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TRUMPONOMICS – WHAT DOES IT MEAN?

Also, we investigate the subject of money in relation to the fear of inflation, myths about money and banking, and the risks to humanity of attempting to maintain the status quo.

We would like to wish all of our readers a safe, happy and reflective Christmas period and a productive New Year. If you would like to attend the ERA end-of-year meeting and dinner in Adelaide on 28 Dec,, contact John Hermann (08 8264 4282)

Please consider re-subscribing your ERA membership for 2017 now.

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ERA is a not-for-profit, non-political organisation, formed in 1993. Its goal is to educate and advise decision makers and the community about what is required for creating a society characterised by social justice, with economic and ecological sustainability. Essential prerequisites for achieving these objectives include reform of the financial and banking systems, taxation, foreign investment, foreign exchange management, and a commitment to economic democracy and sovereignty - entailing full scrutiny and accountability of all economic processes and a recognition that the economic system must serve the people for the global good.

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Money and inflation - a scary subject

John Kelly

The devaluation of peoples' hard-earned money is what Australians fear most. People fear inflation. Never mind the crime rate, political corruption, nuclear wars, family violence, pestilence and the like, inflation is the king of fear factors.

So, when you tell them that a currency-issuing government is not constrained in its spending capacity, they immediately imagine this nightmare scenario where a government will just spend and spend and spend.

This is just one of the reasons why people struggle to accept Modern Monetary Theory. Fuelled by ignorance and being fed the wrong information by others who don't know any better, they cling to old standards such as the myth that running a country is the same as running a household.

They foresee inflation going through the roof, causing all manner of pain and suffering to families, their savings and their future well-being. The word hyperinflation often sneaks into the conversation as well.

It's an entirely false scenario, there is no reason to think that way but, that is the way of people when they are opposed to something or are gripped by the fear of the unknown.

The other great difficulty is that most economists don't accept it either because it goes against everything they have been taught. The problem is that few of them have been taught macro-economics as opposed to micro-economics. Most of them, while acknowledging that we live in a fiat currency world, still maintain a gold standard mindset. That is the sum of their training.

That is why it is easier for people who have not studied economics, to accept it. Their minds have not been polluted with gold standard thinking. Common sense takes over.

People in the financial markets, for example, seem to understand it quite easily. Tell them that bond sales drain reserves and they get it, they understand it. But within the world of the economist, it takes a heterodox-economist to lead the charge, someone trained and qualified in the old ways but who has broken through that glass ceiling. Sadly, there aren't too many of them.

Very few, if any, policy makers understand it. Senior central bankers do, of course, after all they are the ones who juggle the numbers in their computers. But will they dare explain it to the politicians? The very thought of it makes them shudder.

They too fear that once a politician realises the possibilities associated with a fiat currency, the politician will wreak havoc upon a nation's economy, spending recklessly. It's a sad indictment of the perceived maturity of our leaders.

Perhaps the biggest problem in explaining MMT is the language used. Trying to explain to someone that their entire thinking processes need to be turned upside down if they want to grasp it, isn't easy.

When you hear someone say, *"The federal government spends by issuing currency and can never run out,"* they don't respond by saying, *"great, let's have full employment."* They say, *"For goodness sake, don't tell our politicians, they'll just spend like crazy. We'll become another Zimbabwe."*

Somehow, the language has to change. We have to develop a new way of explaining MMT such that the irrational behaviour of those who should know better, can be ignored.

Engaging in a carefully considered language with simplistic clarity, a language that has factored in all the elements of disbelief and fear is a huge challenge.

It's hard explaining that when a fiat currency is misused, inflation is a possible outcome, but that full utilisation of a nation's resources (its people), improving our health, our education, lowering our crime rate, is a far better outcome.

It's hard explaining that a nation is constrained only by its available resources and not by one or two percent inflation. Under our present management, we can't even achieve that. It's also hard explaining that a currency issuing nation can always meet its spending commitments in its own currency, that it doesn't need to borrow to fund its spending and can always pay for goods available in its own currency.

Why is it that the prospect of providing full employment, having a world's best education and health system, a state of the art communications network, a respect for our natural resources and equality of opportunity for all, is restrained by ignorance?

This is the 21st century. The medieval superstitions that so dogged the efforts of people like Galileo and Copernicus should be behind us now. Modern Money Theory, like all theories, needs proper implementation to be accepted.

After all, who can seriously say that the present theory of classical economics has proved itself worthy? Money is indeed a scary subject. But it doesn't have to be.

Source: The AIM Network. 6 Nov 2016
http://theaimn.com/money-scary-subject/

Trumponomics: It's Not All Crazy

Dean Baker

It looks like we will have to get used to the idea of Donald Trump being president for the next four years. In his campaign he pushed many outlandish proposals, like banning Muslim immigrants and deporting 11 million immigrants without documentation. We will have to do whatever we can to block such flagrantly inhumane measures.

There are many other items on his campaign agenda and that of the Republican leadership that will have to be resisted, but at least one part of his agenda could actually offer real gains. Trump has proposed large infrastructure spending and also tax cuts that will hugely increase the deficit. Both offer real benefits, although with substantial risks.

The infrastructure story is straightforward. Roads and bridges in many parts of the country are badly in need of repair. This is both an economic waste, as people needlessly get caught in traffic, and a health hazard when bad roads increase the risk of accidents. Ideally, infrastructure spending would also go to repair schools and improve water systems so that we don't have more Flints with people drinking lead in their water. It would be great if some of this funding also went to mass transit and clean energy to reduce greenhouse gas emissions, but that might be expecting too much from a Trump administration.

The infrastructure spending would also create jobs. Public construction has traditionally been a source of relatively good paying jobs for men without college degrees. In recent years, the construction workforce has been disproportionately Hispanic. Spending in this area benefits a segment of the labor market that badly needs help. Of course the benefits are considerably less if projects are privatized, as Trump has suggested, and this will have to be part of the battle.

The other useful part of Trump's agenda is that he clearly does not care about budget deficits. His tax cuts could add more than $400 billion, more than 2.0 percent of GDP, to the annual deficit. These tax cuts are not a good use of money. They will overwhelmingly go to the rich who have been the main beneficiaries of economic growth over the last four decades.

In addition to not needing the money, if the point is to boost demand, giving tax breaks to the rich is the worst way to do it. If a poor or middle class person gets $1,000 from the government they are likely to spend most or all of it. But if we give another $1,000 or even $1,000,000 to Bill Gates it is unlikely to affect his consumption at all.

Even though the bulk of the Trump's proposed tax cuts do go to the rich, there are still substantial cuts for the middle class, which will provide a real boost to consumption. This boost to consumption, along with the increased demand from his infrastructure spending, will mean a large increase in demand in the economy. The result will be more jobs and a reduction in unemployment.

The strengthening of the labor market will also leave workers better situated to get pay increases. The only time in the last four decades when workers at the middle and bottom of the wage distribution saw sustained gains in real wages was the tight labor market of the late 1990s.

The irony in this story is that it might take a Republican president to give us a tight enough labor market for workers to get their share of the benefits of growth. This is partly due to Democrats having come to idealize the virtues of balanced budgets. Many have wrongly concluded that the prosperity of the 1990s was due to the budget surpluses of the time, which were in fact the outcome rather than the cause of strong growth. In her campaign, Clinton repeatedly promised that her spending plans would not increase the deficit. However the bigger obstacle to larger deficits under a Democratic president is the Republican Congress. The Republicans routinely screamed bloody murder over any effort by President Obama to stimulate the economy with larger deficits. Several times they have balked at raising the debt ceiling, arguing that this routine maintenance measure was somehow a threat to our children's well-being. In fact, the burden posed by servicing the debt, at 0.8 percent of GDP, is near a post-war low.

But Congressional Republicans will no longer care about deficits with President Trump in the White House. This means that he will be able to run deficits large enough to get the economy to full employment and quite possibly beyond. We may once again see issues with inflation and a need for higher interest rates to slow the economy. That will have some negative effects, but at least it will put an end to the long period of high unemployment and secular stagnation. This will be a good thing; it's just unfortunate that we needed a Trump administration to get there.

Source: OpEdNews
http://www.opednews.com/articles/Trumponomics-It-s-Not-All-by-Dean-Baker-Crazy-Politics_Inflation _Infrastructure _ President-Donald-Trump-161117-68.html

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Editorial comment: According to Paul Krugman, Trump's infrastructure rebuilding plan is really just a scheme to enrich a few wealthy and well-connected people [see: http://www.alternet.org/economy/krugman-why-trumps-infrastructure-proposal-huge-scam?]. In our view, the Trump proposals - insofar as there are any concrete proposals - are far from ideal but are better than nothing.

Even so, just spending on infrastructure per se could simply increase waste and use limited resources on poorly-chosen projects, so planning is very important. Another positive feature of Trump's agenda, in our view, is his proposal to tear up the current TPP agreement, which only exists to serve the interests of the large multinational corporations at the expense of everyone else on the planet.

Trumponomics and economic class

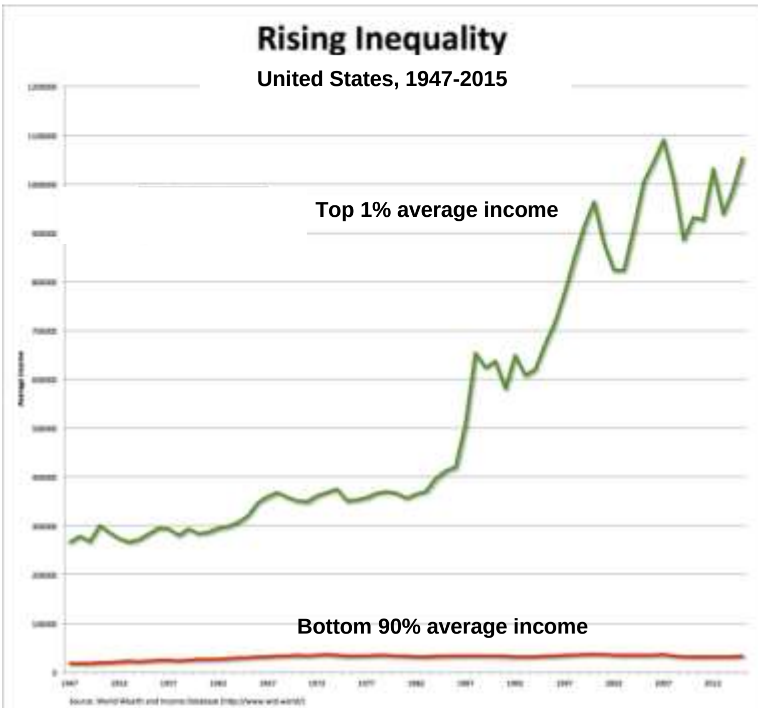
David Ruccio

Right now, after the surprising victory of Donald's Trump and in the midst of the messy transition, everyone is curious about how the U.S. economy will change if and when the president-elect's economic policies are enacted.*

But first things first. We need to have a clear understanding of what the U.S. economy looks like now, during the uneven recovery from the Second Great Depression. In particular, it's important to analyze the class dimensions of that recovery, even before the new administration takes action.

Why class? One reason to focus on class is because it played such an important role in Trump's victory. Not alone, of course, but class interests, resentments, and desires did - in different ways - affect Trump's ability to beat out his rivals in the Republican primaries and the presidential election.

The other reason is that Trump made a whole host of class promises during the course of his campaigns - promises to working-class voters and to members of the tiny group at the top, which gave him the win in the electoral college.



We don’t know, of course, if Trump will keep those class promises. A lot will depend upon the balance of power inside and among the administration, the Republican Congress, and the Democratic opposition, not to mention the debates and struggles by groups and movements outside the corridors of power. But, even before the new alliance assumes control, we need to make sense of the class dynamics that at least in part have defined the U.S. economy during the two terms of the Obama administration.

What is most striking about the economic situation over the course of the past eight years is that, while economic policymakers managed to created the conditions for capitalism to recover from its worst set of crises since the First Great Depression, it has otherwise been pretty much business as usual. What I mean by that is the economic recovery has mostly assumed the same shape and features that characterized the U.S. economy before the crash of 2007-08.**

That’s not to say nothing has changed (a point to which I will return in a future post). But the fact that the benefits of the recovery have been captured mostly by those at the top, and left pretty much everyone else behind, is exactly what was happening prior to the crash.

National Income: Corporate profits before tax /National income

Nonfarm Business Sector: Labor share

1950 **2015**

One way to see this in particularly class terms is to examine the relationship between the “two great classes,” capital and labor. Underlying the growing gap between the top 1 percent and everyone else, which is now well known (and which I have written about many times on this blog), is the less-remarked-upon divergence in the capital and wage shares of national income. After the recovery began in 2009, the share of income going to corporate profits increased dramatically, from 12 percent to 15 percent (in 2014, falling slightly in 2015 to 13.7 percent). Meanwhile, the share going to workers declined by 4 percent (between 2009 and 2014, increasingly slightly in 2015 by about 1.5 percent). As readers can see from the charts above, those short-term trends represent a continuation of longer-term dynamics. The profit share had reached a low of 7 percent (in 1986)—and therefore has just about doubled (by 2015). The labor share has moved in the opposite direction for an even longer period of time, declining by about 12 percent (from 1980 to 2015).

In other words, the so-called recovery, just like the thirty or so years before it, has meant a revival of the share of income going to capital, while the wage share has continued to decline. That, in my view, is the overall class dynamic within the U.S. economy of both the decades leading up to the crash and the years of post-crash recovery prior to the elections of 2016. During both periods, U.S. corporations managed to capture the growing surplus that was being produced by the working-class—both American workers and, importantly, workers around the world.***

***** In a future post, I will look forward to the changes in the U.S. economy that may come from the president-elect’s economic policies.

****** As I see, that’s the major reason Hillary Clinton and the Democrats lost the elections - not FBI Director James Comey’s late announcement about Clinton’s emails, but their decision to embrace Obama’s economic legacy.

******* Loukas Karabarbounis and Brent Neiman have documented the fact that “the global labor share has significantly declined since the early 1980s, with a decline occurring within the large majority of countries and industries.”

Source: Real World Econ Rev, 24 Nov 2016
https://rwer.wordpress.com/2016/11/24/class-before-trumponomics-part-1/

The rise of Donald Trump isn’t a purely American phenomenon

Steven Hail

The phenomenon is a global one, and in large degree is a consequence of the blind adherence to an ideological view of the best way to manage economies, which took control of both sides of politics in many countries in the late 1970s and early 1980s, has since then been taken to an extreme – particularly in the US – and has created a mass of resentment and anger among those who feel left behind and disenfranchised by its consequences.

A few facts tell the story of the U.S. over the last generation:

1. From 1950-1970, about half of U.S. income was paid out in wages to workers: in recent years, that figure has been only just over 40%.
2. Average weekly wages, after allowing for inflation, were almost exactly the same in the U.S. in 2014 as they were in 1979.
3. This is despite an approximate doubling in U.S. GDP per person over that

same period.
4. Income and wealth inequalities increased almost every year during this period, completely undoing the move towards a more equal USA which has happened from the 1930s to the 1970s, and plunging U.S. inequality back to where it was in the 1920s.
5. The official unemployment rate has been falling since 2010, but the more meaningful U-6 unemployment rate remains at nearly 10%, with millions of jobs being part-time, poorly paid and insecure.
6. There have been 10 economic recoveries, following recessions, in the U.S. since 1945, and the share of the increase in income going to the top 1% has increased from 1% (in the recovery of 1949-53) to 95% (in the years 2009-2012). That's not a misprint, and in fact the incomes of the bottom 90% of the US population actually fell during the recovery from the Great Recession of 2009, with more than the whole of the economic expansion going to the richest 10%, and - obviously - especially the top 1%.

Ordinary Americans have had to struggle increasingly hard to get by, and to pay for what most people regard as the basic necessities of a modern life. It has become common for people to take on two or even three jobs to survive, and yet the US has amongst the highest childhood poverty rates in the developed world.

These facts were loudly and repeatedly made clear by Bernie Sanders, in his campaign for the Democratic Party nomination, as he called for changes in government priorities to reverse the increase in inequality, extend access to health care and college education, and move America back onto a path of growing racial, gender, religious and social justice, and away from the cult of individualism, greed and personal wealth for the few.

This has happened during both Democrat and Republican administrations. The name of Clinton is linked by many with the NAFTA free trade agreement with Mexico, which threatened the security and the wages of many low paid Americans; and with measures in the late 1990s that opened up US banking and financial markets to a deregulated free for all, which led eventually to the misery of the Great Recession, and the outrage of a rescue for Wall Street not matched with an equivalent rescue for Main Street.

The Democratic Party leadership, no less than their Republican rivals, came to be seen as part of that Establishment which had abandoned and taken for granted the acquiescence of millions of disenfranchised, frustrated and increasingly disillusioned American voters.

At the very heart of that Establishment appeared to be Hillary Rodham Clinton. And in 2016, many of those angry people struck back.

How strange that, in their anger, they have chosen to support a billionaire like Donald Trump as a means for doing so.

Perhaps the Democratic National Committee should have offered them the chance to vote for Senator Sanders.

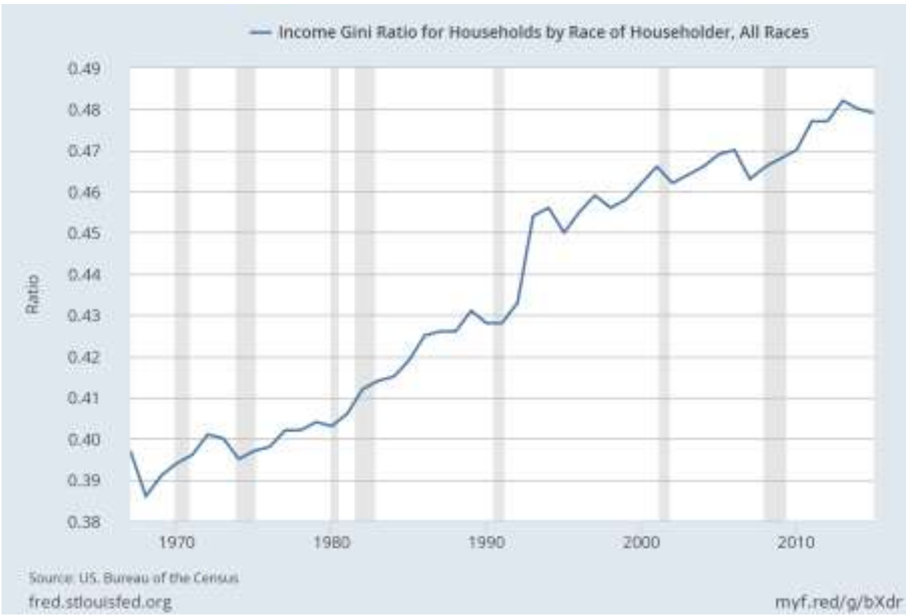
More generally, perhaps political elites in many countries around the world should have taken more note of the needs and aspirations of the great mass of the populations whose interests they claim to represent.

Dr Steven Hail is a lecturer in economics at the University of Adelaide, and is an ERA member.

1. Percent share of national income paid to employees, 1970-2016

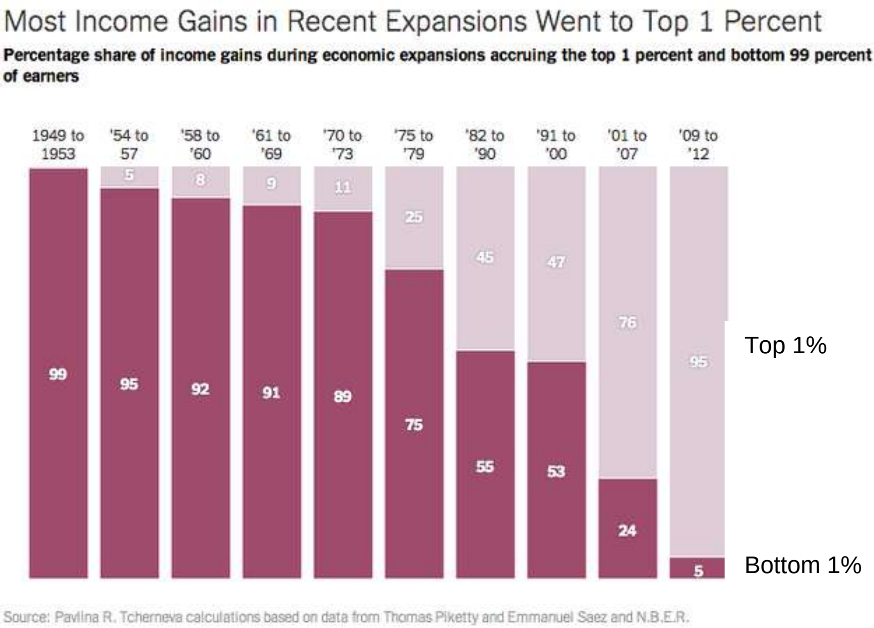
2. Average weekly earnings (wages & salaries) – CPI adjusted, 1979-2016

3. Real gross domestic product per capita, 1979-2016



4. Income Gini (inequality) Ratio for Households, 1967-2016

5. Percent Unemployment (U-6)



6. Percent income gains in expansionary periods from 1949 to 2012

It's the economists, stupid

Editor

We are grateful to Janet Eaton's email network for drawing our attention to this Canadian radio program [1] and for providing a transcript. The participants in this episode [2]:

1. Dr Julie Nelson (Department Chair and Professor of Economics, University of Massachusetts, Boston). She says: "You can find economists shilling for all kinds of groups. If these people are not consciously shilling, then they are incredibly careerist."

2. Dr Richard Denniss (Chief Economist, The Australia Institute, Canberra, Australia). He describes economists as the "new witch doctors in society".

As a group, economists don't have a great track record: they largely failed to predict the oil crisis of the 1970's, the dot-com bubble, and the U.S. housing collapse. Even the Organization for Economic Co-operation and Development (OECD) admits that its forecasts have been way off. One of its staffers even conceded: "maybe we suffer from group think". Little wonder that economics has been known as "the dismal science" since the 19th century.

The famous economist John Kenneth Galbraith once quipped "Economics is extremely useful as a form of employment for economists". However, there are deeper, more serious fissures. Economists explain how the turbulence of housing markets, mortgage rates, inflation and income inequality affect us all. But who are they speaking to and whom do they represent?

Feminist economist Julie Nelson thinks that most economists no longer represent the public good because they're operating out of self-importance and greed. "You can find economists shilling for all kinds of groups. If they're not consciously shilling, then they are incredibly careerist." She believes the media obsession with the state of financial markets doesn't tell us how we're doing as a society. "Maybe we should be asking, who's eating and who's not".

Richard Denniss concurs. He describes himself as a "whistle-blower economist", and believes we have come to view markets as gods. "The market does this, the market does that ... as if it's something magical. It's really just a small group of people with a lot of money who are gambling on making more."

Richard Denniss and Julie Nelson both believe current economic group think produces a mantra that supports cutting taxes, reducing deficits, massive downsizing, bloated CEO salaries, and "shrinking social programs till they scream". Julie Nelson concludes these trends not only generate more poverty; they hollow out the middle-class, and that's bad for capitalism. She says: "this was figured out a long time ago. Henry Ford wanted to pay a wage to his workers that would allow them to buy the kinds of cars they were making. And that makes a whole lot of sense. If you want a market for your product, you have to have people who can afford to buy that product. But that basic logic is drowned out by all the austerity rhetoric that we're hearing from industry and government these days".

1. CBC Radio (Canada), 28 Nov 2016 http://www.cbc.ca/radio/ideas/it-s-the-economists-stupid-1.3219471

2. This episode was produced by Mary O'Connell

We should all beware a resurgent financial sector

Usman Chohan

Around the world, the financial sector is resurgent and is concocting new financial instruments and markets in which to trade them. In Australia the market for some financial securities has quintupled in only a year, encouraged by APRA (the Australian Prudential Regulation Authority).

This is similar to what we saw in the years preceding the global financial crisis (GFC). In those days, the financial industry came up with exotic things to trade like credit default swaps (CDS) – essentially gigantic insurance policies, and mortgage backed securities – bundles of mortgages.

The wider economy saw little benefit from these fancy securities and trading. But the massive expansion of credit and speculation distorted the market, and, combined with little regulatory oversight, helped bring on the GFC.

So as this process of financialisation gathers steam again, we should question the benefits for society at large. There are two broad objectives to balance. Capital markets can support economic growth, but we need a well-regulated and transparent financial sector that brings benefits to society overall. Especially if the underlying economy starts to turn.

Banks are rewinding the clock

Resurgent financialisation in Australia is a trend that goes back several years. In 2013, A$26 billion worth of mortgage backed securities were sold within Australia. This was the most in the entire world at the time. And it hasn't fallen away much since then. As in the years before 2008, this is dangerous. It exposes the entire financial system to household mortgages. If house prices go down the entire system could be affected.

Meanwhile, the financial dysfunction that existed pre-2008 is also reappearing in other countries. In the United States, so-called "subprime lending" – making loans to people with sub-par credit, is back with a vengeance. Even the US Federal Reserve has warned of a new ticking time bomb of subprime loans.

It's all just paper

As banks are creating these instruments, profits are at record highs. But as with the period preceding the GFC, most of the benefit is confined to the financial sector. Firms are creating ever more complex financial instruments which are not being realised in the real economy as increased loans or funding for businesses.

Much of the wealth created by financialisation before 2008 existed nowhere except in documents held by the financial intermediaries themselves. This mutually reinforcing illusion of wealth collapsed everywhere simultaneously because there was scant underlying justification for their inflated values. The GFC wiped out nearly US$7 trillion of this paper wealth.

But the damage to the real economy was greater – lost industrial output, job losses, stalled economic activity and so forth. According to the US Government Accountability Office, total losses exceeded US$10 trillion. And this is why we need to keep an eye on it all.

Fundamentals starting to look bad

Just as before the GFC, some of what underpins this financialisation is starting to become undone. Australians are falling behind on their mortgage payments. This is in part because wage increases have not kept up with house price increases.

Cases of mortgage distress are rising sharply in the country, while there is a rise in non-conforming loans – loans that don’t abide by conventional lending criteria. Further, even Australia is seeng a rise in the rate of subprime lending.

Clearly, these factors in conjunction do not bode well for a financial system with a large mortgage-backed securities market. And that’s before we even factor in real estate prices at bubble-level valuations.

We need functioning markets

The larger purpose of resurgent financialisation in the world, and not least in Australia, should be to cultivate deep financial markets that allocate capital to causes that are both profitable and socially acceptable - all while being subject to appropriate oversight.

The public should insist on robust accountability, tempered expansion of the market, and an emphasis on distributing the gains of financial securitisation to the broader society.

Greater accountability of big finance will require a multifaceted approach. First, financial regulators will need to exercise independence and be forthright in their admonition of risky financial practices.

Second, oversight institutions will also need to be much better staffed and resourced to conduct their work effectively. These bodies will also need to be less corrupt themselves.

Third, a closer inspection of the revolving door that exists between big finance and politics will be necessary.

Fourth, we need to ensure that no financial institution becomes “too big to fail”. It may be time to question whether such behemoths are necessary and whether their enormous power provides any significant benefit to society at large.

Without such insistence for accountability, we may repeat the financial follies of the very recent past. The global financial crisis was not as unique as we might think. To have the same crisis repeat ten years apart, driven by the same trends in financialisation and securitisation without adequate accountability or oversight, would be a truly crippling verdict on modern capitalism.

Source:
The Conversation, 30 Nov 2016
http://theconversation.com/we-should-all-beware-a-resurgent-financial-sector-69402?

Usman Chohan is a doctoral candidate, specialising in economics and policy reform, at the University of New South Wales

Stephen Hawking: "we are at the most dangerous moment in the development of humanity"

"The world's leaders need to acknowledge that they have failed and are failing the many" – Stephen Hawking

The following quotes have been extracted by the editor of the RWER blog [1] from Stephen Hawking's recent article in The Guardian (UK) [2]:

" ... the recent apparent rejection of the elites in both America and Britain is surely aimed at me, as much as anyone. Whatever we might think about the decision by the British electorate to reject membership of the European Union and by the American public to embrace Donald Trump as their next president, there is no doubt in the minds of commentators that this was a cry of anger by people who felt they had been abandoned by their leaders ..

"... The concerns underlying these votes about the economic consequences of globalisation and accelerating technological change are absolutely understandable. The automation of factories has already decimated jobs in traditional manufacturing, and the rise of artificial intelligence is likely to extend this job destruction deep into the middle classes, with only the most caring, creative or supervisory roles remaining.

" This in turn will accelerate the already widening economic inequality around the world. The internet and the platforms that it makes possible to allow very small groups of individuals to make enormous profits while employing very few people. This is inevitable, it is progress, but it is also socially destructive.

" We need to put this alongside the financial crash, which brought home to people that a very few individuals working in the financial sector can accrue huge rewards and that the rest of us underwrite that success and pick up the bill when their greed leads us astray. So taken together we are living in a world of widening, not diminishing, financial inequality, in which many people can see not just their standard of living, but their ability to earn a living at all, disappearing. It is no wonder then that they are searching for a new deal, which Trump and Brexit might have appeared to represent.

" It is also the case that another unintended consequence of the global spread of the internet and social media is that the stark nature of these inequalities is far more apparent than it has been in the past.

".... it also means that the lives of the richest people in the most prosperous parts of the world are agonisingly visible to anyone, however poor, who has access to a phone. And since there are now more people with a telephone than access to clean water in sub-Saharan Africa, this will shortly mean nearly everyone on our increasingly crowded planet will not be able to escape the inequality.

The consequences of this are plain to

see: the rural poor flock to cities, to shanty towns, driven by hope. And then often, finding that the Instagram nirvana is not available there, they seek it overseas, joining the ever greater numbers of economic migrants in search of a better life. These migrants in turn place new demands on the infrastructures and economies of the countries in which they arrive, undermining tolerance and further fuelling political populism.

" For me, the really concerning aspect of this is that now, more than at any time in our history, our species needs to work together. We face awesome environmental challenges: climate change, food production, overpopulation, decimation of other species, epidemic disease, and acidification of the oceans.

" Together, they are a reminder that we are at the most dangerous moment in the development of humanity. We now have the technology to destroy the planet on which we live, but have not yet developed the ability to escape it. Perhaps in a few hundred years, we will have established human colonies amid the stars, but right now we only have one planet, and we need to work together to protect it.

" To do that, we need to break down, not build up, barriers within and between nations. If we are to stand a chance of doing that, the world's leaders need to acknowledge that they have failed and are failing the many. With resources increasingly concentrated in the hands of a few, we are going to have to learn to share far more than at present.

" With not only jobs but entire industries disappearing, we must help people to retrain for a new world and support them financially while they do so. If communities and economies cannot cope with current levels of migration, we must do more to encourage global development, as that is the only way that the migratory millions will be persuaded to seek their future at home.

We can do this, I am an enormous optimist for my species; but it will require the elites, from London to Harvard, from Cambridge to Hollywood, to learn the lessons of the past year. To learn above all a measure of humility. ”

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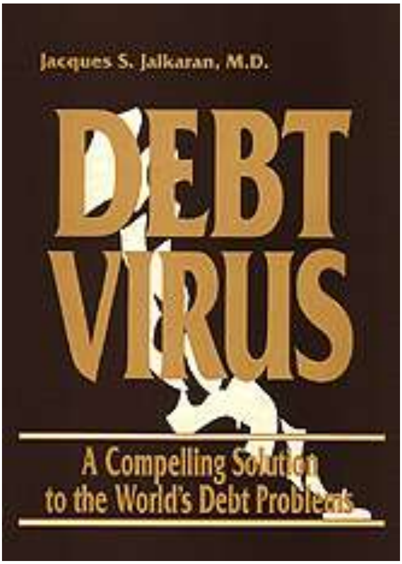
Stephen Hawking is an English theoretical physicist, cosmologist and author.

The cure for the debt virus

Edward Flaherty

The following is a lightly edited version of an article by Dr Edward Flaherty [1] *which sets out to debunk the so-called debt virus hypothesis (the article was last updated on September 6, 2000, however we believe it remains valid today).*

A financial crisis looms over the United States economy, and indeed the global economy, the likes of which history has never seen. The source will not be incompetent bureaucrats or chronic government budget deficits. It won't be Wall Street and it's probably not even an international conspiracy. The cause will be your neighborhood bank. According to Dr Jacques Jaikaran, a plastic surgeon and author of *Debt Virus: A Compelling Solution to the World's Debt Problems* [2], something as fundamental as the very nature of the monetary system will deliver the calamity.



The central thesis of *Debt Virus* is that there exists in the economy an insufficient quantity of money to repay both the principal and the interest on all the currently outstanding debt. To illustrate his point Jaikaran conjures an imaginary world he calls Planet Doom. A place very much like Earth, Planet Doom has a small population, six to be exact. There is a doctor, a carpenter, a fisher, a farmer, a shepherd, and of course a banker. Initially, no money of any sort exists here until one day they all decide to allow the banker to create money in the form of checking deposits.

The banker's first customer is the farmer. He acquires this money by negotiating a loan of $1,000 at an annual interest rate of 10 percent to be repaid in one year. Upon granting this loan, the banker creates checkbook money with a stroke of his pen on his ledger. The money supply on Planet Doom suddenly increases $1,000. The problem, Jaikaran notes, is that when the principal and interest are due for repayment, there is not enough money in the economy for this purpose. The farmer will owe $1,100 but only $1,000 will exist within the whole economy. Thus, no matter how earnest or frugal the farmer might be, there is simply no way he can satisfy the terms of the loan. It is, as Jaikaran wrote, a mathematical certainty the farmer cannot repay both the principal and the interest. Planet Doom's only hope is for the banker to make yet another loan to the farmer, a loan sufficient to pay the interest on the original. But it is obvious this only delays the inevitable. The planet is, well, doomed.

By expanding this simple example to the real world, Jaikaran argues, it becomes easy to see the impossibility of repaying all the debt in the U.S. economy. The problem is as with Planet Doom: When banks lend money, only the principal is created and never the interest. Thus, the money supply can never be sufficient for total debt retirement. He warns this condition is a financial time bomb which will eventually cause an economic crisis severe enough to dwarf the Great Depression. At first he pinpointed his prediction for this event to the year 2012, but then later contradicted himself by the more general guess of sometime between 1995 and 2005.

Fortunately for us, Jaikaran's model contains two gaping holes which collapse his entire thesis. Let's return to Planet Doom. After the farmer acquires the money from his initial loan, he will most likely spend it when buying the goods and services produced by the other inhabitants of his world. He may strain his back on the farm and thus pay a visit to the doctor. Or perhaps he wants an addition to his home and hires the carpenter for the task. These other inhabitants will use at least part of their earnings to purchase the necessities of life, including food from the farmer. In short, we would expect the kind of normal trade to take place on Planet Doom as we would anywhere in the real world, with checkbook money acting as the medium of exchange.

But what of the banker? Initially, no one has any money and only he can create it. How will the banker purchase the sustenance he needs from the farmer without the money to do so? How will he purchase clothing or acquire medical services? Why not just use the same pen which magically created money to lend to the farmer, only this time use it to purchase the necessities of life? Doing so would add new money to Planet Doom's economy without creating additional debt for the rest of the inhabitants to repay. This is the primary flaw in Jaikaran's story. The banker is not an ethereal entity. No, he is a living, breathing person who needs to purchase the products and services which make life possible and enjoyable.

Banks are no different in the real world. Commercial banks and savings and loans have expenses to pay just like any other firm. They must pay their employees, purchase office supplies, and meet the other expenditures which are a part of doing business. When they do this banks spend money back into the economy without any debt being created to burden the non-bank public -- debt-free money, to use Jaikaran's terminology. The revenues banks collect from interest on loans and other services do not disappear into an economic void. Instead, those revenues are used to meet the bank's operating expenses, to purchase assets to generate future income, or are paid to the shareholders as dividends. Those are the only three places any firm's revenues can go.

The other major flaw in the *Debt Virus* hypothesis is that it ignores the role of the central bank in the money-creating process. The Federal Reserve (Fed) creates a measure of debt-free money when it buys government bonds from the public. The Fed buys the bonds on the open market and pays for them by creating new checkbook money. The new money is therefore created without any additional debt appearing in the economy. Jaikaran's central thesis that new money is created only through new bank lending is thus countered by the facts that banks create debt-free money when they pay any of their operating expenses, purchase assets, and disburse dividends, and that the Fed creates debt-free money in the process of buying government bonds.

We can also examine the validity of Jaikaran's hypothesis by a simple appeal to the data. According to Jaikaran the money supply can only increase with a corresponding increase in bank credit, that is, an increase in bank loans and bank purchases of government bonds. According to the F.D.I.C., as of September 1996 bank credit at all F.D.I.C. insured institutions, which includes both commercial banks and savings and loans, totaled $4,436.6 billion. The Federal Reserve's M3 money supply estimate was $4,822.3 for the same month. If bank credit is the only source of money in the economy, then what is the origin of this excess money? Consider also that in February 1996 bank credit increased $10.8 billion over the previous month, but the M3 money supply increased $37.3 billion. Jaikaran's *Debt Virus* hypothesis cannot account for the existence or the creation of this extra money. We must therefore reject the idea as wrong.

The idea is also objectionable for other less direct reasons. Jaikaran's main warning is that if we wished to repay all the debt, we would be unable to do so because of the shortage of money. But why would we wish to retire all the outstanding debt in the economy? Loans and bonds have a variety of maturities and only the most remarkable synchronicity would have them all, or any appreciable portion of them, come due at once. Moreover, most firms try to preserve a certain level of debt even if they have the capacity to repay it. They do so because sometimes debt financing is cheaper than other ways of obtaining money. Jaikaran's argument also ignores the fact that most debt in the U.S. economy is in the form of bonds, not bank loans. This is important for his thesis because unlike the lending process, the issuing of new bonds and the retiring of old ones does not affect the money supply. Therefore, a given money supply can repay a total bond debt many times its size, in fact, a debt infinitely greater than the money supply.

The flaws of his thesis notwithstanding, Jaikaran presents his solution to the country's alleged debt problem. He proposes having the federal government print currency to finance its entire budget, thereby eliminated its need to tax or to borrow. This would create an infusion of debt-free money which would make it possible for the economy to repay all its debts. Since he argues that inflation is really caused by interest on debt, this would have the added benefit of generating price stability. Unemployment, crime, marital difficulties, and war are merely symptoms of our debt-money system and can be cured by something so simple as a switch to a debt-free money supply. In short, Jaikaran promises the reader an economic paradise if only the government would end taxation, cease borrowing, and instead print money to pay its bills.

Any economist in the world would

recognize this idea as a plan for economic chaos. One of the best demonstrated theories in this social science is that an excessive growth of the money supply always causes inflation. The federal government's expenditures totalled $1,560.1 billion in fiscal year 1996. If it were to print and spend all the money for similar budgets rather than raise it through taxes or borrowing, then the M1 money supply would more than double in a year. The annual inflation rate would hit at least 100 percent within two years!

Of course, Jaikaran is not an economist; he is a plastic surgeon. Nor is he much of an historian. Somehow he expects his plan would not be hyperinflationary, even though it was tried once before in American history. The Continental Congress, which organized the principal army which fought the American Revolutionary War, did not have any taxing or borrowing authority of its own and thus had to rely on the meager contributions given to it by the newly independent States. But from 1775 to 1780 it also printed $250 million in debt-free currency and spent it directly into existence. This increase was well out of proportion to any growth in output and hence caused some of the worst inflation in U.S. history. Jaikaran is well aware of this inflationary episode because he discusses it in *Debt Virus*. But he does not address why his plan would somehow not be inflationary even though it is identical to the Continental Congress fiasco. He also displays a bizarre sense of cause and effect. Early in Debt Virus he writes that a monetary-induced crisis caused an economic collapse in France from 1790-1795 which then caused the French Revolution. This is most odd because the peasants seized the Bastille and began the Revolution on July 14, 1789.

Despite the crucial defects in the central thesis of *Debt Virus*, the book has had a significant impact on some people. Grassroots organizations cite it as inspiration for various reform efforts. The Coalition to Reform Money is a thorough believer in the debt-money myth and proposes what it calls the "Monetary Reform Act" with provisions very similar to those of Jaikaran's plan. Bo Gritz, an unofficial interstate leader of the militia movement, not only believes the *Debt Virus* hypothesis but views it as part of the larger international banking conspiracy. To him and many other militia followers, this is just a mechanism by which the international bankers can capture our wealth and, at the appointed time, collapse the U.S. economy, paving the way for the "New World Order."

There is no danger of the *Debt Virus* thesis becoming an accepted idea in Congress, and certainly not among economists, but this has not limited its adverse effects. It has clearly lead many people to an erroneous interpretation of the workings of the financial system and has caused them to direct their political activist energies toward an imaginary problem. At least one benefit, however, is that it has spurred people into political awareness who might otherwise be inert. But instead of directing their efforts toward real social, economic, and political problems, they tilt windmills. What a waste.

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Dr Edward Flaherty serves as Principal at CRA International Inc and specialises in applying statistical analyses to labor employment issues pertaining to age, race/ethnicity, and gender. Prior to joining CRA, he was with ERS Group and has served clients in a wide range of industries, including financial services, big-box retail, telecommunications, and federal agencies. Dr Flaherty holds the degrees of PhD in Economics (Florida State University), MA in Economics (University of Oklahoma) and BS in Economics (College of Charleston).

Comments on *The cure for the debt virus*

John Hermann

The following statement recently appeared on the website of a well-known monetary reformer (who shall remain unnamed): " Banks create the principal but not the interest to service their loans. To find the interest, new loans must continually be taken out, expanding the money supply, inflating prices - and robbing you of the value of your money. "

This is the debt virus hypothesis, an attempt to explain the financial growth imperative within modern economies using a badly misconceived model of banking, which has been thoroughly debunked by orthodox and heterodox economists alike. ERA patron Prof Steve Keen has been writing about this false belief for years, and has always emphasised that interest should be regarded as a flow, not a stock.

As explained by Edward Flaherty in the above article, commercial banks do not need to create the interest component of the loans they make, because almost all of the interest income they receive is effectively spent back into the real economy as follows:

(a) tax paid to government (which authorises the government to spend the same quantity of money back into the economy),
(b) purchase of highly liquid financial assets, including Treasury securities, from bond dealers (who profit from the interest margins in buying and selling) and from the government,
(c) interest paid to bank depositors,
(d) interest paid on bank borrowings,
(e) dividends paid to bank share-holders,
(f) salaries and bonuses paid to bank staff,
(g) money paid to bank contractors and others for overheads, services and maintenance costs.

Very little of the income received by banks is retained over the longer term, and it may be argued that even the few percent designated “retained earnings” facilitates spending into the economy.

In order to fully appreciate the above statement it is necessary to recognise that we have a dual monetary system, in which two different forms of money effectively tag along with each other during every creditary transaction between non-banks. These forms are:
(i) retail deposits within banking institutions - composed of bank credit money, and
(ii) banking reserves, which are matched in some way (either voluntarily or by statute) to those deposits.

Central bankers are well aware that banking reserves do not determine the ability of a commercial bank to create new loans or new credit money, or to maintain solvency (the real determinant of these is bank capital, or net worth). Banks make their loans first, and look for any reserves that they might happen to need - in support of this increased activity - later.

One source of misunderstanding and confusion in regard to banking mechanics is the belief that banks only create credit money when they engage in retail lending. However the simple fact is that banks also create credit money when they spend into the real economy, in order to meet their many costs. Incidentally. bank credit money is also created when the federal government spends into the real economy, and when the central bank buys financial assets from the non-bank private sector.

When a payment is made between a non-bank and a bank, the bank credit money involved in that payment goes out of existence, but reserves are transferred between the payee's bank and the receiving bank and are retained by the latter. The accounting convention is that the reserves transferred with any interest payment to a bank may be identified with its interest income, and are often described as free reserves. The receiving bank might decide to hold these reserves, but in practice it much prefers to lend or exchange them for highly liquid financial assets (which return more interest income of course).

An examination of the annual report of any commercial bank will show how its annual income matches its payments to either non-banks or to the government, implying that an amount of bank credit money equal to that income re-enters the economy sooner or later. This bank spending entails the creation of new retail deposits (composed of new bank credit money) along with the transfer of reserves between the spending bank and the payees' banks.

News and views from New Zealand

Visions of the future

Dennis Dorney

This world in 2036 through a murky crystal

The earth is about 4.5billion years old and can expect to last several billion years more before it is swallowed whole when the sun grows to become a red giant. Life began after 3.7 billion years, and given how stubborn life is, once it had the initial spark it was destined to endure for a very long time.

Whether man is so lucky is another story. Homo sapiens has been around for a mere 200,000 years and became dominant only after the last ice age, when humanity learned all the neat tricks that led on to civilisation. As for the future, I think civilisation, as we know it, probably has no more than 50 years to run. There are a number of plausible ends, most of which are avoidable and which, if not avoided will destroy mankind only, leaving this beautiful planet to recover from our brief intrusion.

The one 'end' that might obliterate every large animal and most growing plants on earth is WW3, in which every single nuclear weapon is detonated, so any attempt to save the planet must start with the assumption that disabling of all nuclear weapons has occurred. It is then possible to think how the world might look in twenty years time. Why 2036? Because if the remedies that I suggest have not happened by then, it will no longer matter.

The population explosion

We have been ignoring laws of Nature that evolved over millennia for our common good. A diverse ecosystem is essential for a healthy planet. Because we are omnivores, who will eat anything, it is not immediately obvious what damage our monoculture farming is doing. We can eat everything in the food chain.

My guess is that we need to reduce population by a third to give the rest of the ecosystems a chance. No one talks about this topic - of course. When the "Titanic" was sinking and there were enough lifeboats to save only half the passengers, to their credit they worked out for themselves who should be saved. If we are not so brave, the matter may be taken out of our hands. The Black Death of the 1340's killed about half of Europe's population.

The end of the Energy Age

Since I have assumed that WW3 will not happen, I must hope, without conviction, that this also means the end of all the lesser, interminable wars that large powers pursue for purely selfish reasons. Since war must be one of the largest energy consumers (both military transport and armaments) the effect on world fuel consumption will be significant.

By 2036 another major user of fuel, the international tourist, on which NZ pins such faith, will be priced out of existence. It is both morally and financially indefensible to fly in thousands of tourists to NZ simply to take 'selfies' outside Dunedin Railway Station.

However the biggest change of all will be the advent of the self-driving electric car. By 2036 the petrol-driven car will be economically obsolete. A new car has a life span of 20 years and will have no value in 2036, so why buy one? You won’t even buy an electric one - they will be available for hire on call to your door. Because they are not owned by you and are simple to make they will all be virtually identical and made in Australia/NZ in Government owned factories.

Taxing the robots

By 2036 the government will have totally revamped its taxation system. The principle being that undesirable items, such as sugar- or alcohol- laced food and drink will be heavily taxed (and cigarettes will have been totally banned). There will be no tax on personal income (which is effectively a tax on work). However there will be a universal basic income (UBI) and also a maximum wage.

A tax on production, but not food, will be levied; which means that the cost of unemployment caused by automation can be funded to a degree by the robots themselves, but the government will go further.

Buoyed by the success of its electric car industry, the government will opt to take its tax on production in the form of shares in the industrial companies, so that over a period, it will become a partner in industry. Whether the factories employ people or robots will become irrelevant. Unemployment will eventually become zero – those who are happy to live on a basic wage will be able to do so, and those who want to work will have that choice. Employment in involving research activities will become popular, and will be well supported by the government (who will become the owners of all research output).

The end of the rentier class

Ever since the 1970's the deregulated banks have failed to provide adequate financial support to industry because issuing mortgages to the public is more profitable and less risky. The involvement of government in research and industry had a useful side effect in providing the support that the banks have refused.

It is still possible for people to speculate with their savings but the chances of competing against government investment is slim, so that it is safer to put personal savings into long term investment accounts. And the safest of these will be made available by a national bank, owned and operated by the state.

Following the next global financial crash (possibly in 2018), the private banks will be required, as the price of their survival, to stop advancing loans for unproductive purposes and to accept a far more stringent level of regulation. Those who decline to do so will be declared insolvent and taken into public ownership. All subsequent bank loans to be advanced on the basis of each bank's own resources, with bank service fees determined in a manner which does not reduce the standard of living of the majority of citizens at the expense of those at the top of the scale of income and wealth.

....and what about climate change?

There must be a dozen different ways that we can, through our foolishness, destroy civilisation. I have highlighted one, the nuclear winter, which is capable of destroying most life on this earth. Another, overpopulation (with its subset of starvation, water pollution, mass migrations, plague) I mention because I doubt that humanity as a whole has, or will have, the will to fix it.

Most other disasters can be fixed, given time.

I have covered lightly economic probems that exist now (energy usage, automation, unemployment, debt and banking malpractice) but these can be fixed if we are determined and I have suggested how.

I have not mentioned climate change because we can’t fix it in the time available; it will not destroy our planet but it may bring down our civilisation. It is beyond the range of my crystal ball, but by 2036 we will see the future clearly. The suggestions I have made may be useful then. Or maybe not.

Dennis Dorney is a regular contributor living in New Zealand, and is an ERA member.

Fiddling while Rome burns

Editor

A recent article by Joseph Camilleri [1], *Australia's political elites are fiddling while Rome burns*, has characterised the range of political games played by Australia's political leaders as being divorced from reality. We reproduce from this article the section dealing with the economic aspects:

Shirking economic realities

On returning from the APEC meeting in Lima in November, the prime minister Malcolm Turnbull reiterated his support for the Trans-Pacific Partnership (TPP). This came just as US President-elect Donald Trump announced that US withdrawal from the TPP would be one of his first acts on assuming office.

Turnbull has repeated the mantra of free trade, growth in trade, and the benefits of an integrated world economy. This is despite large segments of Western electorates that have suffered the ravages of globalisation turning in anger and frustration to the populist slogans and movements that seek to fill the political vacuum by implementing crude appeals to nationalism, prejudice and xenophobia.

Both of Australia's major parties remain ardent advocates of free trade, yet seem oblivious to growing economic inequality. They remain preoccupied with reducing budget deficits and averse to imposing higher taxes on rich people and corporations. This means they have effectively deprived themselves of the levers they need for remedying the glaring gaps in wealth and income.

Glib references to the benefits of innovation are no substitute for thoughtful planning and targeted support for new and socially sustainable industries.

Strangely, the argument implied – though never explicitly stated – is that the benefits arising from the free movement of goods and services somehow do not apply when it comes to the free movement of people.

In recent months, Labor leader Bill Shorten has struck a shrill populist tone, calling for restrictions on the issuing of 457 visas to skilled foreign workers.

1. Source: The Conversation, 6 Dec 2016 https://theconversation.com/australias-political-elites-are-fiddling-while-rome-burns-69102?

Joseph Camilleri is Emeritus Professor of International Relations, La Trobe University

Italy's political troubles have deep economic roots

Mark Weisbrot

Much of the media, and the analysts on which it relies, have provided a misleading narrative on the current political problems in Italy, following Sunday's "no" vote on a referendum on constitutional changes. It has been lumped together with Trump, Brexit, an upsurge of extreme right-wing, anti-European or racist political parties and "populism," - which in much of the media seems to be code for demagogic politicians persuading ignorant masses to vote for stupid things. "Stupid things" here is defined as whatever the establishment media doesn't like.

Of course we do not have a detailed map of why various Italian voters rejected the proposed constitutional changes. The most obvious explanation is that Prime Minister Matteo Renzi, who has been in power since February 2014, had promised to resign if the people voted no. This mobilized all of his political opponents, including those within his own party.

Those who wanted to defend Renzi had a hard sell. He was not offering a future for the country, and especially for the young people who most overwhelmingly voted "no." Unemployment is at 11.6 percent, and youth unemployment is more than 36 percent. Of the unemployed, most are long-term unemployed, having been out of work for more than a year. And there are big regional disparities, with parts of the generally less-well-off South having been harder hit since the world recession.

The IMF projects that the Italian economy will not return to its 2007 level of GDP - what the country produced nine years ago - until the mid-2020s. In other words, nearly two "lost decades", as the Fund itself noted. This is really bad, by any modern historical comparison.

In these circumstances, it is not surprising that voters across the political spectrum rejected sweeping constitutional changes that would have given much more power to the executive. The split in the electorate did not fit the standard media narrative, distilled from Brexit, Trump, etc., of the young, educated, and pro-European on one side (“yes”) versus xenophobic, populist, uneducated and anti-European on the other (“no”). Young people in particular had a reason to vote overwhelmingly “no”: they face a dismal future under the current regime.

In one important sense there are similarities between the rise of Trump and the fall of Renzi. Both are the result of the long-term failure of neoliberal policies implemented by the major political actors. In both cases, the center-left lost a big part of its working and middle-class base because it was jointly responsible for this failure. In the US, the neoliberal era was launched “big league” by Ronald Reagan, but Bill Clinton became a co-owner by bringing us NAFTA, the WTO, financial deregulation, and other neoliberal structural reforms that have done permanent damage.

In Italy there have also been neoliberal reforms since the 1980s, but the most devastating was adopting the euro in 1999. Now you might think that nothing could be worse than having to say the words “President Trump,” but adopting the euro put Italians in an even worse jam. They lost controlover their most important macroeconomic policies (monetary, fiscal, and exchange rate), and gave it to some really wrong people in the European Commission, the European Central Bank (ECB), the Eurogroup of Finance Ministers, and the IMF.

There have been some positive changes in the eurozone since 2012, when the European Central Bank finally decided to act like a normal central bank and effectively guarantee the bonds of the largest member countries (unlike for Greece, where it insisted, together with the rest of the European authorities, on inflicting further brutal punishment).

And the ECB’s quantitative easing, begun in March of 2015, was a major step forward. It has played a significant role in the recovery - however weak - of the eurozone, including Italy, which finally emerged from a three-year recession in 2015.

But the European authorities are still committed to a program that promises another lost decade of mass unemployment, possibly undermining the eurozone and European Union, as inevitably angry voters look for solutions or scapegoats. The elite consensus is that the keys to recovery are in “structural reforms” - deregulation of various markets, especially labor; reduced real wages; and “internal devaluation.” The theory is that such reforms increase efficiency and competitiveness and will allow for economic recovery even as the government cuts pensions, health care, and other social spending in order to pay down debt and please the “confidence fairies.”

Unfortunately, Renzi is part of this consensus, voluntarily or otherwise. His Jobs Act, which took effect nearly two years ago, is typical of these structural reforms. It has gutted employee protections and made it easier to fire and lay off workers, while promising to increase long-term employment relative to temporary contracts. However the opposite has happened so far.

To recreate an economy that would give young Italians a future without having to leave the country, the country would have to leave the euro. Or, alternatively, elect a government that had a credible threat of leaving and was tough enough - presumably with allied governments in the other eurozone countries - to force eurozone authorities to change course. But the options currently on the table for whatever government emerges from the current crisis are looking pretty grim.

Source: Center for Economic and Policy Research; Publications http://cepr.net/publications/op-eds-columns/italy-s-political-troubles-have-deep-economic-roots

The article appeared on *The Hill* and also *The Huffington Post* on December 8, 2016.

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What Australia should fear most

John Kelly

While most people in the world are scratching their heads in confusion and expressing their disgust at the election of Donald Trump as the next U.S. president, there was one important issue raised during the campaign that received little attention and which has thus far been ignored.

Macroeconomics is not very sexy and not something one would associate with Donald Trump, but in an article in the Financial Times on 28th September 2016, the author, Judy Shelton, put the case that Trump had, “broken a cardinal rule in U.S. presidential campaigning by openly questioning the effectiveness of the Federal Reserve.”

Shelton reports that during one of the presidential debates, Trump suggested that the US Federal Reserve had been engaging in politics by suppressing U.S. interest rates. The Fed had been “doing political things” with their interest rate policy and “creating a false economy.” Trump’s comments were seen by right wing conservative economists as supportive of their claims that the Fed was conspiring against them, forcing them to take on riskier positions which, if rates were to rise, would cause their investments to fail.

It's easy to see why such an issue would not gain traction with a media soaking up all the juicy titbits that were flying high during the campaign. But if true, the ramifications would have important consequences for the U.S. economy and certainly go beyond the media's interest in Trump's more exciting personal life.

Trump's comment is important because it raises the issue of future central bank independence. At the moment, sovereign currency issuing Governments impose, under political pressure, a series of voluntary restraints on their behaviour that mimic the actual restraints they faced when we had a convertible currency, i.e. before we abandoned the gold standard and floated our currency.

In short, it continues to issue debt to cover net spending. It's all about fiscal discipline. They just don't like thought of the central bank monetising the net spending. But in reality the so-called national debt, about which so much deceit is practiced, is no more than a voluntary restraint.

But if 'The Donald' feels that 'The Fed' is deliberately suppressing interest rates against the interests of Wall Street, i.e. the U.S. Fed is not being independent of the politics of running the economy, he might move to limit its power by assuming greater control over monetary policy.

If Trump is able to grasp the power of a fiat currency, he could well envisage his popularity soaring if he were to bring an end to the escalating debt by firstly, instructing the Fed to stop issuing bonds and monetise deficit spending. He could then go one step further and instruct the Fed to gradually absorb the $20 trillion-odd on issue (America's national debt) and present himself as America's "debt saviour."

It would amount to no more than juggling a few accounts at the central bank and it would give him sufficient goodwill to appease Wall Street with a lift in interest rates.

He could then have the US Treasury assume much greater responsibility for monetary policy which, in a democracy, it should have anyway. It is high time our politicians faced up to their electors and called the shots, rather than appointing an unelected body to do their dirty work for them.

But, in the area of debt, they would face a new obstacle. The debt issuance (bond sales) is not used to fund deficit spending. It is a place for Wall Street to take out some insurance by buying government bonds. The bonds enable their money to be safely parked in a risk free environment, albeit low return investment portfolio.

So, the final act would then be to instruct the Fed to create a term deposit facility for the banks and bond buyers to park their reserves and be paid interest at a rate that would lessen the pressure on Wall Street to look at riskier investments; a win-win, so to speak.

But here's the kicker. If the US Treasury were to assume greater monetary control and the new U.S. administration was more willing to offer Wall Street a higher return in a term deposit thus enabling investors to avoid meddling in riskier products, it's not hard to see what an increase in interest rates would do to a mortgage belt still recovering from the GFC. This would have far more serious consequences for the Australian economy than it would for America.

An increase in rates in the U.S. would see international bond buyers' desert Australian bonds in favour of term deposits available in the U.S. Australian bonds have always been an attractive investment and this should not mean a rise in rates here, but our Treasury Department, fearing the worst, would feel obliged to react and raise its bond rates anyway.

A rise in the bond rate would give the commercial banks an excuse to raise mortgage rates.

And here is the ticking time-bomb. A rate rise here that impacts upon a mortgage belt which is already seriously over committed, would be disastrous for our economy. We have a government already hell bent on limiting spending, forcing the private sector to make up the difference by taking on more debt. Adding yet more pressure with a rate rise would be, for many mortgagees, the straw that breaks the Camel's back. With private debt currently at 180% of GDP, the pressure could be explosive.

Such are the possibilities of a Trump presidency. Doubtless, there will be many more. If he can see a way to broaden his popularity with the masses by eliminating the debt while also appeasing Wall Street, it may be an opportunity too good to resist.

Source

1. The view from my garden, 9 Dec 2016 https://johnbkelly.wordpress.com/

2. The AIM network, 16 Nov 2016 http://theaimn.com/what-australia-should-fear-most/

John Kelly is an independent Australian commentator with his own website, who also writes articles for the AIM network.

Italy's banking crisis and the bail-in strategy

Editor

Articles by John Mauldin which appeared in Forbes magazine on September 21 [1] and December 8 [2] discuss the high probability that Italy will experience a severe banking crisis in the next few quarters. The simple fact is that Italy's banks are carrying a huge load of bad debt, and political turmoil isn't making that problem any easier to solve. According to the author:

" The current Italian banking crisis carries with it the possibility of bank failures. The consequences of these failures pyramid the crisis because of European Union regulations. Essentially, the position of the European Union is that the European Central Bank and the central banks of member countries cannot bail out failing banks by recapitalizing them - in other words, injecting money to keep them solvent.

" EU regulations go so far as to prohibit Italy from using its state funds to shield investors and shareholders of banks from losses, unless there is risk of “very extraordinary” systemic stress. Rather, the EU has adopted a bail-in strategy. "

But what is an investor? Mauldin says:

" In the view of the EU, **depositors** are, in cases of a bank resolution, investors in the bank. The bail-in process can potentially apply to any liabilities of the institution not backed by assets or collateral.

" There is some insurance available ... ... but there is no EU-wide system of deposit insurance ...

" This means that while the first 100,000 euros ($112,000) in deposits are safe, in the sense that they cannot be seized, any money above that amount can be. "

Sources

http://www.forbes.com/sites/johnmauldin
[1] /2016/09/21/ and [2] /2016/12/08/

Letters Section

From John Rawson (NZ)

FTT and Markups

Further consideration of the Financial Transactions Tax (FTT), or Debits Tax, which is based on withdrawals from financial accounts.

Every stage of production usually “marks up” costs coming from outside, including those from a previous stage of production. Accepted rates appear to range from somewhat less than ten percent up to about sixty percent in some cases. Obviously, such costs must include taxation of any form. Even “price-taking” primary industries must receive payment to cover all their costs, plus a reasonable profit, if they are to stay in business.

With very little exception, the only source of revenue for the industrial stream is from consumers, so all costs must become part of prices. It can be demonstrated that every dollar in tax taken from industrial concerns is likely to result in a rise in prices greater than that amount. For example, let’s take markups as follows: primary industries 6%, manufacturing 15%, wholesale 10% and retail 12%. A tax of one dollar on primary production should result in a price component of $1,50. ($1 X 1.06 X 1.15 X 1.10 X 1.12.) One dollar tax imposed on manufacturing could cause a price component of $1.42, on wholesale, $1.23 and on retail $1.12. The sums compounded would be less in the earlier stages of production, but the principle would apply, as it would if different markup rates were taken. And this model takes no account of taxation on industries serving the later production stages, which would have their own cost-compounded structure.

Obviously this compounding effect is the reason why our present GST is structured to be reclaimable at all but the final stage of the production stream. Otherwise a tax at any appreciable rate would have a disastrous effect in cost-inflation of prices.

From this I draw two conclusions, the first being that FTT must be applied at a very low rate or its purpose will be defeated. The second is that it must cover the “speculation economy” in addition to production. It is generally required to be levied on “all withdrawals from accounts with financial institutions” i.e. related only to “money in circulation”. If so, it would not cover “behind the scenes” trading between banks such as occurs with derivatives. I suggest that this aspect needs rectifying if such a tax is to be practicable.