well as more or less a revolution in 2001, which led to regime change, a floating (and initially heavily depreciated) peso, a default on foreign debt, a job guarantee scheme and a complete change in direction. From 2002 at least until 2008, the Argentine economy was the best-performing economy in the Western hemisphere. You might like to read that last sentence again. High export prices helped, especially after 2005, but were not the whole story. The exchange rate was floating, but fairly stable. Inflation was low by Argentine standards. And from 2002-11, the economy virtually doubled in size. By 2011, with a weak peso and strong dollar, inflation was back above 25 per cent and external conditions were getting tougher. Argentine residents looking to switch pesos into dollars put further downward pressure on the peso and there was the danger of a depreciation-inflation spiral, so the Government moved back towards fixed exchange rates and introduced further controls on the movement of funds into and out of the country.

While "movement" MMT economists agree with mainstream economists in supporting big deficits during the economic crisis, the problem is who should pay.

The period 2011-21 was one of stag-

flation, made worse by the election of the Right-wing Macri Government, which as in the '90s and 2024, pivoted towards neoliberalism, deregulation and fiscal austerity, but this time moving towards a floating exchange rate and central bank inflation targets. Of course, it didn't work. Initially, hot money came in and held the peso up, but by 2018 it was flooding out again. The peso was in free fall, and the Macri government was reduced to borrowing more U.S. dollars to support the currency while being unable to hit its fiscal or inflation targets.

A centrist government got back in in 2019, began to reverse some of Macri's policies and negotiated yet another IMF loan package in 2022. But the consequences of Macri's policies, the impact of the pandemic, European war and climate change, the lack of trust of the population in the country's political and economic institutions, and an ongoing social conflict between labour and capital over income distribution turned the inflation into hyperinflation once more.

Then in came Mr Milei.

What does it mean to say Argentina is not a monetary sovereign? Even while it retains the peso, there are excessive foreign-currency-denominated debts, in both government and private-sector institutions. Given the structure of the economy, peso depreciation feeds

domestic inflation which feeds further depreciation. More foreign debt to resist this adds to the threat of insolvency. A lack of trust encourages capital flight from the peso to the dollar.

It might take another crisis like 2001 to change things for a while, but in the longer term, Argentina needs to diversify its industrial base. It needs to produce more value-added goods and services, reduce dependence on extraction and agricultural exports, and offer savers attractive peso-denominated financial products. Political leaders need to use the power of the government as a price setter to stop the widespread indexation which means external shocks have such devastating effects on the Argentine economy.

When all these things are in place, Argentina could attain the high degree of monetary sovereignty that Australia already enjoys and the logic of my 2014 talk will apply to them, too.

Source:

Independent Australia, 8 February 2024
<https://independentaustralia.net/politics/politics-display/lessons-from-australia-in-solving-argentinas-economic-crisis,18310>

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Before Keynes, most people agreed with Adam Smith when he said, 'What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom.' And some people still do. David Cameron, the British prime minister, said in October 2011 that all Britons should try to pay off their credit card debts, without realizing that demand in the British economy would collapse if a sufficient number of people actually heeded his advice and reduced spending to pay off their debts. He simply did not understand that one person's spending is another's income – until he was forced by his advisors to withdraw the embarrassing remark. — Ha-Joon Chang, *Economics: The User's Guide*



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