ERA Review

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How our financial system works

Articles in this issue explain the reality, as opposed to the myths, behind the operation of our financial system. Important discussions also embrace renewable energy issues and the need for Glass-Steagall type legislation.

ERA REVIEW

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Items suitable for publication may be sent to the editor, who also should be contacted if you wish to receive copies of the ERA Review electronically as an email attachment, instead of as a posted copy.

Disclaimer: The views expressed in these articles are the sole responsibility of their authors and do not necessarily reflect those of Economic Reform Australia

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ERA membership 2017

If you are not a subscribed ERA member, or have not yet resubscribed for 2017, please consider doing so now. We rely on members' subscriptions and donations in order to cover the costs of our activities, including the printing and posting of the ERA Review to those who require a hard copy, and organising of public events. The cost is $20 per calendar year for regular members, $15 concession (pensioners and students), with $10 for each additional family member, forwarded by post as a cheque or as a money order made out to ERA, or as a credit transfer between bank accounts, or by direct payment using a credit card on the new ERA website. The ERA account details are provided on page 2.

New format for ERA Review

We would like to acknowledge the assistance given to us by Tash Lacina of the Relay Team in redesigning the format of ERA Review. The arrangement and the positioning of the information and the table of contents has been changed and has necessitated creating an informative back cover page containing information about ERA. The last page previously contained printed articles.

Redesigned ERA Website and Facebook Page

We are also grateful to all of the members of the Relay Team, and in particular Jordan Graetz, Sarah Brown, Felescia Schemmer and Tash Lacina, who have contributed in various important ways to redesigning the new ERA website and the new ERA Facebook page. Readers will find the new address of the ERA Facebook page on the last page of this publication. The new website may be accessed using the same domain name as previously - www.era.org.au.

New logo for ERA Review

Readers will have noticed that several pages now display a logo consisting of a pair of curved arrows, whose arrangement represents the cyclical nature of many economic processes. Previous issues displayed a symbolic set of balanced scales, representing ERA's concern for social justice. We would appreciate receiving the views of our readers on this change. Please send any comments or suggestions directly to the editor.

Cover page design

The cover page currently has an image contained within a large symbolic double arrow. We are interested in exploring the possibility of having different images and layouts for the cover page of each issue. Please send any suggestions relating to this directly to the editor.

Slide presentations from ERA meetings

We have collected powerpoint slide presentations from two ERA meetings held in Adelaide during December and January. The presenters are Steven Hail, Philip Lawn, John Coulter, John Hermann and Elinor Hurst. The topic details are to be found on the ERA Facebook page. It is possible to obtain a copy of any of the sets of sides as an email attachment. Please send requests to the editor.

Reserve Bank decision time: good luck Australia!

Steven Hail

On the first Tuesday of every month (except January, when they are all off on their holidays) the governor of the Reserve Bank of Australia (RBA) meets with the deputy governor, the Treasury secretary and six other worthies (all appointed by the government) to decide what to do about something called "the cash rate".

It's been a long time since they last raised it and, instead, since 2011, there has been a long series of cuts to an all-time low, in a forlorn attempt to get us all to spend a bit more.

Every month, the RBA board has been torn between a temptation to cut even further and an urge to leave the cash rate where it is. On the one hand, they need us all to borrow more, but on the other hand they are worried about us having too much debt already. What's more, they are scared that one day the cash rate will reach zero and uncertain about what that will mean. It is all a terrible muddle.

The economy hasn't been growing quickly enough to provide enough full time jobs for people and there seems to be no risk of runaway inflation any time soon. Everyone knows that really the government ought to be spending rather more than it has been doing and not matching this spending with higher taxes. But nobody is allowed to say this. It would contradict what Scott Morrison, Malcolm Turnbull, Joe Hockey, Tony Abbott, Uncle Tom Cobley and all have been saying for years now about "balancing the budget" and "living within our means".

They have backed themselves into a corner. It's all been political machismo. There is no budget emergency and there never has been.

And all this machismo is damaging the country.

The politicians would like the RBA to keep cutting in the hope that this will help, but there is nothing useful the RBA can do. They are out of bullets. Interest rates are already close to zero and although several other central banks have shown in recent years that zero isn't a boundary you can't cross – and have introduced negative interest rates for the first time in history – that hasn't been a great success. It seems that the private sector, and in particular

households, are up to their necks in debt and don't want to borrow much more. Interest rate cuts are at most a very short-term sugar hit. The drug doesn't work anymore. It might even further weaken the patient.

What is this thing called the "cash rate"? Just as you and I have deposits at our banks, so the banks themselves have reserve accounts at the RBA. The way our system works at the moment, the cash rate is the rate of interest at which the banks – the ANZ, Westpac, and so on – lend to and borrow from each other the digital "cash" they hold at the RBA. These reserves are used to deal with the millions of transactions that take place every day between account holders at the different banks.

In the run of things, on any particular day, some banks will gain reserves and others will lose them as a result of all this activity. It is normal for a bank with excess reserves at the end of the day to lend those reserves to a bank which is running short. This happens at the "cash rate".

In principle, the cash rate is supposed to be determined by the private banks themselves — in other words, in the money market. In practice, in recent years, the banks have always used the RBA's target rate. The RBA, in return, makes sure that the total supply of reserves in the system is exactly what the banks need.

The way they do this is a little bit more complicated these days than it used to be (involving things called "repos") but the textbook story of the RBA buying government bonds from the private sector when it needs to feed cash into bank reserves and selling bonds when there is too much cash in the system, is still essentially accurate.

If there was too much cash in the system, the cash rate would fall below the RBA's target; if there was a shortage of cash, it would rise above the target. To control the cash rate, the RBA has to make sure banks have just the right amount of cash in their reserve accounts. It is all a bit "Goldilocks" but the RBA and the banks are in constant touch and the system works pretty well.

So much so that all the RBA board has to do is to announce a change in its target for the cash rate on the first Tuesday of the month and, as if by magic, the cash rate used by banks automatically changes the following night. The RBA doesn't have to do anything, except make the announcement. The banks then automatically fall into line with its wishes, as long as the supply of cash into their reserve accounts is "not too hot and not too cold but just right".

That's the story, really - simplified a bit. The cash rate is the key interest rate in our financial system. Short term rates are linked to it very closely. Long term rates, like those on fixed-rate mortgages, depend largely on what banks expect to happen to the cash rate in the future.

There is only one problem with all this, as we said. Using the cash rate to manage total spending and inflation doesn't work anymore. Household debt has trebled since the 1990s. People can't or won't borrow ever more, whatever the interest rate. What's more, for everyone with a mortgage who benefits from a lower mortgage rate, there is a saver who loses out on a term deposit.

The low interest rate drug doesn't work anymore. To the extent it ever did, it did so by loading the private sector up with

more and more debt, and making our financial system increasingly fragile.

The rate of interest, as a tool for pushing the economy forward, appears to be kaput!

I'll let you in on a secret. They all know this. Everyone in the know understands that the government should be stepping up to the plate, and doing the extra spending itself. Everyone in the know understands that the Australian Government can't run out of Australian dollars. The RBA Governor knows. And the Treasury Secretary knows. They must know.

These people know all of this - but they don't dare say anything. Remember the machismo: they have painted themselves into a very awkward corner. Nobody wants to appear irresponsible, so nobody takes responsibility. It is all a terrible muddle. And meanwhile, the threat of a property bubble is still hanging over us. Good luck, Australia. You are going to need it.

Source: Independent Australia, 7 Feb 2017
https://independentaustralia.net/politics/politics-display/reserve-bank-decision-time-good-luck-australia,9999

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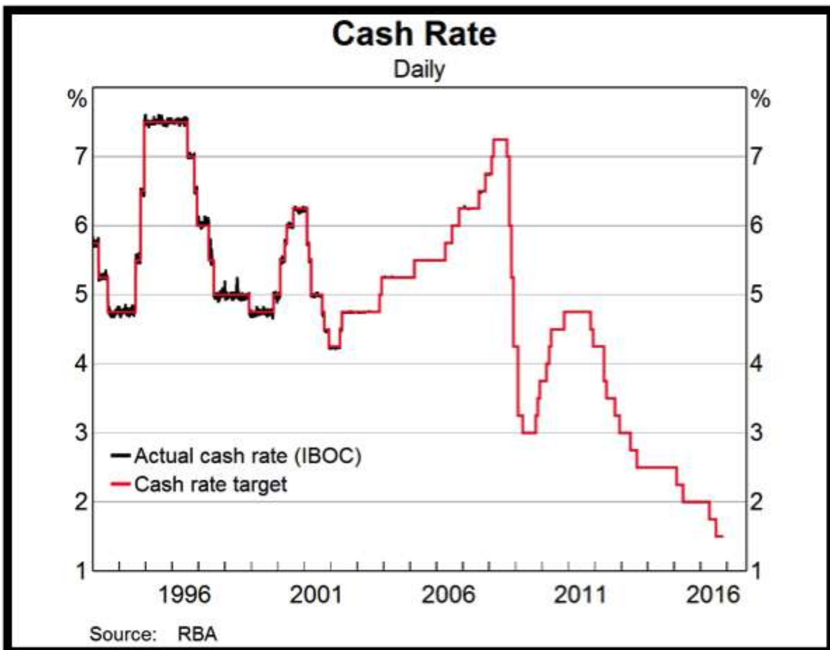
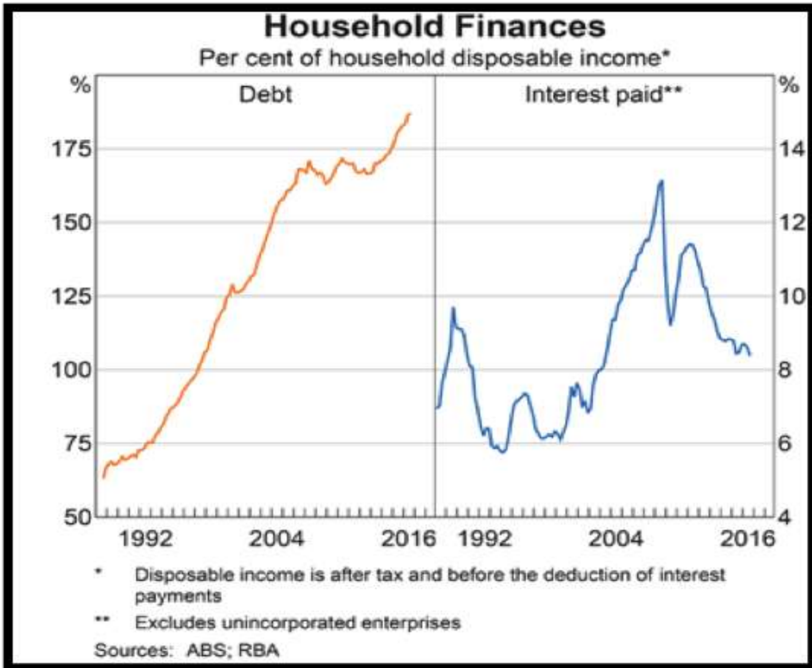
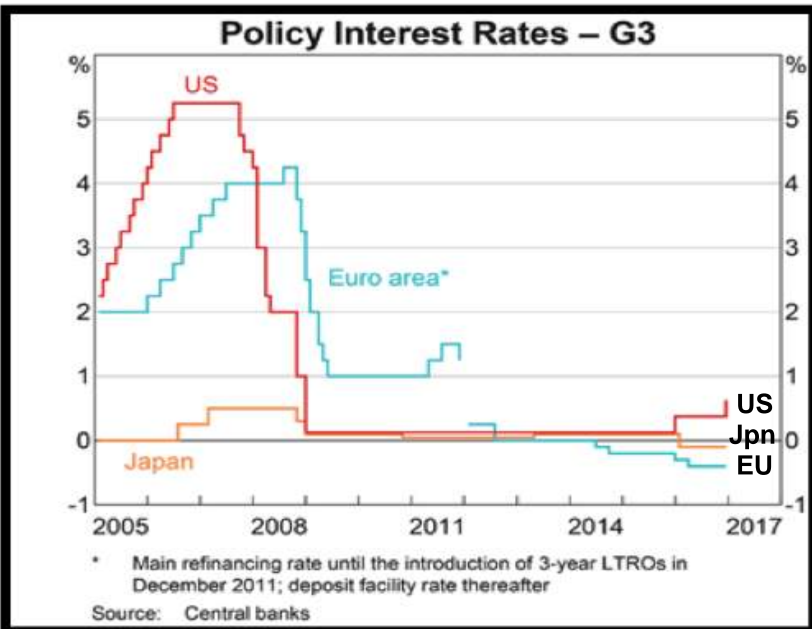
Editorial comment: The following diagrams provide statistical evidence, sourced to the Reserve Bank of Australia, for the assertions made in the above article. The first diagram details the cash rate, now at a record low of 1.5%, and reveals that the actual rate closely follows the target rate. The second diagram reveals the levels of Australian household debt, and the third diagram reveals that policy interest rates in the U.S., Japan and the E.U. are currently close to zero.




Household Finances
Per cent of household disposable income*
%
Debt
Interest paid**
%
175
150
125
100
75
50
14
12
10
8
6
4
1992
2004
2016
1992
2004
2016
* Disposable income is after tax and before the deduction of interest payments
** Excludes unincorporated enterprises
Sources: ABS; RBA


Policy Interest Rates – G3
%
US
Euro area*
Japan
US
Jpn
EU
5
4
3
2
1
0
-1
2005
2008
2011
2014
2017
* Main refinancing rate until the introduction of 3-year LTROs in December 2011; deposit facility rate thereafter
Source: Central banks

Federal Treasury finances: a functional perspective

John Hermann

We know that modern monetary theory offers an analysis of the flow of money within our economy, and in undertaking this task it utilises some basic insights, including its recognition that bank credit money and banking reserves are (a) *destroyed* when federal taxes are paid and when Federal Treasury securities are issued to the non-government sector, and (b) *created* when the Federal Government spends into the non-government sector. This article examines what the analysis implies within an Australian context, although the ideas and conclusions are more generally applicable. However we must firstly define what is meant by money.

1. What is money?

Most economic textbooks tell us that money is any entity which (a) is accepted and used by the public as a means of payment for taxes and debts and for purchasing goods and services -- in other words it behaves as a medium of exchange; (b) can be used as a store of value; and (c) possesses a unit of account (which in Australia is called the Aus Dollar). Item (a) also implies that the range of monetary transactions occurring and permitted within the real economy embraces an adequately sized marketplace of players.

There exist three widely recognised forms of money:

(a) **Currency**, by which we mean coins and banknotes.

(b) **Bank credit money**, an intangible form of money created by commercial banks in the accounts of their retail depositors.

(c) **Banking reserves** (or exchange settlement funds), an intangible form of money created in the depository accounts of commercial banks with the Central Bank (CB).

Items (a) and (c) are collectively sometimes described as the ***monetary base.***

In addition, we have the ***money supply*** - meaning money accessible and used by the nonbank sector - which can be defined in various ways, the simplest definition ("narrow" money) being the conjunction of bank credit money and currency in the hands of the nonbank sector.

Risk-free financial assets like Treasury securities are sometimes described as "near-money", especially assets which are short-term and highly liquid. These

financial assets are not generally used as a medium of exchange for buying and selling goods and services, but they could be so used if the need arose. They can be thought of as contributing to the stock of "broad" state fiat money.

We have excluded various alternative currencies like LETS and BITCOIN from the above list on the grounds that no government accepts their accounting units as a basis for paying taxes (at this stage), and therefore these entities tend to be regarded by central governments as investment assets.

2. Is Federal Treasury a bank?

Some economic commentators have suggested that the Federal Treasury behaves like a bank, but this view is negated by the following facts:

(a) Treasury does not take deposits from the public, or from the commercial banks.

(b) Federal Treasury does not directly create credit money in the accounts of non-banks (i.e. by contrast with the commercial banks). When the Treasury spends, it instructs the Central Bank to transfer reserves to the payee's bank, which authorises that bank to create new credit money in the payee's account.

(c) Unlike commercial banks, Treasury's primary role is not as a store for private savings, or the creation of financial assets via retail lending for commercial profit.

(d) Treasury does not lend reserves to commercial banks (in contrast with the latter, which often lend reserves to each other).

3. What is the nature of Federal Treasury's CB account?

Given that the Federal Treasury is not a bank, any positive entries in its account with the Central Bank should not be thought of as banking reserves (i.e. unlike those of commercial banks). And clearly these entries do not consist of bank credit money, which can only exist within the depository accounts that commercial banks make available to citizens and businesses. Neither are they currency, because they do not have a tangible form. So the question arises, are these Treasury credits a form of money in any sense at all? Officially, they are not a form of money in the sense that they are excluded from the monetary base and from every measure of the money supply.

The following propositions and insights help to answer this question:

1. A monetarily sovereign entity, i.e. one which has the power to create and destroy money, does not need to acquire such money from others for its own use, and does not need to store it.

2. If the Federal Government Treasury is not a bank, then its "deposits" in the Central Bank will have a different function and status to the deposits of commercial banks in the central bank.

3. One of the essential requirements of any entity entitled to be called money is that it can be traded and borrowed/loaned between a number of market-place players (i.e. a number greater than one) who have similar status and objectives in regard to those operations. Bank deposits in the Central Bank satisfy this criterion, since all of the players are in competition with each other with the common objective of maximising their financial profit. In contrast, the Federal Government maintains an account with its Central Bank for a quite different purpose, and its spending has a different objective.

4. Bond sales by the Australian Federal

Treasury do match net spending (deficit spending) these days, and so appear to top up the notional Treasury balance at Australia's Central Bank - the Reserve Bank of Australia (RBA). However this is a relatively new development, having been voluntarily introduced in Australia under the guise of 'sound financial policy' in 1982, and is not the practice in some comparable economies, such as Canada.

Thus the Australian Treasury has not, since 1982, borrowed directly from the RBA - by selling bonds directly to the RBA (sometimes described as Overt Monetary Financing) or by using any other accounting mechanism. Prior to 1982, it did sell bonds directly to the RBA, which meant - to take the logic to its obvious limit - that any number which appeared within the federal government account at the RBA was rendered functionally meaningless. This means that the credits appearing were not matchable to the conjunction of private sector taxing and external borrowing.

The post-1982 voluntary constraint on the government-RBA relationship does not in any sense undermine Australia's monetary sovereignty, but it does appear to do so - by obscuring the fact that the Australian Government cannot become insolvent in its own currency, and is not limited by its ability to attract 'money' into its account at the RBA.

5. The situation in the U.S. is somewhat different, in that the constraint on direct borrowing by the Federal Treasury is not voluntary, but is enforced by legislation. However even in this case the constraint may be easily bypassed if there happens to be a need to do so.

Within Australia and the U.S. there exist statutory regulations to the effect that, whenever a difference over policy exists between Treasury and CB which cannot be resolved by negotiation, the will of Federal Treasury will ultimately prevail. So even if a legislative constraint happens to exist on direct borrowing, the Treasury could - if it so wished - issue a quantity of new bonds to the private sector and at the same time arrange for the CB to buy the same quantity of bonds from the private sector. The net result is the equivalent of direct borrowing from the RBA.

6. The economic mainstream hold that the Federal Government's positive balance in its Central Bank account is a form of state fiat money, moreover one which is interchangeable with reserves. However the above propositions imply that such "deposits" are not money in any real sense, but are merely accumulated credits in an operating account. An operating account records a financial reality, but this does not imply that it is a form of money.

On this basis it may be said that the central government stands alone – that is, that it is not in competition with any other entities possessing accounts with the central bank, and that the entries in the Government's RBA account do not actually function as a form of money in an operational sense.

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Many of us like to think of financial economics as a science, but complex events like the financial crisis suggest that this conceit may be more wishful thinking than reality.
-- Andrew Lo

Economists treat economics as if it is a pure science divorced from the facts of life. The result of this false accountancy is a wilful confusion under cover of which industry wreaks its havoc scot-free and ignores the environmental cost. -- Vivienne Westwood

In economics, the majority is always wrong.
-- John Kenneth Galbraith

Enclosure day?

Colin Cook

Land was the first community asset to be 'privatised', taken over for private use and benefit. Way back in the mists of time, long before King Arthur burnt his cakes, long before the British Isles were so named, all land was common land; none was 'owned' by anyone but parts used by small family groups for their subsistence. Over centuries in those northern isles, larger, more belligerent groups established areas of exclusive use – and chieftains, warlords and Lords of the Manor declared such areas as 'my land'. Thus the concept of private property as opposed to the common, or community, land took hold.

As human populations increased and society became more sophisticated, these concepts were codified by Acts of Parliament – copyhold, tenancies, freehold title, Crown Land – but commons with their age-old rights providing large parts of the population with shelter and sustenance remained. It should be noted that the commons recognised a form of collective ownership of rights; specified persons only had 'rights of common'. It was not a free-for-all.

Contrary to the myth of 'The Tragedy of the Commons' – as enunciated by W Lloyd in 1833 and promulgated by G Hardin in 1968 - generally commons were well managed by local committees and various courts of manorial jurisdiction to provide the ongoing needs of the community; these elemental communities 'lived' sustainability and were not just a band of neo-liberal, economic rationalists each seeking maximum personal benefit as Lloyd and Hardin would have us believe.

Enclosure – privatisation of land

The real tragedy of the commons was that vast areas were usurped by innumerable Acts of Enclosure passed by the

Parliament at Westminster. These Acts - enacted with skulduggery of every description - made it legal for the large landowners to privatise what had previously been common land used by many of the lower echelons of society in a variety of ways for their subsistence.

Between 1700-1760, 152 Acts allowed the enclosure of 240,000 acres of common fields and waste, between 1761-1801, 1500 acts 2,400,000 acres – in 40 years, 10 times more than in the previous period of 60 years - and between 1802 and 1844, 1,100 acts enclosed 1,600,000 acres (quoted by the Hammonds, figures rounded). Notice that when white Australia was founded in late 18th century, enclosure activity was at a peak. The founding of white Australia and Acts of Enclosure were very closely connected not just in time but also in the prevailing attitudes.

The UK elite, effecting and benefitting from the enclosures, really only took any notice of those who could make themselves heard; persons of some substance or influence. The illiterate cottager who simply enjoyed the various rights of common that his father enjoyed stood no chance against an Act of Enclosure; dissenters were required to provide written chapter and verse of their rights and argue them in front of Commissioners. Indeed such lowly citizens were barely considered in the deliberations in Westminster. So it is not surprising that when Westminster's expedition arrived here in 1788, the concept of Enclosure came with them. The idea of commons and persons using the land just for living were of no consequence.

Settlement mind-set

Thus at the beginning of white 'settlement' of Australia the 'Establishment mind-set' was one of 'enclosure' – the concept of 'commons', where land is not owned by any but used by many, was in their view out-dated, bad, inefficient, if indeed they thought about it at all. From my understanding, Australia then was like a vast, continent-wide, agglomeration of Aboriginal Commons – the land not 'owned' at all but used, shared, nurtured and venerated by the numerous tribes of the indigenous population according to their needs and culture. White man did not see this at all, it was 'terra nullius' and the commoners were 'brushed aside' with no thought of compensation – much as in England. Henry Reynolds has written of this in his 'Frontier' (Allen & Unwin 1996); Dr Reynolds examines the close parallels between the conflicts in Europe and the British settlement of Australia; 'the Aboriginal experience can be profitably compared to those of squatters on the shrinking commons, the foresters and men of the fens who struggled to maintain a traditional economy in opposition to the ever growing commitment to absolute property rights'.

Tasmania was different

Van Dieman's Land would seem to be the one place where the concept of 'the commons' did flourish for a few years. 'Van Diemen's Land was aught but a vast common' quotes James Boyce, p70, ref32 in his very well researched history, *Van Diemans Land* (Black Inc. 2008). Ironically, many had been sentenced to transportation because they had been caught out using the commons of England in traditional ways – trapping and snaring game, ways that had been made illegal under the Game laws and Acts of Enclosure. Boyce's Introduction contains many references to convicts' acceptance of sharing

resources with aborigines and each other – land, water, game – and their adaptability to go bush, to obtain 'the essentials of life from the new land'. The early chapters contain many specific references to Van Diemans Land as a common and its effect on the early settlers, how the free access to the natural resources led to much entrepreneurial activity and even ideas of independence and democracy. Such moves were stamped out by Governor Arthur to produce a servile population to meet the needs of the increasing number of free settlers on their large land grants.

Aboriginal philosophy

A deeper connection between the idea of commons versus enclosures was brought to mind a year ago at a Fedtalk by Aboriginal academic and activist, Dr Mary Graham, QUT. She spoke about Aboriginal philosophy in comparison to 'western' modes of thought saying that aborigines had no difficulty in holding to different concepts simultaneously. In contrast, western views were 'either or', 'this or that', 'alive or dead'. This is an exact parallel as between enclosures (this is mine, not anybody else's) and common land that has many users and uses. This is also shown in the western, legalistic 'Native Title' when 'Aboriginal Common' would have been more representative of traditional status. Dr Graham's talk may be viewed at

https://www.youtube.com/watch?v=JAwBqTVbxNs

This article was published in the Byron Shire ECHO on January 18, 2017 under the headline, 'Commons: owned by none, used by many'

Colin Cook is an ERA member living in NSW, and is a retired engineer with an interest in researching current and potential monetary systems.

Keating and the consequences of austerity

Rob Holmes

It was Max Planck, now regarded as a modern-day secular saint of German science, who said that new ideas tend to advance with funerals. That is, old ideas die with those who hold to them. It was Planck's discovery of the quantal nature of energy that was a foundation stone of quantum mechanics - a driver of our digital world. Albert Einstein, who immediately grasped the significance of Planck's work, said that when he read Planck's 1900 paper he felt the earth move beneath him. Yet it was ironic that the deeply conservative yet brilliant Planck refused to accept the reality of his discovery, believing it to be a mathematical contrivance to explain his observations. Indeed, Planck's conservative views died with him.

Paul Keating's career in Australian government outlined in two of the more recent biographies by O'Brien and by Bramston respectively reveal the economic consequences of adhering to outdated assumptions against contrary evidence. One may stare for years at the obvious, mired in theory that is nothing less than back to front to the reality that stares back. One cannot blame Keating, undeniably our most influential leader since Federation, because first of all he was not trained in economics - not that that has been of help to many others - and secondly, on taking the job of Treasurer in 1983, he was dropped into the views held by highly regarded Treasury Department economists. Like the leap from tradit-

Former Treasurer and Prime Minister Paul Keating

ional thinking that Planck could not make even given his brilliance, many economists trained in traditional economic schools appear unable to make the turnaround from "gold-standard" monetarist thinking to the realities offered by an independently floating currency. As in science, its seems economics may only advance with funerals.

Kerry O'Brien's "Keating" is a remarkable insight into the history of the Hawke/Keating era, not only because O'Brien lived and breathed the whole episode as a political reporter, but because Keating was allowed unedited space to respond to some quite hard questions put by O'Brien. The book provides a sweeping review of the period as seen through the lens that both O'Brien and Keating saw events. For better or worse the Hawke/Keating era was one of profound economic change that brought about the modernisation of the Australian economy - the dollar was floated, the financial sector deregulated, banks exposed to foreign competition, significant taxation reform, the Incomes and Prices Accord enacted, enterprise bargaining introduced, tariffs removed, superannuation enacted, and very significantly, Mabo within Keating's last term in office.

The more recently released Keating biography by Troy Bramston is an equally remarkable companion to the personal insights of O'Brian and Keating, taking into account existing biographies and interviews with those whose political and public service careers intersected with Keating's.

Between the lines, both volumes reveal how neoliberalism and its monetarist consequences, once the preserve of the conservative side of politics, has become a fortress of group thinking across the whole spectrum of politics, business and the press - every night on TV we hear comment on "balancing the budget" - the dogma has been normalised and anything contra is now heresy. The Hawke/Keating leadership certainly pushed Labor against the concerns and occasional outrage from the caucus left to where it stands today.

O'Brian's book is also a page-turner insight into Keating's powerful influence over cabinet, caucus and the Lower House - YouTube clips of Keating's

parliamentary performance confirm the powerful theatre he used to cow the opposition into submission. There is no doubt then that the power of his energy and personality steered the Labor government in the direction he believed to be the right path - and in budgetary terms, toward the monetarist path that the Treasury Department believed to be the only path.

Labor won office in March 1983 in the midst of a recession that had run from October 1981. As O'Brien put it, the new Treasurer was faced with double-digit unemployment, inflation and interest rates, a serious decline in the balance of trade and a fifty-percent larger than expected budget deficit - "the country was in a mess". There had been a significant decline in the gross domestic product and as put by Keating, there was a wages explosion and investment was "falling through the floor". Bob Hawk and Ralph Willis had brought the Prices and Incomes Accord from the Australian Council of Trade Unions (ACTU) into cabinet -- a mechanism to bring wages growth under control - "business profits had been shot to pieces and the country was massively uncompetitive". The Accord itself together with the suite of complementary reforms that it brought was revolutionary in its success in bringing industrial harmony, stability and growth to the economy.

Although the United States decoupled its currency from the gold standard in 1971, other currencies including that of Australia that were previously "pegged" to the gold standard via the US dollar remained to stay in line with the value of the U.S. currency that then floated against the price of gold. Significantly, after the U.S. dollar was floated the tonnes of gold hoarded at Fort Knox were no longer needed to support U.S. currency. For those currencies remaining pegged to the U.S. dollar, their solvency depended on maintaining sufficient foreign currency reserves, like the gold needed to back the U.S. dollar before 1971. Both the Soviet Union and Argentina were two examples of the catastrophic failures that can befall pegged currencies under severe current account deficits, not to forget the current plight of Greece, Italy, Spain, Portugal and Ireland that all deal in someone else's currency - the Euro. In Australia's case, the new Labor government had to significantly devalue the Aus dollar almost immediately after taking government in 1983 - the "crawling peg", as Keating put it, was moving too slowly to cope with speculative pressure brought on by ongoing trade deficits.

It was not long after achieving government that Keating's most significant moment of realisation came to him when reading the previously shelved Campbell Report, prompting him to question the validity of the pegged currency - the inability of the "crawling peg" to effectively adjust the dollar against speculative pressures. And although Treasury totally opposed such an initiative, Keating went on to float the dollar [1] enlisting senior Reserve Bank officials who were willing to prepare for and implement such a change.

Throughout his job as the Treasurer, Keating's undying mission beyond economic and structural reform was the goal of budgetary surplus -- unless government expenditure is matched by tax revenues and foreign trade provides a surplus, then "we are living beyond our means". As a consequence, the pursuit of the holy grail of a budget surplus became an annual round-the-

clock grind in the Economic Review Committee preparing for May Statements and annual budgets. The quest for savings in a "line-by-line search" through every departmental budget over time added to the physical and mental burden on both Keating and his senior colleagues, all with their own portfolios to worry about. Ultimately, Keating ended up burned out and others departed in a state of exhaustion. O'Brien's book contributes in part Keating's mental and physical exhaustion to the ultimate defeat of Labor.

Treasury's view unflinchingly rested on monetarist macroeconomics - which unnecessarily generates a suit of complementary dogmas that were and are not at all appropriate to a sovereign currency. Because bond sales by policy or necessity are coupled to deficit budgets, the belief follows that bond sales are debt mechanisms necessary to finance deficits. The reasoning therefore follows that interest paid on bonds incur a debt burden - usually claimed in parliamentary debates to be a debt to be payed off by subsequent generations. Also, as a consequence of deficit spending, bond sales are said to saturate loan markets and therefore "crowd out" private investment. Then there is the "twin deficits" theory that posits budget deficits and current accounts track together in unison.

The "quantum leap" that would turn economic thinking around is evident within the unedited statistics to be observed when national sectoral balances (these being government, private and foreign sectors) for any country running a sovereign currency are graphed out over time. A surplus in any one sector is invariably reflected as a mirror-image deficit in another sector and vice versa, regardless of economic theory or beliefs. This is impersonal currency karma - it just happens. The concept does take more explanation as to why "it just happens". However, the intention here is not to provide a primer for alternative macroeconomic thinking, but an examination of the consequences brought by a combination of neoliberal policies and budget austerity during the Hawke/Keating era.

Unless governments and those who advise them can come to grasp the realities of sectoral balances, they will continue to swim against an economic tide that is beyond their control -- somewhat akin those who believe that nature can be controlled - the environment just fights back. Once sectoral balances are understood it becomes clear that the tenets of monetarist macroeconomics actually happen to work in reverse when applied to a sovereign currency - deficits are a necessary function of government if full employment is to be achieved; bond sales do not "finance" deficits - rather, the necessary function of bond sales is to mop up excess liquidity consequent to government spending.

In explanation, government spending has to end up somewhere - mostly held in bank accounts. Without an option for higher returns on excess liquidity, there would be no demand for interbank lending and no avenue for the Reserve to defend its target rate that would consequently sink to zero. Bond sales are therefore nothing more than swapping of excess cash accounts for a form of interest-earning term deposits. Furthermore, bond sales do not "crowd out" investment because the stability of the interbank lending rate is determined and defended by the Reserve Bank; private sector lenders will set rates at whatever the market will support or the

Government may tolerate. And the "twin-deficits theory" is baseless because it contradicts the evidenced of sectoral balances.

The impacts of the Hawke/ Keating structural and economic reforms had taken hold by 1986, with an "alarming" rise in the negative balance of trade and the value of the Aus dollar was plunging; all seen by Keating to be signs of a looming disaster prompting his infamous "banana republic" statement -- that "we are living beyond our means". In response to the "looming disaster" the Reserve Bank incrementally pushed interest rates to exorbitant levels to attract foreign investment, promised tax cuts were deferred and a decision for severe expenditure restraints in the 1986 budget was agreed to by cabinet. The dominating view across politics, Treasury and the media being that national prosperity, no matter how contradictory this may sound, depended on a current account surplus that had to be achieved at whatever cost to the country.

Both government and the Reserve Bank began pulling all the wrong economic levers - disrupting the economy and creating discontent and misery for burgeoning jobless numbers, home owners and small businesses. Government spending into the private sector was progressively strangled with rising unemployment and interest rates distressing those dependant on debt to finance homes and businesses -- eventually seeing the flight of Labor's heartland to "Howard's battlers".

The sense of crisis that Keating had unleashed created another crisis that was later to see the end of the Keating-Hawke relationship -- a relationship that had created the most successful reforming government since Federation. Going into the 1986 budget, $3.5 billion was cut out of the deficit -- Keating "wanted ultimately to reach the point where the call on Australia's savings was zero at worst, or better still, in surplus".

Again, the 1987 May statement according to O'Brien delivered the biggest ever public-sector spending cutback in health, education, welfare and jobs programs -- estimated by Keating to have a current value of between $15 to $20 billion. A consequent $27 million deficit was delivered -- almost a balanced budget that delighted conservative commentators even though interest rates were around a shocking 14%. Keating boasted a "24-carat budget in a golden age of economic change." Later in 1987 the Reserve Bank lowered interest rates and growth began to pick up -- seen as a triumph for budgetary austerity -- but more likely a consequence of the Accord.

Outside of Labor government control a stock-market crash followed in late 1987 -- O'Brien noted that this held back the Reserve Bank from pushing up interest rates to mitigate signs that "the economy was at serious risk of overheating". Well, what does that mean? It means that private sector borrowing was booming. Keating's austerity measures were certainly mirrored by private sector debt -- then blown out of all measure when the deregulated banks saw unrestrained lending as an opportunity not to be missed -- the "big four" banks determined not to allow a foothold to the foreign competition organised by Keating.

O'Brien quotes a senior Reserve Bank economist who at the time said "Never before in Australian history had so much money been channelled by so

many people incompetent to lend it into the hands of people incompetent to manage it." Keating remarked to O'Brien that "after 1986 we lost control of the economy"; no wonder, because despite the consequences of deregulation and austerity terrifyingly on show, neither Government, Treasury or the Reserve Bank had any idea of the opportunities that the now floating currency offered. Regardless, Treasury continued to cheer on the holy grail of surplus that together with deregulation soon ran the country into "the recession we had to have"; a comment Keating later regretted considering the damage and hurt that the recession did to the country.

The 1988 budget delivered the first government surplus (at $5.5 billion) since 1953 at the cost of cutting funding to everything that had made Australia a liveable country. By November 1988 the Reserve Bank had pushed interest rates to 18% in an attempt to stem borrowing but "by 1989 borrowing was still increasing at 25% per annum, gearing ratios had doubled and share prices went up at 18% per annum". Again, all the wrong economic levers were being pulled building chaos on chaos that had gone before. In 1990 the government recorded another surplus, this time of $9 billion. Despite the private sector disaster now evident, Keating again proudly stated that the surpluses were the achievement of six years of heavy work in the ERC. Despite all the "heavy work", the country soon fell into a recession that ran on for two years from 1990.

The dominanting neoliberal dogma that demanding both deregulation and relentless budget austerity had unleashed an economic storm on the Australian economy. Dodgy entrepreneurs left insolvencies in the billions, Victoria's Pyramid Building Society collapsed in 1990 and the State Bank of South Australia followed in 1991 with Western Australia wracked by dodgy financial scandals. By November 1992 unemployment had reached 11.3% -- the worst since the great depression.

What were the lessons to be learned apart from the consequences of deregulation later recognised by Treasury? Virtually none within the political parties apart from a change in attitude by Keating. In the end he came to the realisation that all the hard work and austerity advised by Treasury had absolutely no effect on the current account balance; he had been "sold a pup" on the "twin deficit theory". On the consequences of austerity, "Treasury's advice not to run deficits because they could never be repaid represented very poor judgement". By 1991, Keating no longer trusted Treasury -- Keating's One Nation policy delivered early 1992 was developed in the prime minister's office without Treasury input. One Nation saw a return to deficit spending to repair the damage wrought by austerity with $2.3 billion for infrastructure and technical education and $8.6 billion promised in tax cuts. And yet again a return to surplus was promised -- assumed to be funded by economic growth, which came too late to save the Labor Government.

The irony of course is that Treasury continues to provide governments with flawed advice. An even greater irony is that Keating is now somewhat of an economic hero to the right of politics - a super-hero of government austerity.

1. There are conflicting claims between Hawke and Keating as to who initiated what over several policy areas.

Dr Rob Holmes' various interests include environmental science, and he was previously engaged with both the Environmental Protection Authority and consultancies for more than twenty years. He is now part-retired, carries out independent consultancy work, and is a self-published author via Tiliqua Books - an outlet for one of his hobbies which is writing.

Solar energy investment is booming

Madia Prupis

Solar investment has gone from literally nothing five years ago to quite a lot.

The cost of solar in 58 developing nations dropped to a third of 2010 levels, BNEF reported. (Photo: Duke Energy/flickr/cc)

For the first time, solar power is becoming the cheapest form of electricity production in the world, according to new statistics released by Bloomberg New Energy Finance (BNEF) on 15th December, 2016.

While unsubsidized solar has occasionally done better than coal and gas in individual projects, 2016 marked the first time that this renewable energy source has out-performed fossil fuels on a large scale. And new solar projects are also turning out to be cheaper than new wind power projects, BNEF reports in its new analysis, *Climatescope*.

The cost of solar in 58 developing nations dropped to about a third of 2010 levels, with China in particular adding a record number of solar projects. And as the *Independent* notes, solar "has proven a godsend for remote islands such as Ta'u, part of America Samoa, in the South Pacific".

In fact, Ta'u has been able to abandon the use of fossil fuels altogether and power itself almost entirely on renewable energy.

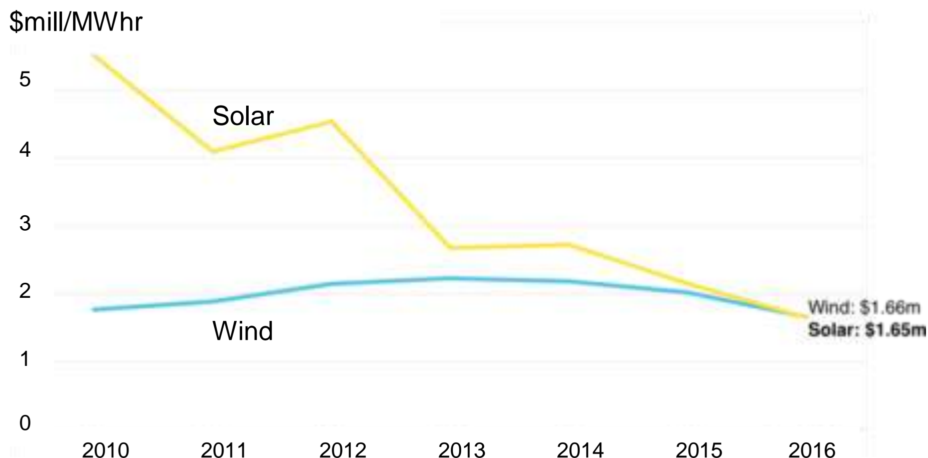
"Solar investment has gone from nothing - literally nothing - five years ago to quite a lot" said Ethan Zindler, head of BNEF's U.S. policy analysis.

BNEF chairman Michael Liebreich also told investors this week that "renewables are robustly entering the era of undercutting" fossil fuel prices.

Unsurprisingly, developing countries are at the forefront of this advancement, having invested in clean energy economies to stave off the catastrophic effects of climate change at a greater rate than have wealthy nations.

Solar prices fall below wind

A turning point for renewables in lower-income countries



(Disclosed capex for onshore wind and PV projects in 58 non-OECD countries. Source: Bloomberg New Energy Finance)

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"For populations still relying on expensive kerosene generators, or who have no electricity at all, and for those living in the dangerous smog of thickly populated cities", Bloomberg reports, "the shift to renewables and increasingly to solar can't come soon enough"

Source: Common Dreams, 16 Dec 2016

http://www.commondreams.org/news/2016/12/16/sun-solution-rises-solar-fast-becoming-worlds-cheapest-electricity-source

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References underpinning the assertions made will be found in the original article.

Issues with renewable energy accounting

Editor

Critics of various published renewable energy analyses have pointed out that modern renewable energy technologies are often dependent upon fossil fuel and other energy sources, and have cautioned that the energy accounting costs might not adequately reflect that dependency. An additional consideration is the associated environmental and social costs. Thus while the cost statistics reported in the above article are interesting, the possibility that

they do not fully account for hidden costs in the manufacture and use of polysilicon solar panels and for waste products disposal must be considered.

The problem is analysed in an important paper by Weißbach et al [1] in terms of the energy return on energy invested, or EROEI – the ratio of the energy produced over the life of a power plant to the energy that was required to build it and any extraneous energy sources that might be involved in its operation. It takes energy to make a power plant – to manufacture its components, mine the fuel, and so on. The power plant needs to make at least this much energy to break even. A break-even powerplant has an EROEI of 1. But such a plant would pointless, as there exists no energy surplus for doing the useful things we use energy for.

There is a minimum EROEI, greater than 1, that is required for an energy source to be able to run society. An energy system must produce a surplus large enough to sustain things like food production, hospitals, and universities to train the engineers to build the plant, transport, construction, and all the elements of the civilization in which it is embedded.

One problem here is that some models for solar energy plants limit their life cycle or EROEI analysis to just the solar panels themselves, and there is a danger in this simplistic approach that the solar energy generated could represent half or less of the overall energy entailed in the construction and use of these plants.

1. The Weißbach et al paper is downloadable from the following less technical review:
http://bravenewclimate.com/2014/08/22/catch-22-of-energy-storage/

Why Glass-Steagall matters

Editor

Sen. Carter Glass (D–Va) and Rep. Henry B. Steagall (D–Ala)

The Glass–Steagall Act describes four provisions of the U.S. Banking Act of 1933 that serve to separate traditional commercial banking from risky investment banking [1,2]. According to ref 1:

" Following the global financial crisis of 2007-08, legislators unsuccessfully tried to reinstate Glass–Steagall Sections 20 and 32 as part of the Dodd–Frank Wall Street Reform and Consumer Protection Act. Currently, bills are pending in United States Congress that would revise banking law regulation based on Glass–Steagall inspired principles. Both in the United States and elsewhere banking reforms have been proposed

that refer to Glass–Steagall principles. These proposals raise issues addressed during the long Glass–Steagall debate in the United States, including issues of “ring fencing” commercial banking operations and “narrow banking” proposals that would sharply reduce the permitted activities of commercial banks. "

An article on the website of former presidential candidate Sen. Bernie Sanders by Richard Eskow [3] details Sanders' proposal to implement a new version of the Act, which was repealed in 1999 after having been successfully in effect for more than 75 years. The following five reasons have been listed by Eskow, explaining why it is important to reinstate the Glass-Steagall Act.

1. Too-big-to-fail banks are bigger, riskier, more ungovernable than ever

America’s largest banking institutions are even larger now than they were before the 2008 financial crisis. The nation’s six largest banks issue more than two thirds of all credit cards and more than a third of all mortgages. They control 95 percent of all derivatives and hold more than 40 percent of all US bank deposits. Simon Johnson, former chief economist for the International Monetary Fund, points out that Glass-Steagall is needed as part of a broad effort to make these banks “simpler and more transparent.” Johnson observes:

“In the run-up to the 2008 crisis, the largest US banks had around 4% equity relative to their assets. This was not enough to withstand the storm … Now, under the most generous possible calculation, the surviving megabanks have on average 5% equity … that is, they are 95% financed with debt.”

As Johnson makes clear, these banks continue to pose a grave risk to the economy. He also notes that they have continued to engage in sanctions violations and money laundering – behavior which suggests that they are still out of control.

2. The argument that the repeal of Glass-Steagall didn’t cause the 2008 financial crisis is wrong

Robert Reich, Bill Clinton’s former Labor Secretary, summarized the anti-Glass-Steagall argument as follows:

“To this day some Wall Street apologists argue Glass-Steagall wouldn’t have prevented the 2008 crisis because the real culprits were the nonbanks like Lehman Brothers and Bear Stearns.”

He followed that with a one-word response: “Baloney.”

Reich then made an important point: “Shadow banks” like AIG and Lehman, which largely function outside the normal bank regulatory system, are a major problem. But the 2008 financial crisis became a systemic threat specifically because too-big-to-fail banks were underwriting the risky bets these companies made. And why were the big banks able to do that?

Because Glass-Steagall had been repealed.

3. Repeal of the Act has not worked as promised

Given the risks associated with the repeal of the Glass-Steagall Act, what about the benefits? It turns out that there aren’t many.

We were told that repealing the Glass-Steagall Act would lead to more efficiency and lower costs, but neither of these promises has come true. No less an expert than John Reed, former CEO of Citigroup, now says those claims were wrong. Reed wrote in a recent

op-ed (behind a firewall) that “there are very few cost efficiencies that come from the merger of functions – indeed, there may be none at all.”

In fact, says Reed, it is possible that this combination of functions actually makes banking services more expensive.

4. The repeal of Glass-Steagall is further corrupting the culture of banking – if such a thing is possible

Sanders was right when he said that “the business model of Wall Street is fraud”. The traditional practice of what Sen. Elizabeth Warren calls “boring” banking – opening savings accounts, reviewing loans, and providing other customer services – has largely been supplanted by high-risk gambling and the aggressive hustling of dubious investments to unwary clients.

The level of fraud unearthed since the 2008 crisis is nothing short of breath-taking. (The fact that no senior banking executive has gone to prison for that fraud is, if anything, even more breath-taking.) How did that happen?

Citigroup’s Reed wrote that the repeal of Glass-Steagall led to a “very serious” problem of “mixing incompatible cultures” – which, he said, “makes the entire banking industry more fragile.” He discussed the relationship-based, sociable culture of traditional banking, emphasizing its incompatibility with the risk-seeking, “short termist” mentality of investment bankers who seek “immed-iate rewards.”

Reed makes a very important point – although he’s being overly kind about it. Yes, traditional bankers tend to be risk-averse and customer-focused. That’s very different from the high-stakes gambling mentality of investment banking.

But what Reed fails to note - or is too polite to mention - is the extent to which today’s culture of investment banking is predicated on outright fraud. That’s reflected in recent polling of the banking community itself, and in the industry’s appalling record of documented illeg-ality. It is this mentality, which is present in banks from the “C” suite on down, which has given rise to Wall Street’s tsunami of misdeeds.

This greed-driven fraud mentality is like a virus, consuming too-big-to-fail banks even as they exert ever-greater control over our economy -- and our political system.

5. Too-big-to-fail banks are a threat to our democracy

These megabanks aren’t just a “systemic threat” to our economy. Through their enormous wealth, and because of the ruthlessness with which they’re willing to wield their influence, they are also a systemic threat to democracy itself.

That threat can be seen in the workings of last year’s U.S. Congress, which saw the successful insertion of a lobbyist-drafted “Citigroup amendment” into a last-minute budget bill.

It can be seen in a political climate where the Republican head of a Congressional Committee can say that “Washington and the regulators are here to serve the banks.”

It can be seen in Wall Street political contributions which flow to powerful and familiar political names, Republican or Democratic.

Banks have acquired too much power. They must be broken up vertically (by line of business) and horizontally (by

size), even as their corrupting influence over our government is ended through a system of fundamental election reform.

In today's environment, reinstating the Glass-Steagall Act is the right policy, and also an excellent litmus test for politicians who say they're willing to take on Wall Street.

1. https://en.wikipedia.org/wiki/Glass%E2%80%93Steagall_legislation
2. https://en.wikipedia.org/wiki/Glass%E2%80%93Steagall_in_post-financial_crisis_reform_debate
3. https://berniesanders.com/yes-glass-steagall-matters-here-are-5-reasons-why/

Letters Section

From Colin Cook
'The Federal Government is not an ATM'

This statement by the PM - at the 2016 COAG meeting last December - shows the confusion, ignorance and/or deceit at the top levels of our body politic.

An ATM is a machine that delivers spending money on request ***providing*** that money has been put into the device beforehand. This is exactly how the government - and opposition - tell us how the federal system of government operates; 'you pay your taxes, then we can provide the services and infra-structure you seek'.

So, to be consistent, the PM should have said that his Government ***is*** like an ATM! On the other hand, maybe the PM believes that an ATM is a source of unlimited cash - but we plebs know differently. Perhaps there is such an ATM in Parliament House to handle entitlement claims but the ones we can use need inputs before they give us spending money!

That such confused thinking can be presented in public ***and*** go unchalleng-ed -- by state premiers, journalists and commentators - demonstrates the need for a greater public understanding of federal finances and where money really does come from - who creates it and how much is there.

Until this greater understanding is widespread, we will continue to be misled and short-changed by the body politic - fed rubbish about 'debt and deficit disaster', the terrors of federal budget deficits, the likeness of federal finances with personal and small business finances, maxed out national credit card, the horrors of suspect credit agencies being upset, and so on.

There is great clarity on Federal funding in a paper by Dr Steven Hail appearing in a recent issue of ERA Review titled, 'Paying for public services in a monetary sovereign state'.

The results of my study of Dr Hail's paper have been published by Independent Australia - with many really worthwhile links that make it a must read:
https://independentaustralia.net/politics/politics-display/paying-for-public-services-dr-steven-hails-solution,9945

- -

The problem with gross domestic product is the gross bit. No deductions are involved: all economic activity is accounted as if it were of positive value. Social harm is added to, not subtracted from, social good. A train crash which generates £1bn worth of track repairs, medical bills and funeral costs is deemed by this measure as beneficial as an uninterrupted service which generates £1bn in ticket sales. - George Monbiot

Explainer: what is modern monetary theory?

Steven Hail

There is a school of thought among economists who aren't worried about the so called "budget black hole", where tough choices have been called for to reduce government spending. The proponents of modern monetary theory like Prof Stephanie Kelton (who is chief economic adviser to Bernie Sanders) claim that the Australian government need not balance its budget, and are instead calling for the government to balance the economy - which they argue is a different thing entirely.

Modern monetary theory (MMT) is an approach to economic management developed after the 1990s by Australia's Prof Bill Mitchell and U.S. academics like Prof Randall Wrayand Stephanie Kelton, as well as investment bankers and fund managers like Warren Mosler. It builds on the ideas of a previous generation of economists, like Hyman Minsky, Wynne Godley and Abba Lerner, whose interpretation of the work of the famous economist John Maynard Keynes was very different from that which became dominant by the 1980s.

By the 1980s, most people saw Keynes as an advocate of budget deficits only during periods of high unemployment. Lerner, as early as 1943, in a paper entitled *Functional Finance and the Federal Debt*, argued that Keynesian economics involved running whatever government deficit was necessary to maintain full employment, and that deficits should be seen as the norm. Keynes, in a letter to economist James Meade written in April 1943, said of Lerner, "His argument is impeccable. But heaven help anyone who tries to put it across".

While the theory has attracted its own interpretations and criticism it's also gaining traction in a global economic environment that continues to defy the efforts of policymakers to restore sustained economic growth. There are three core statements at the heart of MMT. The first two are:

1. Monetary sovereign governments face no purely financial budget constraints.

2. All economies, and all governments, face real and ecological limits relating to what can be produced and consumed.

The first statement is the one which is widely misunderstood. A monetary sovereign government is one with its own currency and central bank, a floating exchange rate, and no significant foreign currency debt. Australia has a monetary sovereign government. So does the U.K., the U.S. and Japan. The Eurozone countries are not monetary sovereigns, as they do not have their own currencies.

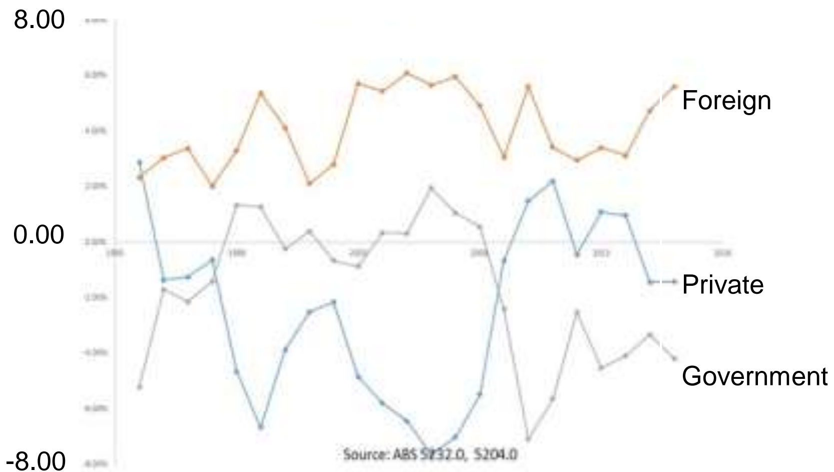
The second statement confirms the obvious fact that governments can cause inflation if they choose, by spending too much themselves or by not taxing enough. When this happens, the total level of spending in the economy exceeds what can be produced by all the labour, skills, physical capital, technology and natural resources which are available. We can also destroy our natural ecosystem if we produce too many of the wrong things, or use the wrong processes to produce what we wish to consume.

The Australian government, being a currency-issuing central government, cannot run out of Australian dollars. It is never forced to borrow Aus dollars - although it can and does choose to do so - and its debt securities play a useful role in our financial system.

It doesn't exactly need to tax us to pay for its spending either. Taxes exist to limit inflation. It's necessary for us to pay taxes to keep total spending – government and private – at a level which will not be inflationary. This does not mean that government spending and taxation have to equal each other, and in countries like Australia this rarely happens in practice. This leads to the third principle of modern monetary theory:

3. The government's financial deficit is everybody else's financial surplus. For every lender, there must be a borrower. That means that across our financial system, surpluses and deficits always add up to zero. This is clear from Fig 1, which shows the financial balances of the Australian private sector, Australian government sector, and the rest of the world, since 1994.

Fig 1: Australian 3-sector balances, 1994-2016 (% GDP)



For every saver who earns more than they spend, there must somebody or some institution which spends more than it takes in. If we want the private sector as a whole to save rather than go further into debt, the government will probably have to spend more than it taxes (depending on what the rest of the world is doing).

It works the other way around too. The Howard government was only able to run fiscal surpluses because the private sector went heavily into deficit.

Household debt trebled during the Howard years. Since then, we have been in a tie with a couple of other countries for the highest household debt to income ratios in the world.

So, the government cannot run out of dollars; that doesn't mean the government should "spend like a drunken sailor" or that we don't have to pay taxes; it does mean balanced budgets are unnecessary. It also means government deficits can play a supportive role, allowing the private sector to build up its saving.

Australian governments have nearly always run deficits anyway. None of the above ought to be shocking. On average, governments of both left and right have run deficits, ever since federation. It just might be that you have been misled by that metaphor of the government as a household.

In a country with nearly 15% underutilisation of labour, over 30% youth underutilisation, fragile private balance sheets, and a growing need for green and other infrastructural investments, it does imply that budget repair is a red herring. This means the government could and should be using its role as the currency issuer to promote full employment, social inclusion, ecological repair, and healthy private sector balance sheets.

Politicians are, according to modern monetary theorists, currently obsessed with something which doesn't matter (balancing their budget), and are ignoring many things which do matter a great deal for the future of the country.

This is the perspective you get when you start to see Australia and the world through the prism of modern monetary theory. It's based on nothing more than a comprehension of how modern financial systems actually work, and in that sense, perhaps it should not be controversial at all.

MMT proponent Professor Bill Mitchell advocates for governments to use the policy space provided for them by monetary sovereignty to introduce a job guarantee and pursue unemployment rates of 2% or less. These rates were achieved in Australian across the 1960s and early 1970s. He proposes a return to full employment through a federally funded and locally managed program of public employment. He does not believe that this need be inflationary - indeed the job guarantee is an essential part of the modern monetary theory framework for stabilising the economy and avoiding inflation.

In Australia, the three major political parties have as yet paid little attention to his ideas. But his fellow modern monetary theorists got close to government in the USA (with Senator Bernie Sanders) and two micro-parties have been set up in the last year with the express intention of promoting modern monetary theory as a frame for understanding economic issues. So you can expect to hear a lot more from both the proponents and the critics of modern monetary theory.

Fig 2: Australian private sector debt (incl households), household debt, and general government debt, 1988-2015 (% GDP)

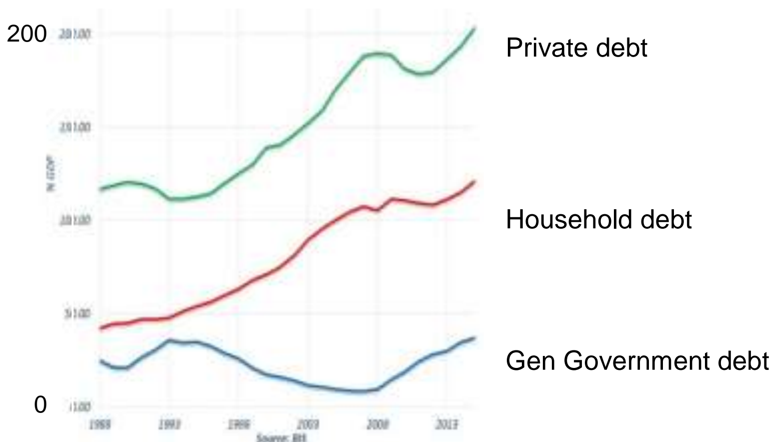
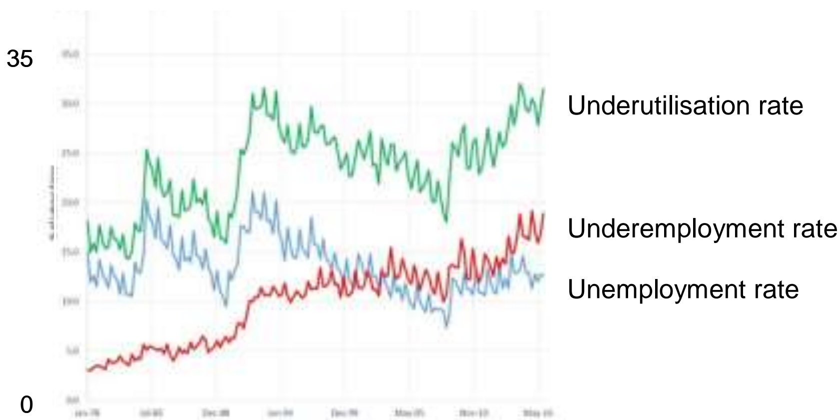


Fig 3: Unemployment, underemployment and underutilisation rates for those aged 15-24 yrs in Australia, 1978-2016 (% of labour force)



Source: The Conversation, 31 Jan 2017
https://theconversation.com/explainer-what-is-modern-monetary-theory-72095?

Dr Steven Hail is an ERA member and teaches financial economics at Adelaide University

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If the authorities constrain banks and are aware of the activities of fringe banks and other financial institutions, then they are in a better position to attenuate the disruptive expansionary tendencies of our economy. - Hyman Minsky

Social and economic problems requiring reform

Editor

In a recent communication, NZ member John Rawson discussed a range of social and economic issues requiring reform. John said that the first step must be to identify existing problems and their causes, and the second should be to decide which problems can be remedied by human action and which must be left to natural forces. Only then can we make intelligent decisions for reform. John lists the major social and economic problems confronting the modern world as:

1. Economic and financial instability, with periodic crises.
2. The impossibility of a steady state economy while a continual growth imperative persists.
3. Growing inequality, i.e. deprivation of a considerable section of communities from access to the benefits from production, with starvation in some of the poorest nations.
4. A financial structure characterised by generally increasing debt.
5. The risk of excessive changes in the price level (i.e. in inflation or deflation).
6. Progressive restriction of fundamental human and democratic rights.
7. Impending shortages of natural raw materials.
8. Impairment and decay of the natural environment.
9. Increasing crime and a legal system that does little to reform the culprits and provides insufficient aid to the victims.

To which list I suggest one should add:

10. Large scale involuntary unemployment and underemployment.

Make GDP great again

David Ruccio

Mainstream economics presents quite a spectacle these days. It has no real theory of the firm and, even now, more than nine years after the Great Recession began, its most cherished claim to relevance - the use of large-scale forecasting models of the economy that assume people always behave rationally - is still misleading policy-makers.

As if that weren't embarrassing enough, we now have a leading mainstream economist, Havard's Martin Feldstein, claiming that the "official data on real growth substantially underestimates the rate of growth".

Mr. Feldstein likes to illustrate his argument about GDP by referring to the widespread use of statins, the cholesterol drugs that have reduced deaths from heart attacks. Between 2000 and 2007, he noted, the death rate from heart disease among those over 65 fell by one-third.

"This was a remarkable contribution to the public's well-being over a relatively short number of years, and yet this part of the contribution of the new product is not reflected in real output or the real growth of GDP" he said. He estimates - without hard evidence, he is careful to point out - that growth is understated by 2 percent or more a year.

This is not just a technical issue for Feldstein:

" .. it is misleading measurements that are contributing to a public perception that real incomes - particularly for the middle class - aren't rising very much.

That, he said, 'reduces people's faith in the political and economic system'.

“ 'I think it creates pessimism and a distrust of government', leading Americans to worry that 'their children are going to be stuck and won't be able to enjoy upward mobility', he said. 'I think it's important to understand this.' ”

Here's what folks need to understand: mainstream economists like Feldstein, who celebrate an economic system based on private property and free markets, build and use models in which market prices capture all the relevant costs and benefits to society. And, since GDP is an accounting system based on adding up transactions of goods and services based on market prices, for mainstream economists it should represent an accurate measure of the “public's well-being”.

Mainstream economists can't have it both ways - either market prices do accurately reflect social costs and benefits or they don't. If they do, then Feldstein & Co need to stick with the level and rate of growth of GDP as the appropriate measure of the wealth of the nation. And, if they don't, all their claims about the wonders of free markets simply dissolve.

Notice also that, for Feldstein, the problem is always in one direction: GDP statistics only undercount social well-being. What he and other mainstream economists fail to consider is that whole sectors of the economy, like financial services (or, more generally, FIRE -- finance, insurance, and real estate), are counted as adding to national income.

As Bruce Roberts has explained [1], ".. because “financial services” are deemed useful by those who pay for them, those services must be treated as generators in their own right of value and output (even though there is nothing there that can actually be measured as output at all) ...

" ... the standard (neoclassical) approach embedded in GDP accounting means, in concrete terms, that profits in FIRE must be treated as a reflection of rising real output generated by FIRE activities, requiring a numerical “imputation” of greater GDP. And, worse, that 'rising' profits in FIRE then go hand in hand with 'rising' levels of imputed 'output' and hence enhanced 'productivity'. "

If Wall Street doesn't add to GDP - if FIRE activities just represent transfers of value from other economic sectors (both nationally and internationally) - then its resurgence in the years since the crash doesn't contribute to output or growth.

The consequence is that GDP, as it is currently measured, over-counts national output and income. Actual growth during the so-called recovery is much less than mainstream economists and politicians would have us believe.

That's the real reason many Americans are worried they and “their children are going to be stuck and won't be able to enjoy upward mobility.”

1. https://anticap.wordpress.com/2016/12/02/class-before-trumponomics-part-3/#comment-28751

Source: Real World Econ Rev blog https://rwer.wordpress.com/2017/02/17/make-gdp-great-again/

Comments

(1) Ecolecon (Feb 17, 2017)

I agree with most of David Ruccio's critique of the position of Feldstein & Co. I agree in particular that we are on very dangerous ground thinking that profits earned in monopolistic and oligopolistic

sectors (like much of the FIRE sector is) are in any meaningful sense an additive element in a measure of national income that purports to say anything about human welfare, given the zero-sum nature of so many transactions in that sector.

Nonetheless, I find it quite staggering, that any critic of neoclassical economics, when correctly pointing out what a ram-shackle measurement of well-being GDP is, can fail to also point out that the GDP accounting rules make no effort whatso-ever to measure the degradation and depletion of critical stocks of natural capital.

I suppose that is in some sense subsum-ed in the critique that says you can't measure anything that matters, using market prices. Natural capital stocks are never counted by mainstream econo-mists – instead their depletion is only sporadically (and rather absurdly) counted as income when (after appropriation from nature) such stocks are sold, as if out of a reproducible inventory – so if we some-how were not so determined to be exclus-ively reliant on revealed market prices, we might naturally begin to get to grips with the issue of depletion of natural capital.

Still, if some form of national income accounting is to survive in mixed economies, we will probably have to start with market prices for a lot of economic activity. What we desperately need though, is to also account, via judicious adjustment rules, for unpaid labour, non value-adding, zero-sum transactions between households and economic agents with market power (or even among households) and certainly among firms, and above all else, for the dangerous depletion and degradation of stocks of natural capital.

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(2) Geoff Davies (Feb 18, 2017)

Ecolecon it's worse than that. Not only do they implicitly attribute zero value to many valuable things, they count many negat-ives as positives. They count the cost of cleaning up pollution, storm damage, car crashes etc as positive contributions to GDP. It's all just "economic activity" folks. They get the sign wrong!

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