ERA Review

Journal of Economic Reform Australia

Vol 9 No 3, ISSN 2202-0934 (Print), 2202-0942 (Online)

For a just and sustainable society

May-June 2017

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The IMF is showing some hypocrisy on inequality

Christopher Sheil and Frank Stilwell

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CHRISTINE
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"I hope people will listen now" said Christine Lagarde, managing director of the International Monetary Fund (IMF), at the World Economic Forum in Davos last January.

Lagarde was alluding to the wave of reactionary populism that's currently sweeping the developed economies, and was harking back to her speech at Davos in 2013 when she warned that economic "inequality is corrosive to growth; it is corrosive to society".

The IMF has been expressing public concern about inequality since 2010, but this has not translated into concrete action within the IMF's own policies and programs, according to new research by British political economists, Alex Nunn and Paul White.

No references to inequality were added in 2014 when the IMF last reviewed the operational guidelines for its annual macroeconomic surveys, the grading of national economies, which it conducts in consultation with each of its member states (including Australia).

In a sample of 11 countries surveyed since the latest guidelines became effective, Nunn and White found little more than "very passing references" to inequality.

Nor has anything significant changed in the requirements that the IMF imposes on countries to which it provides financial assistance. The IMF reviewed the guidelines that shape the conditions on borrowing members in 2011-12 and revisions were introduced in mid-2015. The new "guidance on the guidance" accepts inequality as a concern, but only as secondary and subordinate to its long-established primary concerns with economic growth and fiscal discipline.

Nunn and White's 11-country sample included all seven member states that have struck new borrowing arrangements with the IMF since the guidelines were updated. In every case, the IMF has continued to recommend fiscal discipline, and very few of the policies that could be used for reducing inequality have even been mentioned.

Challenging Piketty but getting it wrong

Another example of the IMF's hypocrisy on this issue is its stance on research from French political economist Thomas Piketty. The IMF has criticised Piketty's evidence and arguments on making the case for reducing wealth inequality.

A widely-reported IMF working paper, released last August, purported to show that there is "no empirical evidence" to support Piketty's claim that growing inequality results from the return on capital exceeding the economic growth rate.

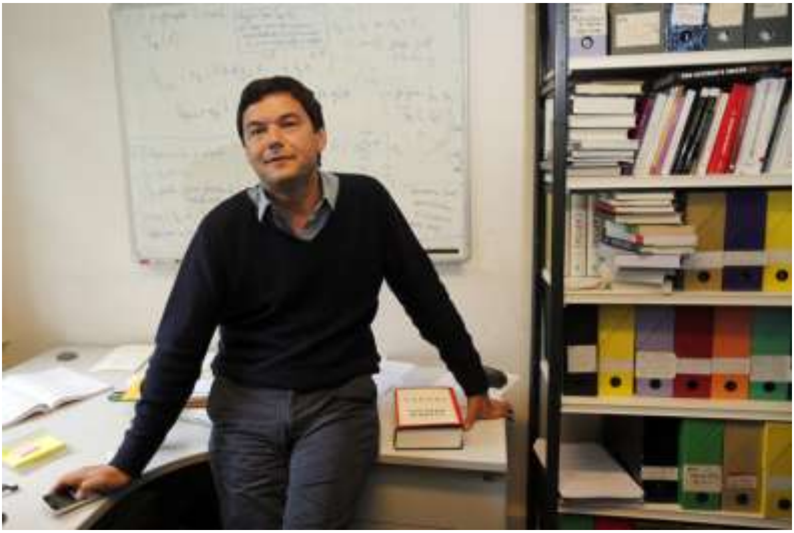
Less widely reported was Piketty's patient response, pointing out that the IMF paper made the embarrassing error of confusing labour incomes with the return on capital, and that the latter was incorrectly estimated in any event.

Together, the IMF's apparent lack of practical action and the sponsoring of this research paper reinforces the suspicion that Lagarde has failed to move "the IMF in the direction of looking at inequality as mainstream and core business", as she boasted in Davos in 2015.

Why hasn't the IMF walked the talk?

The IMF has long been criticised for tending to create the inequality it now claims to be tackling. Historically, its "structural adjustment programs" forced many poor countries to scrap welfare policies and pursue privatisations under the so-called "Washington Consensus", exacerbating economic inequalities. This was the subject of a withering critique by Nobel-prizewinning economist Joseph Stiglitz in the wake of the East Asian financial crisis, spawning numerous protests around the world.

One reading of the IMF's new high-level rhetoric is that it seeks to distance the institution from this history. . It offsets the criticism while allowing the IMF to maintain its adherence to neoliberal



Economist Thomas Piketty rebuffed the criticism of his research. Charles Platiau/ Reuters policies. This is what Nunn and White refer to as “organised hypocrisy”.

A somewhat more sympathetic reading of the situation would be that, while the IMF’s commitment to managing the systemic risks that inequality presents for global economic stability and growth is real, the institutional barriers to implementation are formidable.

Large organisations seeking to make a change of direction are often frustrated by internal struggle and institutional inertia.

It might also be be inferred that there is a need for greater support from the member states if reducing inequality is really to become a practical policy priority. This is because of changes to the operational guidelines for the IMF’s surveillance activities, including it’s annual economic surveys, in the wake of the global financial crisis.

The guidelines have been changed so that the IMF is more firmly guided by the economic objectives of its member states, whose social and political policies are supposed to be respected.

Perversely, the central global body that many believe exacerbated inequality is now less able to redress the problem.

Implications for Australia

If tackling the general trend to increased inequality is to be a reality, the main political pressure still needs to be on national governments. In Australia, for example, we need a federal government committed to directly implementing policies to reduce inequality.

Dovetailing with these concerns is the more mundane matter of improving the distributional economic data. The aggregate income statistics in the standard national accounts need to be augmented by distributional measures, as recently modelled by a group of leading inequality scholars.

The current disconnect between national accounts and inequality data makes it difficult to know what fraction of economic growth accrues to the bottom 50% and the top 10%, as well as the relative income going to workers and owners. Nor do policymakers have a comprehensive view of how the government programs designed to ameliorate the worst effects of inequality succeed.

This data should be of interest to any government that is serious about eschewing populism in favour of effective policies to head off the wave of discontent and destabilisation.

As a report for the Evatt Foundation last year showed, the distribution of wealth in Australia is dramatically and increasingly unequal. There’s no basis for thinking this country is immune from the corrosive effects of inequality on economic growth, society and politics.

So people should listen now, both in Australia and worldwide, as Christine Lagarde urges — including those who have apparently remained deaf in the IMF.

Source: The Conversation, 13 Feb 2017
https://theconversation.com/the-imf-is-showing-some-hypocrisy-on-inequality-72497

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Cutting wages is not the solution

Lars Syll

A couple of years ago I had a discussion with the chairman of the Swedish Royal Academy of Sciences (yes, the one that yearly presents the winners of The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel). What started the discussion was the allegation that the level of employment in the long run is a result of people's own rational inter-temporal choices and that how much people work basically is a question of incentives.

Somehow the argument sounded familiar.

When being awarded the 'Nobel prize' for 2011, Thomas Sargent declared that workers ought to be prepared for having low compensation for unemployment in order to develop the right incentives to search for jobs. The Swedish right-wing finance minister at the time appreciated Sargent's statement and declared it to be a "healthy warning" for those who wanted to increase compensation levels.

The view is symptomatic. As in the 1930s, more and more right-wing politicians – and some economists – now suggest that lowering wages is the right medicine to strengthen competitiveness within each faltering economy, to get the economy going, to increase employment and to create growth that will remove towering debts and create balance in state budgets.

But, intimating that one could solve economic problems by wage cuts and impairing unemployment compensation, in these dire times, should be taken as more as a sign of how low confidence in our economic system has sunk. Wage cuts and lower unemployment compensation saves neither competitiveness, nor jobs. What is needed more than anything else in these times is stimulus and economic policies that increase effective demand.

At a societal level, wage cuts will only increase the risk that more people will become unemployed. To think that this can solve an economic crisis amounts to turning the clock back to those faulty economic theories and policies that John Maynard Keynes conclusively showed to be wrong in the 1930s. It was such theories and policies that made millions of people all over the world unemployed.

It’s an atomistic fallacy to imagine that a policy of general wage cuts would result in a strengthening of the economy. On the contrary, the aggregate effects of wage cuts would - as shown by Keynes - be catastrophic. They would start a cumulative spiral of lower prices that would make the real debts of individuals and firms increase since the nominal debts wouldn’t be affected by the general price and wage decrease. In an economy that more and more has come to rest on increased debt and borrowing this would be the entrance gate to a debt deflation crisis with declining investment and higher unemployment. In short, depression would be knocking on the door.

The impending danger for national economies is that they won’t get consumption and investments going. Confidence and effective demand have to be re-established. The problem of our economies is not on the supply side. Overwhelming evidence indicates that the problem is on the demand side today. Demand is – to put it bluntly – simply not sufficient to keep the wheels of national economies turning. To suggest that the solution is lower wages and lower unemployment compensation is just to write out a prescription for an even worse catastrophe.

Source: Real World Econ Rev., 22Feb 2017
https://rwer.wordpress.com/2017/02/22/cutting-wages-is-not-the-solution/#comment-117294

The decoupling delusion: rethinking growth and sustainability

James Ward, Keri Chiveralls, Lorenzo Fioramonti, Paul Sutton, Robert Costanza

Our economy and society ultimately depend on natural resources: land, water, material (such as metals) and energy. But some scientists recognise that there are hard limits to the amount of these resources we can use.

It is our consumption of these resources that is behind environmental problems such as extinction, pollution and climate change.

Even supposedly “green” technologies like renewable energy require materials, land and solar exposure, and cannot grow indefinitely on this (or any) planet.

Most economic policy around the world is driven by the goal of maximising economic growth (or increase in gross domestic product – GDP). Economic growth usually means using more resources. So if we can’t keep using more and more resources, what does this mean for growth?

Most conventional economists and policymakers now endorse the idea that growth can be “decoupled”from environmental impacts – that the economy can grow, without using more resources and exacerbating environmental problems.

Even the then US president, Barack Obama, in a recent piece in Science argued that the S economy could continue growing without increasing carbon emissions thanks to the rollout of renewable energy.

But there are many problems with this idea. In a recent conference of the Australia-New Zealand Society for Ecological Economics, we looked at why decoupling may be a delusion.

The decoupling delusion

Given that there are hard limits to the amount of resources we can use, genuine decoupling would be the only

No matter how hard we dig, the Earth's resources are ultimately finite.

thing that could allow GDP to grow indefinitely.

Drawing on evidence from the 600-page Economic Report to the President, Obama referred to trends during the course of his presidency showing that the economy grew by more than 10% despite a 9.5% fall in carbon dioxide emissions from the energy sector. In his words:

> *…this "decoupling" of energy sector emissions and economic growth should put to rest the argument that combating climate change requires accepting lower growth or a lower standard of living.*

Others have pointed out similar trends, including the International Energy Agency which last year – albeit on the basis of just two years of data – argued that global carbon emissions have decoupled from economic growth.

But we would argue that what people are observing (and labelling) as decoupling is only partly due to genuine efficiency gains. The rest is a combination of three illusory effects: substitution, financialisation and cost-shifting.

Substituting the problem

Here's an example of substitution of energy resources. In the past, the world evidently decoupled GDP growth from buildup of horse manure in city streets, by substituting other forms of transport for horses. We've also decoupled our economy from whale oil, by substituting it with fossil fuels. And we can substitute fossil fuels with renewable energy.

These changes result in "partial" decoupling – that is, decoupling from specific environmental impacts (manure, whales, carbon emissions). But substituting carbon-intensive energy with cleaner, or even carbon-neutral, energy does not free our economies of their dependence on finite resources.

Let's get something straight: Obama's efforts to support clean energy are commendable. We can – and must – envisage a future powered by 100% renewable energy, which may help break the link between economic activity and climate change. This is especially important now that President Donald Trump threatens to undo even some of these partial successes.

But if you think we have limitless solar energy to fuel limitless clean, green growth, think again. For GDP to keep growing we would need ever-increasing numbers of wind turbines, solar farms, geothermal wells, bioenergy plantations and so on – all requiring ever-increasing amounts of material and land.

Nor is efficiency (getting more economic activity out of each unit of energy and materials) the answer to endless growth. As some of us pointed out in a recent paper, efficiency gains could prolong economic growth and may even look like decoupling (for a while), but we will inevitably reach limits.

Moving money

The economy can also appear to grow without using more resources, through growth in financial activities such as currency trading, credit default swaps and mortgage-backed securities. Such activities don't consume much in the way of resources, but make up an increasing fraction of GDP.

So if GDP is growing, but this growth is increasingly driven by a ballooning finance sector, that would give the appearance of decoupling.

Meanwhile most people aren't actually getting any more bang for their buck, as most of the wealth remains in the hands of the few. It's ephemeral growth at best: ready to burst at the next crisis.

Shifting the cost onto poorer nations

The third way to create the illusion of decoupling is to move resource-intensive modes of production away from the point of consumption. For instance, many goods consumed in Western nations are made in developing nations.

Consuming those goods boosts GDP in the consuming country, but the environmental impact takes place elsewhere (often in a developing economy where it may not even be measured).

In their 2012 paper, Thomas Wiedmann and his co-authors comprehensively analysed domestic and imported materials for 186 countries. They showed that rich nations have appeared to decouple their GDP from domestic raw material consumption, but as soon as imported materials are included they observe "no improvements in resource productivity at all". None at all.

From treating symptoms to finding a cure

One reason why decoupling GDP and its growth from environmental degradation may be harder than conventionally thought is that this development model (growth of GDP) associates value with systematic exploitation of natural systems and also society. As an example, felling and selling old-growth forests increases GDP far more than protecting or replanting them.

Defensive consumption – that is, buying goods and services (such as bottled water, security fences, or private insurance) to protect against environmental degradation and social conflict – is also a crucial contributor to GDP.

Rather than fighting and exploiting the environment, we need to recognise alternative measures of progress. In reality, there is no conflict between human progress and environmental sustainability; well-being is directly and positively connected with a healthy environment.

Many other factors that are not captured by GDP affect well-being. These include the distribution of wealth and income, the health of the global and regional ecosystems (including the climate), the quality of trust and social interactions at multiple scales, the value of parenting, household work and volunteer work. We therefore need to measure human progress by indicators other than just GDP and its growth rate.

The decoupling delusion simply props up GDP growth as an outdated measure of well-being. Instead, we need to recouple the goals of human progress and a healthy environment for a sustainable future.

Source: The Conversation, 13 Mar 2017
https://theconversation.com/the-decoupling-delusion-rethinking-growth-and-sustainability-71996

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Creation and destruction of bank credit money

John Hermann

It is well known and understood that the nation's money supply overwhelmingly consists of deposits within commercial bank accounts of an intangible entity known as bank credit money. This form of money is exchangeable with coins and banknotes on demand. It fluctuates according to economic circumstances, and its dynamic is one of continuous creation and destruction.

There is a widespread belief that credit money is only created by commercial banks when they lend to their retail customers. The reality is that bank credit money is created and destroyed by a variety of routes. These include:

Credit money creation:
(1) Retail bank lending
(2) Bank spending into the real economy
(3) Bank purchase of assets from the non-bank private sector
(4) Government spending
(5) Government lending to the non-bank private sector
(6) Reserve Bank purchase of assets from the non-bank private sector

Credit money destruction:
(1) Repayment of bank retail loans (principal and interest)
(2) Any other payment to banks from the non-bank private sector
(2) Government sale of Treasury securities to the non-bank private sector
(3) Taxation receipts obtained from the non-bank private sector
(4) Bank sale of assets to the non-bank private sector
(5) Reserve Bank sale of assets to the non-bank private sector
(6) Repayment of government loans by the non-bank private sector

Letters

From John Rawson (New Zealand)

Re: Social and economic problems requiring reform

My thanks to the Editor of the Review for publishing my comments in the Mar-Apr issue, and for correcting a gross omission - unemployment. I believe his inclusion of the word "involuntary" is a very necessary part of the statement.

Some reformers, particularly Social Crediters, would prefer to use the word "underconsumption" for the situation, based on the concept that modern industry is coming to require less and less human labour, therefore employment is an outdated angle to pursue. They would correct the situation by paying out a national dividend to all citizens, funded by newly created money and trimmed to a level that would not cause demand inflation.

Other reformers promote the idea of a universal basic income. Discussion of this concept would open an immense field and needs to take place, however here I would like to deal with the concept of employment only.

The policy of at least one NZ political party is that anyone who wishes to work should be guaranteed useful employment. Is this an outdated concept or is it realistic and why could it be necessary? I do believe that many people feel unwanted by society if they are not working, and in extreme cases may turn to crime. Is this a natural human reaction? Or is it simply a result or propaganda to which they have been subjected since childhood that can be countered by training them to cope happily with leisure, as is often suggested? Is it a concept that must eventually become outdated?

For the immediate future, my personal belief is that there is an immense amount of desirable, indeed almost essential, work that is not being done.

A few examples from NZ are:

(a) Proper care of the elderly and debilitated, which I think requires no explanation.

(b) Placing a second person in school classrooms to maintain discipline so that the teacher can teach for a considerably greater part of each hour instead of spending much or most of it dealing with unruly pupils. This would also help to reduce the imbalance where few men are now willing to go into teaching, partly because of the risk of having their careers wrecked by unfounded accusations from female pupils. Children are missing out on male influence at this stage. I am not exaggerating. I have spent part of my career teaching. My wife is one of the best classroom disciplinarians I have known. She still does some relieving at an average secondary school and simply has to ignore the fact that some in her classes just do no work whatever for the whole period.

(c) Putting more police on the beat. A glaring example occurred in a medium-sized little town north of here recently. Two visitors had their valuable mountain bikes stolen. Despite a reported sighting of them being ridden in a named street, police resources were so low that they could only give the owners a report number for insurance purposes.

(d) I'll gloss quickly over the absurdity of having idle men and machinery while badly needed road works remain in the planning stage for years ahead, owing to a claimed shortage of available funds. This situation is often resolved by setting up toll roads.

(e) In my own field, Forestry, I believe that I could usefully engage a large proportion of the whole country's unemployed willing workers within the northern peninsula region alone, in eradicating noxious weeds, culling pests, and fencing off and planting the sides of waterways to bring our filthy creeks and rivers back to a more civilised state.

Editorial comment: 1. The work embraced under the umbrella of a government guaranteed job scheme should not be targeted as being exclusively manual. Planning and management are also needed, and are likely to be more important at a base level.

2. Proposals for a universal basic income and for a national dividend are very different. Protagonists of the former scheme claim to provide citizens with the means to survive, even if frugally, and is envisaged as an entitlement for all citizens, not an unemployment benefit. It also has been argued that many citizens would feel obliged to top up this income with employment income, in order to provide a satisfactory standard of living for themselves and their family.

A national dividend, by contrast, may be thought of as a means of stimulating the economy by direct government payments into citizens' accounts. In Australia, the Rudd government did this following the GFC in 2009-10, which served to keep recession from Australia's door.

From Greg Reid

Challenges of the new energy paradigm

We are all children of the coal era but it is now coming to an end and much will have to change including the way we consume power.

The energy system in Australia is fragmented into numerous markets to be exploited by networks, retailers, speculators and generators of different types. The system is ineffectively controlled by regulators and joined through a national energy market (NEM) and the ASX Energy futures market.

Daily energy use typically varies about a third from late afternoon peaks to lows after midnight. During heat waves, air conditioning can push demand a third higher again and send wholesale prices in this inelastic market to 200 times their off peak lows [1]. This pattern is a consequence of ponderous Coal fired power stations that cannot respond to rapid changes and operate continuously regardless of demand. The result has been “baseload” or cheap off-peak power at night and on

cheap off-peak power at night and on

week-ends. Many industries and services have come to rely on this surplus power subsidised by higher prices in peak periods.

Gas turbine power stations can be “spun up” in a few hours but are a very expensive way to make power. In a properly functioning market these generators should respond to demand surges and so limit price spikes. Unfortunately this space is dominated by a few players skilled in arbitrage. Exports of LNG are creating a domestic gas shortage while consuming massive amounts of electrical power to liquefy their product. Timely failures at less efficient generators also help to drive profitable price spikes [2].

Fear of the spikes has driven the electricity futures markets to double over the past year [3]. In February in NSW, three brief price spikes added nearly a billion dollars to power costs. Our coal generators are already far beyond their design life and they must close down soon. Power shortages and price spikes will become more frequent unless there is rapid investment in new power sources with short construction times.

Solar and Wind power are now cheaper than coal or gas and can be constructed relatively quickly however without extensive energy storage it will be difficult to meet our expectations of limitless 24 hour power and so there is still plenty of room for profit by the fossil fuel generators. Of course it helps to delay and resist any coordination of a renewable energy transition.

One delay tactic is misinformation. An apparently credible report on “Energy Return on Investment” (ERoI) was cited in the last issue of ERA. Unfortunately, more technical and peer reviewed analysis shows that ERoI is repeated used to misrepresent renewables compared to incumbent energy generation [4]. Similar “studies” reported in the wider media blame renewables for power outages or power price rises. In this time of “alternative facts” reality is often very different and always more complicated than we would like.

Technology is advancing rapidly and now battery prices are falling. Large scale battery storage will help to reduce price spikes in the NEM. For households, the high retail price of electricity means that batteries make sense if you have solar panels. The spread of batteries will reduce off peak demand but not as fast as the contraction of off peak supply. For factories, sewage works, hospitals, supermarkets and other heavy power users that run day and night, batteries are not a panacea.

Pumped Hydro is paraded as the answer to everything but not only is its construction time too long to be helpful but it relies on some other unidentified cheap power source to pump the water back to the reservoir. Clearly there is no integrated plan or even market rules that drive investment in solutions such as solar thermal storage and continuous renewable power sources like ocean currents. The supply of off-peak power will continue to decline as coal stations close and the price differential between peak and off peak power must narrow or even reverse. The resulting pain will be felt in many parts of the economy to become reflected in the price of a wide range of essential goods and services.

Energy supply in Australia is a prime example of the flaws in privatisation, of market failure to look beyond near term profits, and of a political preference to lay blame rather than solve big problems. The absence of coherent planning means rising economic costs and inevitable casualties. Perhaps one casualty will be our expectation 24/7 power, after all, that is the norm in third world countries where the political process is corrupted by vested interests.

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The decadent international but individualistic capitalism in the hands of which we found ourselves after the war is not a success. It is not intelligent. It is not beautiful. It is not just. It is not virtuous. And it doesn't deliver the goods. - John Maynard Keynes

From Richard Giles

Re: Keating and the consequences of austerity

In this rather lengthy article in the Mar-Apr issue (pp.13-19) by Dr Rob Holmes many fiscal causes of the 1990 recession were carefully examined but its originating cause is omitted.

The 1990 recession originated in our ability to gamble with real estate prices. That ability comes from the privatising of economic rent which attaches to land titles.

Real estate is easily the largest form of investment in Australia. It is thus the hardest to control. When after 1985 land speculation ran rampant, as Dr Holmes reports, Keating was honest enough to say "after 1986 we lost control of the economy". Why was speculation hard to control? One reason was that, to allow interest rates to rise to control the rise in loans, would also knock out genuine investment in goods and services. A more compelling reason was that, it caused mortgages to collapse. That collapse in 1990 took an enormous amount of 'capital' out of the banking system. And that failure of credit caused a recession.

It was as Keating famously said "the recession we had to have". Why? Simply because the government cannot control rampant land speculation by fiscal policies, including "austerity".

This is the reason why government now cannot control land price speculation. Its dilemma is simple: the artificial rise in rents and land prices caused by speculation is bad for the economy but measures that will stop speculation threaten society with recession.

The answer is simple: take economic rent for the community that creates it. The tragedy is as Clarence Darrow once said, that this fiscal solution will be just about the last thing our society will ever do.

How Land Disappeared from Economic Theory

Editor

Anyone who has studied economics will be familiar with the 'factors of production'. The best known 'are 'capital' (tools, machinery, computers) and 'labour' (physical effort, knowledge, skills). The standard neo-classical production function is a combination of these two, with capital typically substituting for labour as firms maximize their productivity via technological innovation. The theory of marginal productivity argues that under certain assumptions, including perfect competition, market equilibrium will be attained when the marginal cost of an additional unit of capital or labour is equal to its marginal revenue. But there has always been a third 'factor': Land. Neglected, obfuscated but never quite completely forgotten, the story of Land's marginalization from mainstream economic theory is little known. But it has important implications. Putting it back in to economics, it is argued in a new book, 'Rethinking the economics of land and housing' [**1**], could help us better understand many of today's most pressing social and economic problems.

Thanks to Colin Cook for drawing our attention to the evonomics article on this topic by Josh Ryan-Collins:

1. http://evonomics.com/josh-ryan-collins-land-economic-theory/

To be a good economist, one cannot only be an economist

Lars Syll

Economics students today are complaining more and more about the way economics is taught. The lack of fundamental diversity - not just path-dependent elaborations of the mainstream canon - and narrowing of the curriculum, dissatisfy econ students all over the world. The frustrating lack of real world relevance has led many of them to demand the discipline to start develop a more open and pluralistic theoretical and methodological attitude.

There are many things about the way economics is taught today that worry me. Today's students are force-fed with mainstream neoclassical theories and models. That lack of pluralism is cause for serious concern.

However, I find the most salient deficiency in 'modern' economics education in the total absence of courses in the history of economic thought and economic methodology. That is deeply worrying since a science that doesn't self-reflect and ask important methodological and theoretical questions about the own activity, is in dire straits.

Methodology is about how we do economics, how we evaluate theories, models and arguments. To know and think about methodology is important for every economist. Without methodological awareness it's really impossible to understand what you are doing and why you're doing it. Methodology is a necessary and vital part of science.

Source: Real World Econ Rev, 21 Mar 2017
https://rwer.wordpress.com/2017/03/21/to-be-a-good-economist-one-cannot-only -be-an-economist/

The super stupid way to get your own piece of over-priced housing

Claire Connelly

IMAGE: Jeff Kubina, Flickr

Can't afford a home deposit? Want to help drive the already insane price of housing into the stratosphere? Claire Connelly unveils a few simple strategies.

I hate to burst your bubble, but allowing Australians to use their super to buy property is a really bad idea. When even the banks are calling for a calm on prices, you know there's a problem.

NAB chief Alan Olster said during March that housing markets in Sydney and Melbourne continue to 'defy belief', with median dwelling prices climbing up to nine times higher than gross household incomes in Sydney and seven times higher in Melbourne, on the back of surging investor demand.

There have been more than a handful of suggestions road-tested in the press about policies to make housing more affordable. Few, if any, will result in anything but higher prices.

Last week John Alexander, the Federal MP for Bennelong, suggested in a piece for The Huffington Post three core proposals to making housing more affordable

(a) Empowering APRA to target housing market volatility (even though it already has the power to do this, but generally hasn't).

(b) Allowing Australians to access their superannuation fund to pay for a property.

(c) 'Open up vast tracts of affordable housing supply by boldly taking action connecting the big cities with their regions via fast rail connectivity'.

Economist Philip Soos described allowing people to access their super to buy a property as a 'poor policy to further inflate housing prices'.

"The Liberals floated the policy back in 2016 suggesting high speed rail could link the cities to regional areas. It had little to do with transportation policy or housing affordability as opposed to spreading the bubble-inflated housing prices of the capital cities to regional areas instead," Soos told New Matilda. Alexander says he rejects the political opposition's housing policies because it could crash the market, but how could a market crash if there is no bubble?

"He is implicitly admitting to the existence of the bubble despite the fact the party doesn't want to admit it," Soos said.

"Allowing first homebuyers to access super will not make property more affordable. If anything, it will drive up demand and hence prices. They will simply draw upon what they have in their accounts to supplement their deposit or take upon a larger loan than they would otherwise have. All it does is increase demand further."

The policy is a rhetorical oxymoron.

"It's all about creating more affordable expensive property, that's what it is," he says.

Futurist Accountant and Accodex CEO, Chris Hooper told us that the Australian economy is now being propped up by immigration and the "seemingly endless foreign money".

"I'm not going to trust banks, politicians or boomer economists telling me there's nothing to worry about, when they all have investment property portfolios," he said.

Hooper described opening super to pay for property as "ponzi finance which will bankrupt a generation".

"The music will stop," he said.

Hooper decided to forgo the deposit he had saved for a house and put it into building a business instead.

"I'm not going to buy a house until I can pay for it in cash," he said. Having just turned 30, Hooper is one of many in Generation X and Y (we are not millennials - a topic for another conversation) who worry over Australia's rapidly increasing private debt.

In 1987, the median price of a home in Adelaide was $74,500. In Melbourne it was $89,500, Brisbane $63,500, Perth $61,225, Hobart $63,450, Darwin $81,075, Canberra $90,125, Sydney prices were already high in 1987, around $120,025.

"For my friends in Sydney, the ratio moves from 5.6 times in 1987 to 12.7 times in 2016," said Hooper. "If property

Houses in Glebe, Sydney. (IMAGE: andrea castelli, Flickr)

had kept track with inflation, then the Australian Bureau of Statistics' own calculator says that median house price should be $171,225. Sure, our average salary would only be $51,988, but at least those ratios would have stayed in check."

The average full-time ordinary earnings for the November '87 Quarter in South Australia was $435 a week or $22,620 a year, according to the ABS. In NSW the average was $451.40, In Victoria $454.10, in Queensland $432.60, In WA it was $461.10, Tasmania, $438.70, the NT $484.30 and the ACT $509.10. The average full-time ordinary earnings for the November 2016 Quarter in South Australia put weekly income at $1444.90 per week, according to the ABS or $75,134.8 a year. In New South Wales that figure is $1537.60 a week or $79,955 a year, Queensland $1480.00 a week or $76,960 a year, in WA the weekly earnings averaged $1701.80 a week or $88,493.6 a year, Tasmania $1344.10 weekly or $69,893.2 a year, The Northern Territory $1633.10 a week or $84,921.2 a year, the ACT $1744.00 a week or $90,688 a year, and Victoria, $1494.50 or $77,714 yearly.

Here's a reality check:

Over the last 12 months, Australia has lost 34,000 full-time jobs (in net terms) and added only 91,500 overall. In fact, Australia just marginally survived a technical recession. In November 2016, there were 725,000 unemployed people in Australia, according to the ABS.

Another 1,070,000 were underemployed (that is working part time or casual). There are another million or so people who are not included in these statistics because they either are unable to commence work within the next seven days, or haven't worked in the last four weeks.

Australia also happens to be second only to South Korea in aged pensioners falling below the poverty line. Household debt to disposable (after tax) income is now over 180%, to GDP it is about 125%. Private debt to GDP is just over 200%.

Do you know what happens when a bunch of people who don't earn enough money or work enough hours take on a buttload of debt to compensate for the fact that they don't earn enough – at work – to support even a basic standard of living? Let alone the unemployed, part-time workers, those for whom the cost of childcare or the care of a loved one, outweighs the benefit of a salary, or who cannot work due to illness or injury.

Bad things happen.

Roughly 40% of Australian jobs are predicted to be replaced by automation within the next 15 years. There has been no guarantee from any government that those workers will have new jobs to replace their old ones in different industries.

What happens if a business goes bust, or decides to outsource its workforce, and all of a sudden Australians who have been leveraged up to their eyeballs in debt can't make their mortgage payments? A glut of properties will hit the market - and POP! The bubble bursts. America's housing bubble burst when household debt to GDP ratio peaked at 98% in 2008. Australia's ratio is at 123% and rising.

Dr Steven Hail, economics lecturer at The University of Adelaide told us the elimination of involuntary unemployment and underemployment would raise GDP by at least $50 billion.

"The long term supply-side benefits and positive social benefits are far greater than $50 billion but would be incalculable without making a heroic set of assumptions," he said.

Economic insecurity – and instability – has come to such a point that even households many of us would consider to be 'well off' are just as – if not more vulnerable – to having the rug pulled out from under them.

This is not a single-generation issue it is one that reaches across all generations, classes, and communities.

The economist says it has been so long since the last property crash in Australia that many people don't remember what it is like and consequently have taken on so much debt that politicians don't dare allow house prices to fall.

"Instead, they grasp desperately at any idea that might support prices and hold off a price correction," said Dr Hail. This is just another in a long series of foolish ideas. Using super to prop up the property market would just add to and prolong the bubble, and make an eventual crash more probable and more severe."

Wealth inequality may mean that fewer people possess more of the country's income but it doesn't mean that the banks aren't forking out billions of dollars in loans to millions of Australians who have either borrowed too much, or who shouldn't have been borrowing at all. And I'm not just referring to millennials here. The relative security of what is left of the middle-class and those above the age of 40 will not protect the market from tanking when the bubble bursts, and burst it will.

Economist Philip Soos says that with interest rates bottoming out, the government has but two choices left: wage growth or lower prices. Prevention control could address issues of access and affordability. APRA already has this power but the economist says it has "sat on its hands between its inception in 1998 and December 2014", when it put a 10% annual limit on investor debt growth, while household debt and house prices increased rapidly over this period. “APRA has a wet lettuce leaf approach and the banks know it,” he says.

Tax concessions for property investors could also stand to be cut or eliminated entirely. Australia has world’s highest tax concessions relative to GDP, according to the IMF. The concessions are largely dominated by housing and super.

“You’ve got the 50% discount on capital gains tax for investors, including negative gearing,” says Soos. “The capital gains and land tax exemptions for homeowners amounts to tens of billions of dollars annually. We’ve not seen any reform of that. Of course there should be stringent macroprudential controls implemented to stunt household debt growth but that simply has not been done.”

“As Alexander wrote recently, he does not want prices to go down. Having talked to him personally he wants them to level off and go no further. This unfortunately allows existing owner-occupiers and investors to unfairly capture the unearned capital gains made over the last two decades.

“This policy sets one party against another. You can’t have existing owner occupiers and investors wanting higher prices while at the same time wanting to create more affordable prices for aspiring first time owners. There is a clear contradiction.”

The last thing we should be doing is letting first-home buyers give away their nest-eggs to finance a property. When that bubble bursts, people will lose their homes. There will be nothing left but a bunch of fire-sale priced homes that still no one can afford to buy and debt no one can afford to pay.

Source: NewMatilda,19 Mar 2017 https://newmatilda.com/2017/03/19/the-super-stupid-way-to-get-your-own-piece-of-over-priced-housing/

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Claire Connelly is an award-winning freelance journalist and the co-host of The Week In Start-Ups Australia podcast, specialising in economics, finance, policy, & technology. With more than a decade in the industry, she writes for publications which include The AFR, ABC, The Saturday Paper, SBS and The Age. She is currently working on her first book, *How the World Really Works*. Claire's website is: claireconnelly.com.au/hello-humans

More on Australia's housing market bubble

Editor

What defines a property bubble? A bubble is where investors drive prices higher due to expectations of future capital gains, rather than the income generated by an asset, such as rental from a house or unit.

Two years ago the Federal Treasury secretary John Fraser declared that a bubble exists in parts of the Sydney and Melbourne housing market. However such a declaration today would be a gross understatement. A recent article on the ABC News website by business reporter Michael Janda [1] provides the following revealing statistic:

" Household debt [in Australia today] is more than 200 per cent of disposal income, and 120 per cent of GDP ... "

Australia's housing market is in a bubble caused by the "neglect and drift"

of successive state and federal governments, economist and former Liberal leader John Hewson has concluded.

Speaking as part of a panel during a Lateline special on housing affordability [1], Dr Hewson said national economic data conclusively showed evidence of a housing bubble:

"I think it's a crisis, it is a bubble. I know people are hesitant in saying that it is a bubble .... however house prices have gone up 250 per cent since the middle '90s in real terms. "

Dr Hewson is not the only commentator to declare Australia has a property bubble. ASIC boss Greg Medcraft used the term almost two years ago and repeated it again during March.

The real danger for the economy of Australia's current housing bubble is that any rapid fall in property prices would most likely create a banking crisis, since our banks are heavily involved in providing mortgages and in financing property investments.

What all housing bubbles have in common

An article by Katherine Jimenez in *The Australian* on 16 June 2016 [2] entitled "Housing market a 'time bomb', says investment legend" discusses statements made by the legendary U.S. investor and cofounder of the huge global investment management firm GMO, Jeremy Grantham. He is considered an expert on asset bubbles, and reported a year before the GFC:

"In five years, I expect that at least one major bank (broadly defined) will have failed and that up to half the hedge funds and a substantial percentage of the private equity firms in existence today will have simply ceased to exist."

He also said on June 15 that Australia had an unmistakable housing bubble and that prices would need to come down by 42 per cent to return to the long-term trend.

"Australia is having one now. [House pricing is] near 7.5 times family income .... which suggests you are twice the size that you should be ... Bubbles have many things in common but housing bubbles have a spectacular thing in common, and that is every one of them is considered unique and different."

Mr Grantham described Australia's housing market as a "time bomb" just waiting for interest rates to increase and then becoming impossible to support.

1. ABC News website
http://www.abc.net.au/news/2017-03-22/property-bubble-called-by-former-liberal-leader-hewson/8375868

2. The Australian, 16 June 2016
http://www.theaustralian.com.au/business/housing-market-a-time-bomb-says-investment-legend/news-story/4a2a50abe1324fac50b0e63b661cf9e8

Government mismanagement and Australia’s debt time bomb

Steven Hail

If the federal government keeps discussing non-existent "black holes" instead of addressing fiscal policy, it is just a question of when, not if, the bubble will burst.

(Image via netrightdaily.com)

Australia faces major long-run economic challenges in the areas of climate change and energy policy, net migration and population growth, and provisioning for an ageing population.

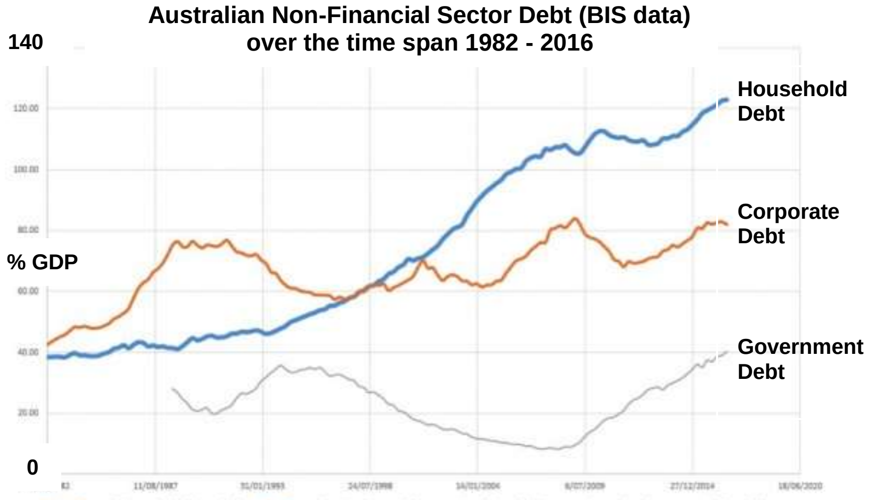
These issues are complex enough, but are currently being made to appear even more difficult to manage than they ought to be because the short-run economic management of the country is being so badly mishandled.

Like many countries, Australia has deregulated, privatised and financialised itself into a more insecure, more unequal, less tolerant society and, at the same time, created a mountain of household debt alongside an inflated property market, which now acts as a drag on economic prosperity and threatens the stability of the financial system.

Successive Governments have contributed towards these developments, while boasting about Australia’s now long period of avoiding what they have defined as a recession (an arbitrary definition, requiring real GDP to fall for two successive quarters) apparently unaware that this record was largely based on an increasingly precarious private debt mountain.

The blame might lie mainly with the Howard Government, but not exclusively so. The Hawke, Keating, Rudd, Gillard, Abbott and Turnbull administrations, have all played their part in getting us to where we are now.

And where are we? Well, let’s take a look at Australia’s debt, using a graph based on data provided by the Bank for International Settlements (BIS):



Australian Non-Financial Sector Debt (BIS data) over the time span 1982 - 2016

The above graph records the total debt of Australian households, Australian corporations which are not financial institutions and the Australian Government, relative to our national output in a year, going back to the 1980s.

What stands out from the graph? Corporate debt varies over time, but the ratio now isn’t so different to what it was 30 years ago. Government debt has been rising since 2009, as you would expect, but the ratio isn’t far above what it was in the early 1990s (and is very far below its level in previous decades, although that is not shown here).

What stands out is household debt — 30 years ago, Australian housing was affordable and Australian households had very little debt. Now, Sydney, in particular, is one of the most expensive places in the world to live and Australian households have a very high level of indebtedness. You can find one or two special cases around the world of countries with a higher ratio than us, including Norway and Switzerland, but it is reasonable to argue that Australia has become the world champion for household debt.

Is this a global phenomenon, or is it a particularly Australian one? Let me put it this way. In the late 1990s, countries classified as advanced economies by the BIS had about the same level of household debt as Australia. They now have a ratio of 76%. Ours is 123%. They never went collectively above an 85% ratio of household debt to GDP, although of course, individual countries did, even just before the global financial crisis (GFC).

Why, fundamentally, have we been running our economy in this apparently crazy way? We have become addicted to a rising property market and to mortgage debt. Mortgage lending was rising by up to 20% a year in Australia before the GFC and although the typical growth rate has fallen to well below 10% in recent times, mortgage debt has continued to grow, as house prices have continued to rise. Just look at the blue line on the graph. It paused and threatened to turn down when the crisis hit but in recent times it has been rising again — albeit not on its pre-GFC trend.

In recent years, bankers and regulators have become increasingly concerned about the ticking time bomb of household debt and uncertain of how to extinguish the fuse before it explodes, or of how powerful that explosion might be if and when it happens. Both the RBA (Reserve Bank of Australia) and APRA (Australian Prudential Regulatory Authority) have repeatedly warned of the dangers. They have caused the RBA to avoid further cuts in interest rates for fear of a further stimulus to household borrowing, and APRA to tighten up on its regulation of mortgage lending and investment mortgages in particular. It is this tighter regulation that has driven small increases in mortgage interest rates by most lenders recently.

And yet others have seemed unaware there is a problem, or unwilling to admit one exists and determined to "explain" the rise in house prices as purely the result of a housing shortage. They have either seen rising house prices as a sign that Australians are "more wealthy" (this will prove an ephemeral form of wealth if and when the market turns down) or used the bubble to argue for further deregulation of planning regulations.

Politicians, in particular, have been too intimidated even to consider reforms to the tax system which might limit further house prices and possibly trigger falling prices, have been happy to use subsidies to prop prices up and in many cases have accused their opponents of wanting to make Australian households poorer by pushing prices down. We have even lately seen the Turnbull Government advocating for the use of superannuation as a vehicle for forcing prices up yet further because that would be the effect of allowing the use of super to pay deposits on homes. Anything to avoid a downturn on your watch, Malcolm. Kick it down the road!

From where we are now, a property downturn with such a high level of household debt would be a major problem. It has the potential to severely impact Australian banks’ capital ratios and to even cause insolvencies within the financial system and force a government bail-out.

Exactly what is the solution? In the long run, we need to reduce the financialisation of our economy. This means taking a long hard look at financial deregulation, privatisation, private superannuation, and a whole range of other issues — such as the state pension and university tuition fees.

In the short run, we need to tighten up on mortgage lending a great deal more and accept that house prices need to fall. We need to wean our economy off its dependence on household debt and allow households to pay down their debts over time without that household saving driving the economy into a recession. It is true that supply side factors need to be addressed in the housing market but – as RBA research has demonstrated – it is simply not true that the Australian property bubble can be entirely explained as being due to a housing shortage. The financial factors that I have mentioned above are partly to blame for the bubble, with rising prices fuelling further debt, which drives prices up further.

Weaning our economy off household debt will require developing a willingness to produce significantly more of what in the graph is labelled "Government Debt". As I have explained elsewhere, Australian Commonwealth Government financial liabilities denominated in Australian dollars are not "debt" in the conventional sense at all. Our Government cannot run out of dollars, even though we very much can. Our Government, via its RBA, is a currency issuer; the rest of us are currency users. Technically they don't even need to issue "Government Debt" at all when they spend into the economy more Australian dollars than they tax out of it, although for more than 30 years now this is what they have chosen to do, virtually dollar for dollar.

Moreover, for us to net save and pay down our (private sector) debts, then absent an Australian current account surplus with the rest of the world, it is essential for the Australian Government to net spend. That is where the dollars we need to pay down our debts will have to come from.

Economies which have current account deficits, as ours has had, can't grow for long if their governments doesn't run budget deficits, because otherwise the growth has to be driven by an increasing ratio of private debt to GDP. This is, even more, the case in an economy which has been financialised, so that the amount of money sucked up by stock market and property market speculation is increasing.

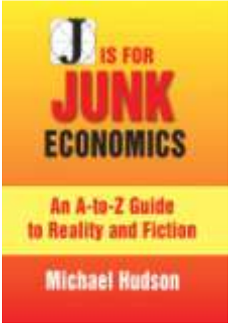
So the last part of my recommendations is firstly for the Australian Commonwealth Government to increase government investment in the economy and its deficit by 1.0-1.5% of GDP. There are many ways to do this, but dealing with those long-run challenges I mentioned at the beginning should be priorities. And secondly, for the rapid introduction of a voluntary, inclusive and extensive, locally managed but Federally funded job guarantee programme, to eliminate involuntary unemployment, underemployment and insecure employment, and to act as a shock absorber for the economy in the event of an economic downturn.

If politicians on both sides of Parliament keep calling for "a return to surplus" and discussing non-existent and essentially meaningless "budget black holes", in ignorance of the appropriate role for fiscal policy in stabilising an unstable economy and of the damage caused to Australia by the Howard "surplus", then all I can recommend to you is that you prepare yourself for a bumpy ride when that bubble deflates.

It is just a question of when — not if.

Dr Steven Hail is attached to the University of Adelaide, and has special interests in macroeconomics and finance. He is also an ERA member.

Recommended book: J is for Junk Economics, by Michael Hudson

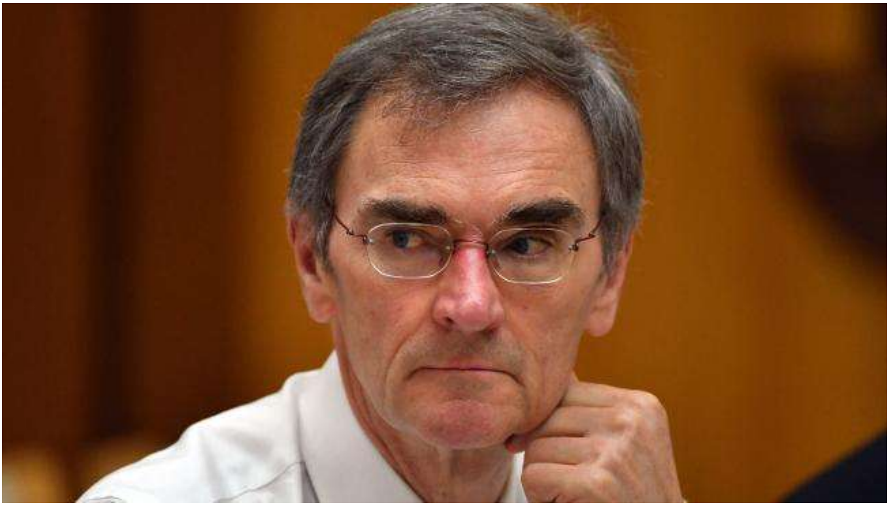


In this follow-on to his book ***Killing the Host*** **(2015),** Professor Michael Hudson discusses how mainstream economic vocabulary has been contorted to obscure the manner in which financial giants extract wealth from rest of the economy. This A-Z user's guide will serve as critical reading for those seeking to understand the broader economic system during this new "post-fact" era.

From Dr Paul Craig Roberts: "If you want to learn real economics, instead of neoliberal junk economics, read Michael Hudson's books. What you will learn is that neoliberal economics is an apology for the rentier class and the large banks that have succeeded in financializing the economy ... "

ASIC chairman talks about the risk of mortgage crash

Editor



ASIC chairman Greg Medcraft.

An article by Michael Roddan in the Australian on 7 April [1] reports that the corporate watchdog ASIC (Australian Securities & Investments Commission) has stepped up warnings on the outlook for the housing market, "raising the fear that the hot east coast property scene resembled the US ahead of the sub-prime mortgage crash".

The chairman of ASIC, Greg Medcraft, commented that observing the local -property rush was “like groundhog day”. He urged regulators and banks to be vigilant about responsible lending standards, which he said had been overlooked amid surging prices in both the Sydney and Melbourne property markets. While addressing a forum in Sydney on 6 April, he said:

“ What happened in the subprime housing collapse in the U.S. was people were getting loans that they should never have been getting.

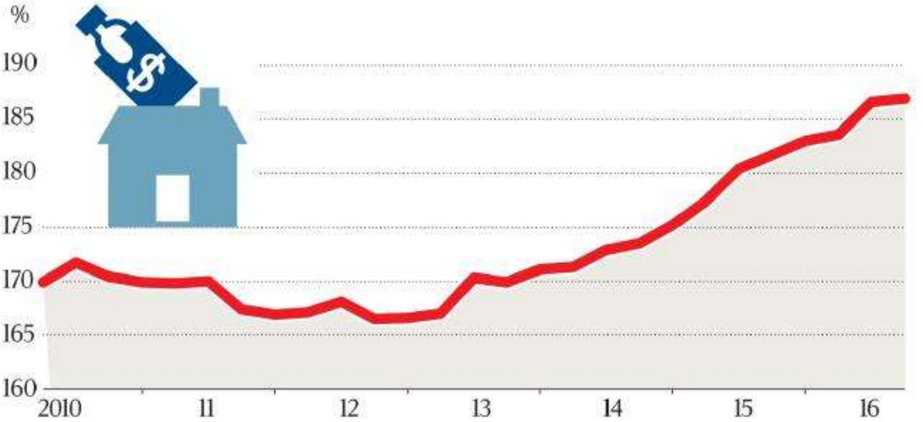
“ The sad thing is, markets will adjust but people often never recover. The big concern I have is the human factor. What happens when interest rates go up and you discover you can’t pay the mortgage?

“ I’ve funded billons of mortgages around the world, I’ve looked very closely at residential market risks. It’s not so much about the property price; my big concern is that people are realistic. Rising costs of living, fairly low wages growth - when you think about your future in borrowing, be realistic about the amount you have to pay back. "

Moody’s credit rating agency has drawn attention to rising mortgage stress, with new data indicating that the proportion of Australian home loans more than a month in arrears rose to 1.52 per cent in November, up from 1.2 per cent in the previous corresponding period. According to Moody’s vice-president and senior analyst Alena Chen:

“ We expect mortgage delinquencies to continue to increase over 2017.

Household debt as per cent of household disposable income



Source: Moody's

" Weaker conditions in states reliant on the mining industry, high underemployment and less favourable housing and income dynamics will drive delinquencies higher."

APRA demands more bank capital

APRA (the Australian Prudential Regulatory Authority) has indicated that it intends to impose tough new capital reserve rules on commercial banks in order to make them "unquestionably strong". It will be limiting the amount of higher-risk interest-only loans written by banks, which now account for about 40 per cent of lending in the market.

And ASIC is taking legal action against Westpac over alleged breaches of responsible lending practices, and in particular failing to adequately ensure that borrowers could pay down their mortgages.

Morgan Stanley analyst Richard Wiles recently said that:

" the case for even more [bank] capital is justified by Australia's high systemic risk"

and noted that CBA and Westpac faced the greatest challenge to meet the new APRA rules given their large investor loan books.

Source:

1. Michael Roddan, "ASIC boss Greg Medcraft warns of housing pain", The Australian, 7 April 2017

http://www.theaustralian.com.au/business/economics/asic-boss-greg-medcraft-warns-of-housing-pain/news-story/a0c8595c02a5751464066edd712e4fd5

The privilege of creating and issuing money is not only the supreme prerogative of government, but it is the government's greatest creative opportunity. - Abraham Lincoln

Once you realize that trickle-down economics does not work, you will see the excessive tax cuts for the rich as what they are -- a simple upward redistribution of income, rather than a way to make all of us richer, as we were told. . -- Ha-Joon Chang

The best way to boost the economy is to redistribute wealth downward, as poorer people tend to spend a higher proportion of their income. -- Ha-Joon Chang

Mainstream understanding of inflation may be all wrong

Editor

How much money a central bank creates may be less important to inflation than commodity prices

The Wall Street Journal recently published an article (March 6, 2017) by Jon Sindreu [1] which challenges the myths propagated by mainstream macroeconomists. Prof Bill Mitchell referred to this article and its implications in a recent blog" [2]. According to Mitchell:

" Mainstream macroeconomics is largely fake knowledge. It has been categorically exposed by the deviations from usual behaviour in the lead up and following the GFC (Global Financial Crisis).

" There we have seen major policy shifts, new policy initiatives (building massive bank reserves), large fiscal deficits, and more – and, one by one, the main predictions of mainstream macroeconomics have come to nought.

" But we didn't need the GFC to expose the fallacies of mainstream macroeconomics. The Japanese economy has been doing a good, real world job of that for two and a half decades now "

In his article, Sindreu makes the following points:

" No number is more important for investors right now than inflation. The belief that it will continue to rise underpins the recent rally in financial stocks and the slump in government bonds. It is key to commodities, currencies and more. Yet investors are in a quandary: Theories used to forecast it just don't seem to work.

" ... For decades, the assumption has been that central banks have the ultimate handle on inflation. When inflation goes up, they raise interest rates to quell it; when it goes down, they lower the rates. Investors care a lot, because bond yields broadly track interest rates. They need to predict inflation levels as well as how central banks would react. "

However, after many years of post-GFC experimentation, it is unclear whether the tools traditionally used by central banks can do much to influence inflation at all. A recent conference paper by Ceccetti et al [3] indicates that the main gauges used by policymakers for understanding inflation (such as slack in the labour market) do not actually explain it.

It has been commonly believed within financial markets that inflation is ultimately a function of how much money a central bank creates. This was also Milton Friedman's view. In the wake of the GFC, a number of major central banks slashed interest rates and created trillions of dollars, euros, pounds and yen. When this happened, many investors and policy makers assumed that inflation would quickly soar, accompanied by a sell-off of government bonds. However neither of these things happened.

The research reported by Ceccetti et al is consistent with the following:

(a) The quantity of money created by central banks is a consequence of rising prices, not the cause.

(b) There is little connection between people's expectations of future inflation and what prices actually turn out to be.

(c) Lower interest rates are not a key factor in the decisions of households and businesses to take on more debt and spend more.

What, then, causes an unacceptably high level of inflation? In order to fix our bearings, we will assume that the central government maintains levels of net spending that can be accommodated by the real economy without generating inflationary pressures. According to Sindreu:

"... historically, a better guide to inflation [than simple assumptions about demand-pull] has been prices of raw materials, largely commodities. Swings in oil markets and market expectations of long-term inflation have moved in lockstep. Arend Kapteyn, chief economist of UBS's investment bank, calculates that 84% of inflation variations since 2002 is explained by shifts in oil and food prices.

" Demand may play a small role indeed in fuelling inflation. Research finds that businesses rarely price their products based on how much they are able to sell. Rather, companies pass on to consumers as much of their costs as competition will allow. Throughout history, most sudden spikes in inflation were preceded by rising commodity prices pushing up costs. "

References:

1. Jon Sindreu, *Everything the Market Thinks About Inflation Might Be Wrong*, https://www.wsj.com/articles/everything-the- market-thinks-about-inflation-might-be-wrong-1488796206

2. Bill Mitchell blog, 15 Mar 2017, *When fake knowledge peddled by macro-economics starts to fail the 'investors'* http://bilbo.economicoutlook.net/blog/?p=35549

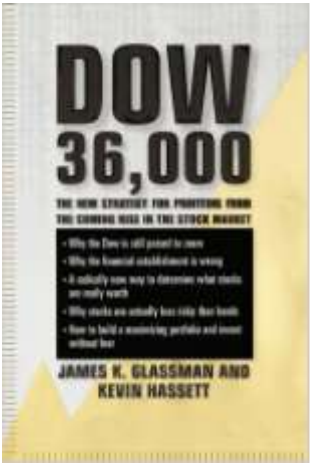
3. U.S. Monetary Policy Forum (Conference) March 2017, *Deflating Inflation Expectations: the implications of inflation's simple dynamics* https://research.chicagobooth.edu/~/media/806FC2DED9644B5DA99518D2B07CC637.pdf

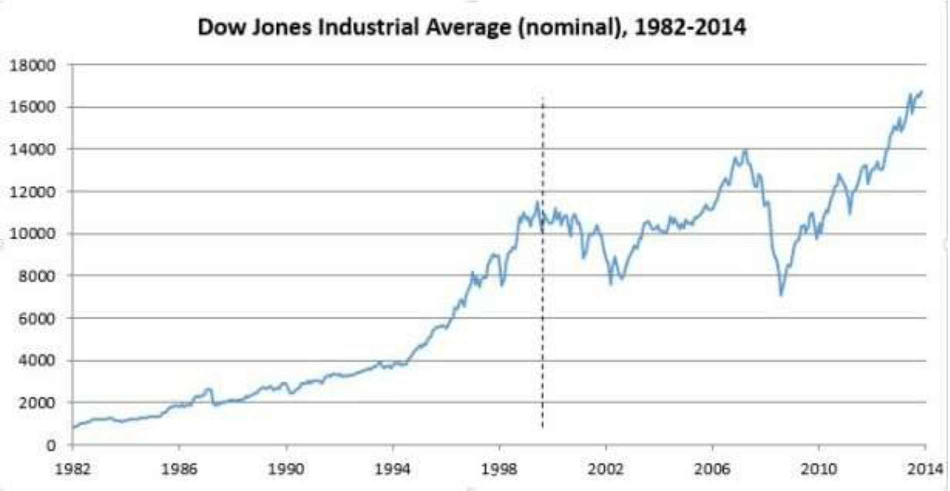
Trumponomist

David Ruccio

According to recent news reports, Kevin Hassett, State Farm James Q. Wilson Chair in American Politics and Culture at the American Enterprise Institute (no, I didn't make that up), will soon be named the head of Donald Trump's Council of Economic Advisers.

Yes, that Kevin Hassett, the one who in 1999 predicted the Down Jones Industrial Average would rise to 36,000 within a few years. Except, of course, it didn't. Not by a long shot. The average did reach a record high of 11,750.28 in January 2000, but after the bursting of the dot-com bubble, it steadily fell, reaching a low of 7,286 in October 2002. Although it recovered to a new record high of 14,164 in October 2007, it crashed back to the vicinity of 6,500 by the early months of 2009. And, even today, almost two decades later, it's only just cracked the 20,000 barrier.


DOW
36,000
THE NEW STRATEGY FOR PROFITING FROM THE COMING RISE IN THE STOCK MARKET
JAMES K. GLASSMAN AND
KEVIN HASSETT



But, no matter, mainstream economists and pundits - like Greg Mankiw, Noah Smith, and Tim Worstall - think Hassett is a great choice.

Perhaps, in addition to his Dow book, they want to place the rest of Hassett's writings on an altar.

Like Hassett's claim is that "lowering corporate taxes is the only real cure for wage stagnation among American workers."

Or his other major, that poverty and inequality in the United States are merely figments of our imagination.

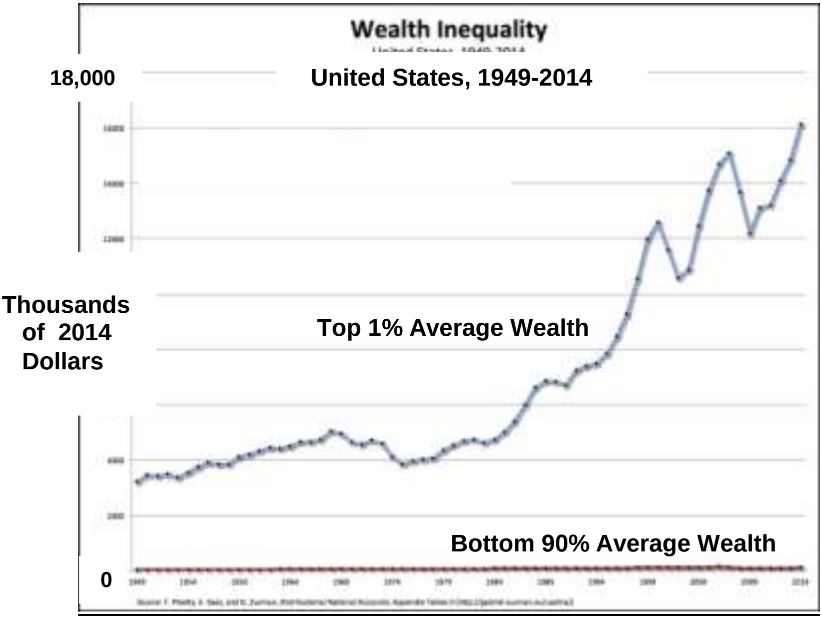
Let's focus on that last claim. As my regular readers know, income inequality - whether measured in terms of fractiles (e.g., the 1% versus everyone else) or classes (e.g., profits and wages) - has been increasing for decades now. But for conservative economists like Hassett (who was an economic adviser to Mitt Romney before being a Trump team candidate), inequality has not been growing and poor people are actually much better off than they and the rest of us normally think. What they do then is substitute consumption for income and argue that consumption inequality has actually not been growing.

So, what's the big problem?

But even in terms of consumption they're wrong. As Orazio Attanasio, Erik Hurst, Luigi Pistaferri have shown, once you correct for the measurement errors in the Consumer Expenditure Survey (which Hassett and his coauthor, Aparna Mathur, don't do), and bring in other sources of consumption information (including the well-regarded Panel Study of Income Dynamics), consumption inequality has increased substantially in recent decades - more or less at the same rate as inequality in the distribution of income.

Overall, our results suggest that there has been a substantial rise in consumption and leisure inequality within the U.S. during the last 30 years. The rise in income inequality translated to an increase in actual well-being inequality during this time period because consumption inequality also increased.

And, remember, that doesn't take into account other forms of inequality, such



as the increase in the unequal distribution of wealth, which has exploded in recent decades. The poor and pretty much everyone else - the 90 percent - are being left behind. It’s the spectacular grab for income, consumption and wealth by the small group at the top that Hassett and the new administration will be trying to protect.

Source: Real World Econ Rev, 7 May 2017 https://rwer.wordpress.com/2017/ 03/07/trumponomist/

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Time for new economic thinking using the best science available

Eric Beinhocker

If 2008 was the year of the financial crash, 2016 was the year of the political crash. In that year we witnessed the collapse of the last of the four major economic-political ideologies that dominated the 20th century: nationalism; Keynesian Pragmatism; socialism; and neoliberalism. In the 1970s and 80s the centre right in many countries abandoned Keynesianism and adopted neoliberalism. In the 1980s and 90s the centre left followed, largely abandoning democratic socialism and adopting a softer version of neoliberalism.

For a few decades we thought the end of history had arrived and political battles in most OECD countries were between centre-right and centre-left parties arguing in a narrow political spectrum, but largely agreeing on issues such as free trade, the benefits of immigration, the need for flexible efficient markets, and the positive role of global finance. This consensus was reinforced by international institutions such as the IMF, World Bank, and OECD, and the Davos political and business elite.

In 2008 that consensus was rocked, last year it crumbled. Some will cling on to the idea that the consensus can be revived. They will say we just need to defend it more vigorously, the facts will eventually prevail, the populist wave is exaggerated, it's really just about immigration, Brexit will be a compromise, Hillary Clinton won more votes than Trump, and so on. But this is wishful thinking. Large swathes of the electorate have lost faith in the neoliberal consensus, the political parties that backed it, and the institutions that promoted it. This has created an ideological vacuum being filled by bad old ideas, most notably a revival of nationalism in the US and a number of European countries, as well as a revival of the hard socialist left in some countries.

History tells us that populist waves can lead to disaster or to reform. Disaster is certainly a realistic scenario now with potential for an unravelling of international cooperation, geopolitical conflict, and very bad economic policy. But we can also look back in history and see how, for example, in the US at the beginning of the 20th century Teddy Roosevelt harnessed populist discontent to create a period of major reform and progress.

So how might we tilt the odds from disaster to reform? First, listen. The populist movements do contain some racists, xenophobes, genuinely crazy people, and others whom we should absolutely condemn. But they also contain many normal people who are fed up with a system that doesn't work for them. People who have seen their living standards stagnate or decline, who live precarious lives one paycheque at a time, who think their children will do worse than they have. And their issues aren't just economic, they are also social and psychological. They have lost dignity and respect, and crave a sense of identity and belonging.

They feel – rightly or wrongly – that they played by the rules, but others in society haven't, and those others have been rewarded. They also feel that their political leaders and institutions are profoundly out of touch, untrustworthy, and self-serving. And finally they feel at the mercy of big impersonal forces – globalisation, technology change, rootless banks and large faceless corporations. The most effective populist slogan has been “take back control”.

After we listen we then have to give new answers. New narratives and policies about how people's lives can be made better and more secure, how they can fairly share in their nation's prosperity, how they can have more control over their lives, how they can live with dignity and respect, how everyone will play by the same rules and the social contract will be restored, how openness and international cooperation benefits them not just an elite, and how governments, corporations and banks will serve their interests, and not the other way around.

This is why we need new economic thinking. This is why the NAEC initiative is so important. The OECD has been taking economic inequality and stagnation seriously for longer than most, and has some of the best data and analysis of these issues around. It has done leading work on alternative metrics other than GDP to give insight into how people are really doing, on well-being. It is working hard to articulate new models of growth that are inclusive and environmentally sustainable. It has leading initiatives on education, health, cities, productivity, trade, and numerous other topics that are critical to a new narrative.

But there are gaps too. Rational economic models are of little help on these issues, and a deeper understanding of psychology, sociology, political science, anthropology, and history is required. Likewise, communications is critical – thick reports are important for government ministries, but stories, narratives, visuals, and memes are needed to shift the media and public thinking.

So what might such a new narrative look like? My hope is that even in this post-truth age it will be based on the best facts and science available. I believe it will contain four stories: (1) A new story of growth, (2) A new story of inclusion, (3) A new social contract, (4) A new idealism.

This last point doesn't get discussed enough. Periods of progress are usually characterised by idealism, common projects we can all aspire to. Populism is a zero-sum mentality – the populist leader will help me get more of a fixed pie. Idealism is a positive-sum mentality – we can do great things together. Idealism is the most powerful antidote to populism.

Finally, economics has painted itself as a detached amoral science, but humans are moral creatures. We must bring morality back into the centre of economics in order for people to relate to and trust it. All of the science shows that deeply ingrained, reciprocal moral behaviours are the glue that holds society together. Understanding the economy as not just an amoral machine that provides incentives and distributes resources, but rather as a human moral construct is essential, not just for creating a more just economy, but also for understanding how the economy actually creates prosperity.

In short, it is time to forge a new vision that puts people back at the centre of our economy. To paraphrase Abraham Lincoln, it is time to create an economy that is "of the people, by the people, for the people." We are truly at a fluid point in history. It could be a great step backwards or a great step forwards. We must all push forwards together.

Based on remarks originally delivered to the OECD New Approaches to Economic Challenges workshop, December 14, 2016, Paris.

Source: Evonomics, 31 Jan 2017 http://evonomics.com/time-new-economic-thinking-based-best-science-available-not-ideology/

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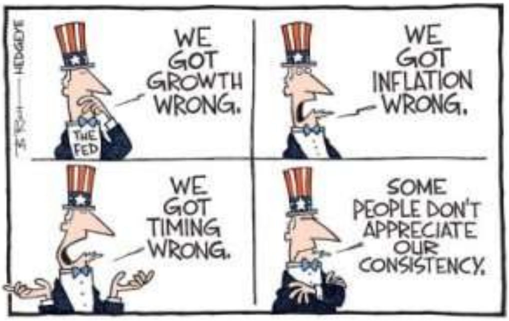
HEDGEYE
WE GOT GROWTH WRONG.
THE FED
WE GOT INFLATION WRONG.
WE GOT TIMING WRONG.
SOME PEOPLE DON'T APPRECIATE OUR CONSISTENCY.

What I cannot understand is what leads someone … to argue against the use of evidence, and instead that "economics is primarily a way of organizing one's thinking".

Astrology is also a way of organising one's thinking, but it fails because evidence does not back it up.

-- Simon Wren-Lewis

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