

Economic Reform Australia Review



For a just and sustainable society

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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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ECONOMIC REFORM AUSTRALIA (ERA)

ERA is a not-for-profit, non-party-political organisation, formed in 1993 as a union of the Economics Review Association and other reform groups. Its long-term goal is to achieve a socially, environmentally and financially sustainable economic system. ERA's commitment to economic sovereignty seeks to return control of the economic and financial system to the people. This requires full public scrutiny and accountability for all economic processes and a recognition that economic systems must serve the people for the global good.

Membership of ERA is open to all who agree with its objectives and overall philosophy, and may be effected by forwarding A\$20.00 per annum (A\$15 concession; A\$10 extra for each additional family member) to the Treasurer (address below), together with address, telephone and fax numbers, and email address. It would be appreciated if new members would calculate the part of the year remaining and remit the appropriate pro-rata amount, with the option of paying for the following year as well (make cheques out to E.R.A.) All members are entitled to receive the regular ERA publication *The ERA review*, and to vote at ERA meetings and participate in organized activities.

ERA's Patrons

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Meetings are held on the last Saturday of each month at the SA Conservation Centre, 157 Franklin Street, Adelaide, SA 5000 (Level 1). Meetings begin at 2pm. Details: Tel: (08) 8264 4282

Items suitable for publication may be sent to any member of the editorial committee. Please contact John Hermann if you wish to receive the ERA Review electronically as an email attachment, instead of as a posted copy

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Austerity budgeting

In this issue we address claims made by members of the current federal government that austerity budgeting is necessary because there is a "budget emergency", and we also provide evidence that there is no such thing as a sustainable budget surplus. Moreover available statistics reveal that government budgets have usually been in deficit for a very long period of time, both in Australia and in most other countries. Arguments are provided for the view that this is in fact a good thing.

ERA annual general meeting 2014

The 2014 annual general meeting of Economic Reform Australia was held in Adelaide on 31 May, and the following ERA members were appointed to the positions indicated:

President – Darian Hiles, Secretary – John Hermann, Treasurer – Leona Hermann, Public Officer – Dick Clifford, Membership Officer – Hugh Wigg, Minute Secretary – Michael Plowright.

President's Report

ERA continues to expand its contribution to the economic debate, with lectures in South Australia, the sponsorship of lectures interstate and the distribution of the excellent ERA Review to Australian states, New Zealand, U.S. and Canada.

The ERA Review is well respected and continues to receive strong praise. We congratulate John Hermann for his editorship of this publication and the Editorial Committee for their support.

Work has also begun on restructuring the ERA website and the result is now on track to be a major improvement that will greatly extend our penetration in the general debate on matters economic, particularly at a national level.

The current Federal budget is a particular target and we sincerely hope we can make an impact and contribute to a fundamental change in this unexpectedly critical issue for the nation today.

Darian Hiles

Secretary's Report

The process of structural change has continued for ERA during the past twelve months. Some notable events include:

1. The name of the association was changed to Economic Reform Australia Inc, in line with the national restructuring. ERA also has been successfully registered with ASIC as an incorporated national entity.
2. The position of public officer was taken up by Dick Clifford, and there were recent changes of Treasurer (to Leona Hermann) and Membership Officer (to Hugh Wigg), following Victoria Powell's resignation from these positions.
3. It was agreed to contract a website designer for restructuring the ERA website.
4. The following public meetings were held:
 - (a) Lecture by Prof Frank Stilwell, 22 August 2013, at the UniSA (Hawke Institute), co-sponsored with Australian Options.
 - (b) Late December 2013 meeting (four speakers) at the CCSA city building.
 - (c) Lecture by Dr Geoff Davies on 25 March 2014 at Univ of Adelaide, co-sponsored with the Futures Foundation.
5. The ERA Review was changed to double column format, with spacing changes, font size changes, and abandonment of right justification.
6. We had a presentation at the March meeting from Mr Pas Forgione on behalf of the SIMPIa campaign, which ERA supports.
7. A protocol was constructed and approved for the conduct of ERA meetings.

John Hermann

Economic development and public investment

Felipe Rezende

You may check James K. Galbraith's interesting conference paper "The Macroeconomic Considerations of a Public Investment Strategy" [1]. An important point is that "contrary to popular myth, U.S. economic development has never been solely the result of private investment." He goes on to demystify the belief that government deficits crowd out private investment and that the U.S. federal government relies on foreigners to finance its spending.

Interest rates

"Critics assert that efforts to expand the scope of the public sector will drive up interest rates and crowd out private business investment. The accusation is particularly likely to be heard when a proposal explicitly foresees the use of the credit market, deficits, and public debt to finance the expansion.

"Are these fears justified? There is a two-part answer to this question, the first related to economic theory, and the second to the specific conditions facing the United States in the world credit markets. The "crowding out" theory is based on a commonly held misconception of the nature of savings in our economy, namely the idea that savings are a "pool," fixed in size, from which the public and private sectors alike draw to finance their desired rates of spending.

"No such pool exists. Rather, what we measure as savings is created after the fact, by the spending decisions of governments and private businesses. These decisions create income; the

difference between income and consumption (the latter strongly established by habit), is savings... We can conclude, first, that there is no direct connection between federal budget deficits or surpluses and long-term interest rates."

Financing abroad and the dollar

"The deficit in the external accounts is the accounting counterpart - the exact equal - of the sum of public and private sector deficits in the domestic economy.

"This phenomenon is often referred to as "borrowing from foreigners to finance current consumption," but again the shorthand is misleading. When an American purchases a Japanese car, credit is created and extended by an American bank.

"Rather, a bank loan made in the United States has created a dollar asset, which subsequently has been purchased by an institution (the Bank of Japan) that has no immediate use for it and merely chooses to store it in a liquid, interest-bearing form."

Source: New Economic Perspectives
<http://neweconomicperspectives.org/2009/06/economic-growth-and-public-investment.html>

Reference: Prof J.K. Galbraith
 <http://www.newamerica.net/files/NAF_PubIivInvest_color.pdf>



Asst Prof Felipe Rezende PhD teaches economics at Hobart & William Smith Colleges, Geneva NY, and has written articles for New Economic Perspectives.

 Economists must set aside their contempt for other disciplines and their absurd claim to greater scientific legitimacy, despite the fact that they know almost nothing about anything.
 Thomas Picketty

Mainstream economists do not understand banking

John Hermann

The following quotes from famous heterodox economists and leading central bankers reveal that they understand something about the nature of banking which we know is simply denied by many mainstream economists. Namely, that banking institutions around the world create new bank credit money in the process of advancing retail loans, as well as when they buy goods and services from the non-bank private sector.

Moreover, as has been pointed out on many occasions by ERA patron Prof Steve Keen, the change in net debt arising from bank lending makes a significant contribution to economic performance and aggregate demand.

The fact that so many neoclassical economists have failed to grasp these important aspects of the mechanics of modern banking, as well as the reality that money creation by banks occurs



The process by which banks create money is so simple that the mind is repelled.

John Kenneth Galbraith - Economist



Banking is not money lending: to lend, a money lender must have money.

Hyman Minsky - Economist



Of all the many ways of organising banking, the worst is the one we have today.

Sir Mervyn King - Former Governor, Bank of England



In the real world, banks extend credit, creating deposits in the process, and look for the reserves later.

Federal Reserve Bank of New York (1969)



The financial crisis of 2007/08 occurred because we failed to constrain the private financial system's creation of private credit and money.

Lord Adair Turner, former chairman of Financial Services Authority, United Kingdom

endogenously (rather than being under the direct control of the central bank, as many mainstreamers seem to assume) is nothing short of a major intellectual scandal. And their ignorance of the underlying mechanics of banking is hindering their ability to adequately analyse and deal with the world's pressing economic problems.

The previous issue of ERA Review contains two excellent articles, by Steve Keen and Geoff Davies, which flesh out the abysmal failure of the economic mainstream to reappraise their theoretical models in the light of their inability to predict the financial crisis of 2007-8. And with very few exceptions, their second failure has been their inability to take a big bite of humble pie, a necessary precursor for bringing their models into alignment with the basic realities of banking as understood by central bankers.

John Hermann is the ERA network editor

Congratulations Steve Keen

ERA patron Prof Steve Keen was recently appointed Head of the School of Economics, History and Politics at Kingston University in

London. He takes up the position in time for the beginning of the Autumn term, which begins on September 23. Australia's loss is Britain's gain.

Comment on economic rent **Richard Giles**

The editorial comment to my article in Vol. 6 No.3 of *ERA Review* that there are economic rents other than the rent of land invites some discussion.

Certainly that is said to be the case. An economic rent is often defined as an income in excess of what is needed to induce one to enter an industry. That is, it is an income in excess of a 'normal return' to labour or capital, otherwise known as a 'surplus profit'.

But is a surplus profit an economic rent or is it just something that looks like an economic rent, a *quasi-rent* as Alfred Marshall called it? It is but common sense to suggest that, if the concept of rent above is not the concept of rent in its original sense, then what we are talking about are two different things that ought to have two different names.

In its original Ricardian sense rent is not a *profit*. It is a surplus *production* over what the same application of labour and capital yields on marginal land. Rent exists before the market that distributes that production. It is a natural law.

This natural phenomenon should not be confused with either what western civilisation has done to the law of rent by creating private property in land or with the corrupt-ions of government that lead to 'surplus profits' from artificial scarcities based on mono-poly. In the latter case there is no surplus production - rather the reverse.

The only 'industry' involved in what is nowadays called economic rent is the industry of reaping where you have not sown. Location, from which rent arises, is not an industry.

It is said that Frank Sinatra's voice has a rent or the Collingwood football team has a rent but this is only to confuse rent with wages.

Richard Giles is a NSW member of E

News and views from New Zealand **Inflated expectations** **Dennis Dorney**

The state of the NZ economy seems to depend on who you ask. In recent months the government has been claiming that we have a 'rock star economy', a phrase created by a bank economist and picked up by the government as an endorsement of its economic policies. It is not surprising that the banks think all is well since they have once again reported record profits but a closer examination of the detail shows little that the government can be proud of. For most people the 'recovery' has passed them by.

The case for the prosecution depends on infrastructure activity in Auckland and Christ-church and overseas earnings from our dairy industry. The evidence however is that all of these factors have been mishandled and are doing more harm than good, especially to those parts of New Zealand which are too remote from these hot spots to derive any benefit.

I have mentioned in previous reports that a housing bubble, confined mainly to Auckland and Christchurch, has been building for some time to the point where houses are now too expensive for new-home buyers. This

is mainly due to a rapidly increasing population and a shortage of houses, due to government neglect in the case of Auckland, and to the earthquake in the case of Christchurch.

Since it is not possible to provide large numbers of houses at short notice, the Reserve Bank has limited demand by forcing banks to require larger deposits on mortgages. The result has been a drop in house sales, especially in the cheaper end of the market, but the fundamental problem of too few houses remains.

However higher house and house utility prices has caused 'inflation' to rise. The one and only tool that the Reserve Bank has to fix inflation is to increase the Official Cash Rate (OCR), which after a very long time at 2.5% was raised to 3% in April, with a promise of more to come. If the restrictions on house buying leads to lower prices, the outcome may be mortgage holders falling into negative equity - again. Ever since the 2007 housing bubble burst there has been on average about 1000 forced mortgagee sales per year. Here we go again playing the same old tune.

The sad thing is that the image of the white knight, Reserve Bank, slaying the dragon of inflation is a myth. Recently in response to an inquiry the Reserve Bank gave the conventional definition that 'inflation is too much money chasing too few goods'. It might be permissible to refer to house price inflation because it is clearly true that the banks are shovelling too much money into too few houses, but in general what is called inflation should be more properly called dollar devaluation, which is rather different.

When new money is created by the

banks, there is no corresponding increase in goods, which in any case are not in short supply (witness all the retail sales). Effectively this devalues the currency. It can be argued that the debt gets repaid so it is a zero sum game, but that cannot be said of the interest on the loan, which remains in circulation forever.

The Reserve Bank's one and only tool against inflation therefore causes inflation and is ineffective. In the present context it will be highly damaging to the economy because the 'inflation' is limited to Auckland and Christchurch but mortgage holders everywhere will have higher loan repayments.

Also the overseas returns on milk products are sliding; dairy farmers will have to repay more on their loans, which amount to \$32 billion and some will definitely be in trouble. This is the product on which our economy depends. So what was the inflation figure that Graeme Wheeler, Governor of the Reserve Bank, found it necessary to battle? In the first quarter of 2014 it was just 1.5% ! Something is sadly amiss in the world of economics.

In the case of Christchurch the rebuild following the earthquake, that is helping fuel the housing bubble, has another side effect which will hamper New Zealand for decades.

The earthquake revealed the structural deficiencies of much our past housing stock. The Government has been loath to get involved in meeting the cost of the rebuild and has left the bulk of the cost in the hands of the insurers. The rest of the costs it is sharing with Christchurch Council, which seems to be a brutal expect-

ation to impose on a stricken Council. Apart from leaving as much as possible to the free market, it has also decided that all buildings must be upgraded to meet higher earthquake-proofed standards. If a building cannot be economically upgraded, it will almost certainly have to be bulldozed.

This market-driven approach has produced serious unintended consequences. Most of the underground infrastructure, belongs to local councils, who cannot now afford to pay the premiums for those assets. Some are self insuring, some not insuring at all.

Virtually all heritage buildings do not meet the required standards, and their heritage value cannot be assessed in purely commercial terms. These may not be insurable either. Dunedin has a huge number and their value as a tourist attraction is immense but their private owners want a commercial return. Dunedin City Council, up to its neck in debt, can't afford to buy them. What a mess!

Dennis Dorney is an ERA member living in New Zealand

Theoclassical economists are basically immoral

William K Black

The failures of theoclassical economists and economics are total and myriad. Many of their theories are long-falsified dogmas. Their methodological preference is econometrics – which gives the worst possible results in bubbles and when accounting control fraud epidemics occur.

Theoclassical policies are intensely

criminogenic, anti-democratic, and grotesquely unfair. Their proudest creations – their risk and price models – proved to massively understate risk and overstate asset values. They betray the scientific method that they purport to exemplify because they are overwhelmingly mono-disciplinary, in thrall to their dogmas, driven by self-interest, incapable or unwilling to follow logical standards of internal consistency, and intellectually dishonest. They award Nobel Prizes to economists who fail what economists claim is the decisive test of truth and success – predictive ability. Theoclassical economists are infamous for their arrogance, praising their field as the only social science worthy of the term “science” and celebrating its “imperial” nature while ignoring work in other fields that has proven to have far superior predictive success. Theoclassical economists are infamous for their lack of altruism.

But the gravest failure of theoclassical economists; and one that is the source of many of these other deficiencies I have just described is that they are basically unethical. The obvious aspects of this lack of ethics are that theoclassical economists act as if their conflicts of interest are so irrelevant that they do not even require disclosure – much less avoidance. Theoclassical economists, however, are immoral in a more fundamental manner. They repeatedly advance positions that are profoundly unethical – and bad economics and bad criminology.

Paul Heyne's Defense of Theoclassical Economics

I recently came across one of the primary efforts to defend theoclassical

economists against the criticism that they are basically immoral. “*Are Economists Basically Immoral?*” and *Other Essays on Economics, Ethics, and Religion* (2008). The compendium was created after Heyne’s death by the “Liberty Fund.” The desire of theoclassical economists for such a defense is easy to understand. Heyne was an obvious choice for the task because he was a theologian and then studied economics at Washington University, a bastion of theoclassical thought. Heyne was even more dismissive of other fields than was George Stigler. *3.5 “[L]ess than 1% of what is published by academics in the social sciences and the humanities has any value and 90% of it would have been rejected by any editor with a modicum of intelligence and a concern for the public interest and would thus not even have been allowed to compete for attention and survival; theology has absolutely nothing to contribute to the discussion of public policy issues....*

“[E]nvironmentalism has become a dogmatic, fundamentalist, persecuting religion that will keep us from ameliorating our environmental problems (p. xvi).”

In sum, he was a theologian who came to believe that theology was irrelevant to public policy and that the social sciences and humanities were overwhelmingly unworthy of existence or study. Heyne concluded that Christian social teachings were not simply useless but actually harmful. The Liberty Fund editors that published the book of his essays on the subject of economists’ morality say that Frank Knight, his greatest intellectual influence, and Heyne

agreed on “the futility of Christian ‘social teaching’” and that “‘established’ religion is likely to do more harm than good” (pp. xix-xx). Theoclassical economics became Heyne’s one true religion in the social sphere. The editors state that Heyne shared their view that “Economics is a way of thinking.”

Economics is not “a way of thinking”

The claim that “economics is a way of thinking” is bizarre. It cannot survive even the briefest examination. The “way” we “think” as humans is a fascinating question that we are just beginning to study with the aid of neurobiology and psychology. There is evidence that economists differ in values from the general human population.

Most studies find that those that choose to study economics are less likely to be altruistic (presumably from self-selection) and that over the course of studying economics they become still less altruistic (presumably due to learning, socialization by their professors, and peer influences). But we have no good data suggesting that economists “think” differently than other humans, much less other social scientists.

It is true that we are increasingly learning that the human brain is plastic and that the way we use it rearranges the neural architecture. In this sense, if there were some approach to “thinking” largely unique to economists it could be that we could influence our students’ “thinking” processes to be more likely to mirror our unique cognitive process of “thinking.” There is, however, nothing remotely unique about

economists' mode of "thinking" that one can readily discern from the actual teaching or practice of economics. Economists purport to use the scientific method, to rely on standard logic, and to engage in hypothesis testing using statistical techniques. The same could be said of many social sciences. While economists like to think of their statistical techniques as uniquely sophisticated, mathematicians and physicists think our statistical techniques are remarkably unsophisticated and unsound. In any event, I have never met an economist who claimed that econometricians "think" differently than statisticians. It would be profoundly disturbing if there were a scientific field – any field – in which the scholars had a "thinking" process unique among human beings. It would be equivalent to finding a new species of humanoid had long existed among us, but never been recognized.

The claim – wholly unsupported – that economics is the unique "way of thinking" is an astonishing arrogant claim of disciplinary exceptionalism. Only economists are purportedly capable of this (wholly unspecified) "way of thinking" that is purportedly (in a second, equally unsupported, claim of exceptionalism) uniquely capable of understanding the economy and human behavior in the economy. I have dealt closely with economists for forty-five years and I can assure the reader that their "way of thinking" is not unique. They are all too human. When they attempt to describe their "way of thinking" economists use the same terms everyone else uses (some mixture of logic and inspiration).

Economists simply have different tribal taboos and cultural norms

Economists are not just like everyone else, and theoclassical economists vary a great deal from most humans, but the reason is not that they have a different way of "thinking." The French and Germans have different cultures. They have been socialized to frame the issues that they will think about and the issues and the modes of analysis that are taboo. Economists have different cultures than other fields. The theoclassical culture is a powerful sub-culture within economics. I warn constantly about the risks of theoclassical economists' false *implicit* assumptions because these cultural taboos and dogmas are so dangerous and result in recurrent, disastrous errors to which theoclassical economists are blind.

Heyne Refutes His Thesis on Page One and Shows Why Theoclassical Economics Fails

The Liberty Fund editors do not bury the lead. The first article they present is entitled: "Are Economists Basically Immoral?" It, unintentionally, refutes Heyne's thesis that theoclassical economics is basically moral and that theoclassical economists have strong predictive abilities. As someone who taught for years in a public policy school (the LBJ School of Public Affairs at UT Austin) and as a white-collar criminologist who studies elite corruption, I found the two examples Heyne (and his editors) chose to present first of particular interest. Here is the first page of the article in its entirety.

"Whenever my wife and I have economists and their spouses over for dinner, I try to keep the convers-ation

away from politics, because otherwise it almost always ends up in a somewhat rancorous dispute, not about candidates or policies, but about the democratic political process itself.

The division is always the same: all the economists insist that voters have no incentive to cast an informed ballot, while the non-economists protest that this is a cynical and immoral view of the world.

As another example, I recently gave my students a newspaper article that was headlined 'Food Aid from West Falls Prey to Corruption.' It began with this line: 'Western food aid to former Soviet Republics is being syphoned off to the black market or falling into the hands of corrupt local authorities.' I asked my students to tell me in writing what difference this makes and why donor nations should be concerned that their food is being stolen. I found that some of the students were appalled at my claim that stolen food was more likely to get to hungry people than food that had not been stolen. I hastened to add, I said, that I do not approve of theft. But the damage was done; the students were very upset. It was wrong to argue that thieves are usually more effective in getting food to hungry people than Red Cross officials are. But thieves have a more effective incentive: no sale, no profit."

Reprinted, *Policy* 9 (Autumn 2003): 33

Voting

Heyne's description of the "rancorous dispute" between economists and non-economists about voting is a non sequitur that demonstrates the poor predictive ability of economists. First, consider the multiple dimensions of falsity and intellectual dishonesty inherent in his description of the economists' position (and recall that

he is one of those economists): "all the economists insist that voters have no incentive to cast an informed ballot." There is nothing in economics that could support that claim. Indeed, to an economist the fact that so many people do in fact vote should lead to the assumption that they have powerful incentives to vote. Even theoclassical economics recognizes that people have a vast range of incentives, not simply economic.

There is a significant literature in other disciplines about why people vote and what factors drive turnout. It is possible, of course, that the economists were blind to the research in other fields. Heyne's contempt for other social sciences and the humanities, if shared by the other economists at his table, was particularly likely to render them ignorant of why people choose to vote.

In any event, in his first example of the supposed superiority of economics he shows that economists are not simply wrong but dogmatically hold to their errors after centuries of experience prove that their views are false. Indeed, economists, in Heyne's telling, are such jerks that they engage in "rancorous disputes" with their own spouses because the economists insist on pushing claims that are false – and that their spouses know to be false. In Heyne's telling of the tale, the economists are always wrong, but never willing to admit their errors. Instead, they attack even their spouses. Heyne's telling of the story makes it plain that he still claims that that there is "no incentive" to vote. Imagine what Heyne and his economic colleagues did to students who dared contest their long falsified

dogmas in class.

Note also that Heyne adds the word “informed” before “ballot.” The implication is that people may vote but their votes are not entitled to respect because they will not bother to inform themselves before they vote. Heyne is a big fan of Friedrich von Hayek, who consciously sought to discredit the legitimacy and efficacy of democratic government by making even more insulting insults about voters.

Second, notice the hidden issue of gender. The only folks invited to these dinners, as Heyne describes them, are economists (in this era, overwhelmingly male) and their spouses. So the men engage in a “rancorous dispute” with the women – and the fight is frequently between spouses where each wife understands her husband’s expertise in theoclassical economics – and knows he’s dead wrong and immoral in what he considers to be his core area of expertise.

Third, the “rancorous dispute” is in a non-economic field (i.e. voting) in which other disciplines have far greater expertise than economists. Several of the wives may well have had a far better understanding of voting than their economist-husbands for the simple reason that they have studied political science, sociology, anthropology, or psychology.

Heyne was a Terrible Criminologist

Heyne’s second example is even more revealing about theoclassical economists’ immorality and incompetence. Heyne takes Stigler’s distortion of Coase’s work and amps it up to a classic (unintended) *reductio ad absurdum*. Coase’s work on the

critical role of transaction costs emphasizes that Stigler’s formulation of the so-called “Coase Theorem” (which assumes transactions costs out of existence) has no application in the real world.

In Heyne’s extension of Coase (as distorted by Stigler) and Adam Smith it really does not matter if “property is theft” and if the “invisible hand” is boosting your wallet. Private sector theft is inherently superior in providing aid to poor than NGOs because private thieves have superior incentives to NGO volunteers. Heyne takes the twin myths that lie at the core of theoclassical economics – that the “unintended consequences” of private sector actions are inherently desirable for society while the unintended consequences of NGO and governmental actions are inherently harmful to society – and supercharges it with his ode to thieves and disdain for NGOs.

Unintended consequences can be either positive or negative in any sector. An example of unintended negative consequences is the unintentional spread of infectious disease by private commerce, NGOs, and governments.

Heyne’s story of private sector virtue through theft of food aid was obviously intended to shock his students. Note that Heyne’s tale of the beneficent food relief thieves is premised on zero facts. Heyne *assumes* that the thieves’ actions must prove beneficent because he *assumes* that the thieves’ incentives are superior to the NGO volunteers’ incentives. He presents no evidence that the thefts actually helped society and no evidence that NGO volunteers’

incentives are inferior from a societal perspective to that of thieves of food relief. In short, he has invented a fictional “just so” myth with no supporting facts and presented it to his students as if it were indisputable truth.

Let us examine three examples of such thefts where we have facts. We will consider how a white-collar criminologist would evaluate Heyne’s claim that the invisible hand turns thieves of relief aid into creative capitalists. He asserts that the thieves will act as if they were moral (*after* the theft) because they are subject to the mandate of the “invisible hand” to (unintentionally) maximize social utility due to their quest to maximize their wealth – “thieves have a more effective incentive: no sale, no profit.”

Doctors Without Borders

Doctors Without Borders is an NGO that provides medical care in regions with health crises. The NGO has equipment and medicines that can be stolen, including many vaccines such as those that protect against polio. The NGO faces three major crime problems. First, combatants may kidnap its personnel to hold them for ransom. Second, combatants may murder NGO personnel and destroy the equipment because they are engaged in terror tactics or believe (or purport to believe) that the vaccines are a Western plot against Muslims. Third, thieves steal the NGO’s medicines and equipment.

It is not true that the theft of drugs from the NGO inherently aids society because thieves inherently have superior incentives arising from their “more effective incentive.” Doctors and other volunteers from this NGO

have died due to the strength of their incentive to aid those that most need their help. Heyne’s casual dismissal of altruism in favor of a thief’s greed as an inherently superior incentive and a demonstration of the intrinsically moral nature of capitalism is another example of our family rule that it is impossible to compete with unintentional self-parody.

A criminologist (or anyone who worked with the NGO) would know that Heyne’s “efficiency” claims for theft was typically nonsense, as

1. People and property frequently suffer damage during a theft.
2. The people who steal medicine from such an NGO often have to grab quickly and try to escape rapidly. This too can destroy drugs. Other drugs may be ruined without refrigeration or because they are contaminated unintentionally by the manner of theft.
3. When the thieves go through what they have stolen they may destroy or abandon (and allow to be ruined) drugs or equipment that are too hard to sell without a material risk of detection or simply lacks a sufficient profit relative to the risk of sale.
4. The people who steal the drugs from the NGO may use the proceeds to purchase arms and IEDs that they use to murder and maim hundreds or thousands of people.
5. The group that steals the medicine from the NGO may not sell the medicine – or use it. It may reserve it for use only by a particular Somali clan. It may build up an inventory of medicines and supplies such as bandages that will be necessary for the clan’s own medical needs once the clan initiates a war against rival clans.
6. Medicines and medical equipment may require skilled nurses and/or

doctors to be effective, so once they are stolen they may be far less effective in helping people in need.

7. The thieves may dole out the medicine and equipment to aid rival clan leaders in order to recruit war allies and punish opponents.

8. Stolen medicines and medical equipment may not be sold, but instead traded for sexual favors by mothers who are desperate to get medicines for their children.

9. Stolen medical equipment can easily be misused, e.g., by reusing needles, in a manner that spreads disease.

10. Stolen medicines and equipment will, at best, go to those best able to pay for it rather than to those who most need them.

11. People who steal often also cheat the purchaser by ripping them off entirely or providing inferior, contaminated drugs and medical equipment. This is the reality of thieves, rather than Heyne's "fable of the bees" (or, more aptly in the case of those who steal huge amounts of relief aid, "myth of the maggots").

Theft of Food Aid in Somalia

The massive thefts of food aid in Somalia, primarily by the dominant clan, have worked just like Heyne predicted. As a result, Somalia is a true utopia. (It is also an NRA paradise in which because nearly everyone has an automatic weapon the streets are perfectly safe.) The reality of course is the same as what I described above in my discussion of thefts from Doctors Without Borders – except that thefts of food aid have caused far more deaths and widespread malnutrition.

As with Heyne's tale of economists'

invariably false predictions about voting based on a primitive misunderstanding of incentives the common denominator is that theoclassical economists are terrible at understanding the true nature of human incentives. The very thing that theoclassical economists claim to be the defining element of their approach to predicting behavior, understanding incentives, turns out to be a great weakness.

Iraq: an ode to "privatization" via theft becomes a nightmare

As I write, Sunni Iraqi extremists have taken over Mosul, Iraq's second largest city, Tikrit, much of Falluja, and key facilities in a key oil city. This is eleven years after President Bush's infamous "Mission Accomplished" propaganda event on an aircraft carrier. One of the primary reasons that the U.S. occupation turned into a strategic disaster for Iraq and the U.S. is that the Bush administration took Heyne's approach to epidemics of the theft from the Iraqi and U.S. governments. They treated epic thefts of state assets as "privatization" – and assumed it made Iraq's government, society, and economy stronger.

Rajiv Chandrasekaran wrote a now classic but deeply disturbing book revealing the theoclassical dogmas that underlay so much of our occupation policy failures entitled *Imperial Life In The Emerald City: Inside Iraq's Green Zone* (2005). On pp. 135-136 he describes how the ideologues interpreted the theft of government trucks and police cars as desirable "privatization" – and the reality that the thefts crippled police effectiveness and the ability to distribute aid to the needy. We will never know how

many people died as a result of the “privatization” of these vehicles by those who used them, and continue to use them, to transport terrorists, heavy weapons and ammunition or to create car and truck bombs.

Conclusion

Heyne demonstrates the unintended consequences of trying to create ethical apologia for theoclassical economics. He demonstrates that theoclassical economists are not simply wrong but wrong in areas in which an eight year old would consistently get the right answer. It is good to vote and tens of millions of U.S. citizens vote for reasons that reflect well on them and the Nation. The inability of theoclassical economists to comprehend this fact and their efforts to destroy the legitimacy of democratic government demonstrates a sad combination of incompetence, intellectual dishonesty, and immoral shilling for their plutocratic patrons.

Eight year olds understand that theft is morally wrong and harmful. Excluding sociopaths, only theoclassical economists think that if they assume an incentive or the non-existence of an incentive they can predict results without determining though a real factual inquiry whether their assumptions are correct. When they make those assumptions about incentives implicitly they are most vulnerable to disastrous error.

Heyne’s editors have, unintentionally, selected an article by Heyne that self-destructs his thesis that theoclassical economists are “basically moral” on page one of the book by demonstrating the opposite. Heyne unintentionally proves that theoclassical economists make massive predictive errors

based on false assumptions about incentives – and refuse to abandon their dogmas no matter how many times they are falsified by reality. He also unintentionally demonstrated the folly that comes from the arrogance that he shared with theoclassical economists that leads them to ignore the literature not only of other social sciences with expertise in the subject matter they are guessing about but also of economists like George Akerlof and Paul Romer who have successful predictive records but contradict theoclassical dogmas.

I would have loved to see how Heyne sought to justify private sector fraud as optimizing, but the book contains the word “fraud” only once – and that is a brief mention that opponents of evolution originally tried to claim that the theory was a “fraud.”

There are, of course, strong reasons why libertarians so religiously ignore fraud led by CEOs. Control fraud falsifies a vast array of theoclassical dogmas, reveals their policies to be criminogenic, and makes their econometric studies and pricing models perverse. When the concepts of control fraud and the Gresham’s dynamic are combined the core immorality of theoclassical economics emerges. Worse, the paramount function of democratic government – the provision of a rule of law and effective regulation and prosecution of the unethical CEOs who breach that rule of law – is revealed as a necessary condition for efficient and moral markets.



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Source: New Economic Perspectives
<http://neweconomicperspectives.org/2014/06/yes-theoclassical-economists-basically-immoral.html>

TISA versus public services

Public Services International website

A new report by Public Services International (PSI) warns that governments are planning to take the world on a liberalisation spree on a scale never seen before. According to the report, this massive trade deal will put public healthcare, broadcasting, water, transport and other services at risk. The proposed deal could make it impossible for future governments to restore public services to public control, even in cases where private service delivery has failed. It would also restrict a government's ability to regulate key sectors including financial, energy, telecommunications and cross-border data flows.

Treating public services as commodities for trade creates a fundamental misconception of public services. The Trades in Services Agreement (TISA), currently being negotiated in secret and outside of World Trade Organization rules, is a deliberate attempt to privilege the profits of the richest corporations and countries in the world over those who have the greatest needs.

 In a query on quantitative easing, U.S. congressman Keith Rothfus asked the Federal Reserve chairman "Where does the Fed get the money to buy [assets]?"... "Do you create the reserves?", receiving a simple "yes" from chairman Bernanke.

I'd rather be vaguely right than precisely wrong. John Maynard Keynes

Economics has never been a science - and is even less now than a few years ago. Paul Samuelson



Public services are designed to provide vital social and economic necessities – such as health care and education – affordably, universally and on the basis of need. Public services exist because markets will not produce these outcomes. Further, public services are fundamental to ensure fair competition for business, and effective regulation to avoid environmental, social and economic disasters – such as the global financial crisis and global warming. Trade agreements consciously promote commercialisation and define goods and services in terms of their ability to be exploited for profit by global corporations. Even the most ardent supporters of trade agreements admit that there are winners and losers in this rigged game.

The winners are usually powerful countries who are able to assert their power, multinational corporations who are best placed to exploit new access to markets, and wealthy consumers who can afford expensive foreign imports. The losers tend to be workers who face job losses and downward pressure on wages, users of public services and local small businesses which cannot compete

with multinational corporations.

The report on TISA was prepared for Public Services International, written by Scott Sinclair, Canadian Centre for Policy Alternatives, and Hadrian Mertins-Kirkwood, Institute of Political Economy, Carleton University.

Source: Public Services International (PSI) website, 28 April 2014
<http://www.world-psi.org/en/psi-special-report-tisa-versus-public-services>

Thanks to Dick Clifford for drawing our attention to the existence of this report.

Compulsory income management Communicated by Pas Forgiore

The following is an open letter to the Australian federal government by the SA organisation SIMPla (Stop Income Management in Playford). The letter was tabled in the Senate on Wednesday March 26th 2014.

1. We the undersigned call for the suspension of the federal government's compulsory income management, expanded to Playford and four other sites as part of programs that began in July last year.
2. We believe compulsory income management is humiliating, unfair, and unlikely to improve quality of life for recipients or their children. We note the lack of solid evidence that this policy achieves its goals, and fear this approach will be counter-productive.
3. We also note the expensive cost of the scheme, which we consider wasteful when more effective, less-heavy handed options are under-funded.
4. We believe the existing guardianship laws are far more democratic, effective, and flexible mechanisms for dealing with welfare recipients with severe mental health issues.
5. Compulsory income management in Playford will affect welfare recipients deemed "vulnerable" by Centrelink or

referred by state government agencies like Housing and Families SA.

6. Recipients will be forced to have 50-70% of their payments "quarantined" onto the BasicsCard, which can only be spent on "essentials". Recipients volunteering for the scheme receive bonuses but must spend at least three months on the system.

7. This policy is an expensive, radical experiment. It breaks with the established tradition that welfare recipients have the right to control their payments. We believe the burden of proof falls on the federal government -- to clearly demonstrate this approach will improve the health and financial situations of recipients. This has not happened.

8. The Commonwealth Parliamentary Library's paper on income management last year concluded that there is "an absence of adequate data relating to the effectiveness or otherwise of income management".

9. Given the government's stated commitment to "evidence-based policy", it is particularly disappointing that compulsory income management is being expanded beyond the NT when there is no compelling, objective evidence the policy achieves its goals.

10. We note the Menzies School of Health's 2010 study of spending patterns of NT income management recipients, which reported that apart from the impacts of government stimulus payments, there have been no significant changes to consumption of alcohol, cigarettes, and soft drink, nor to fresh fruit and vegetables.

11. The Equality and Rights Alliance's 2011 report into income management surveyed 180 women in the NT on the system. It found 85% had not changed what they purchased; 79% wanted to leave the scheme; and 74% felt discriminated against.

12. It is claimed that compulsory income

management helps welfare recipients become more financially responsible. It is unclear how reducing recipients' control over their payments will achieve this goal. We are concerned this measure will entrench dependency and discourage recipients from developing financial management skills.

13. We note the Western Australian Council of Social Service's 2009 evaluation of child-protection income management in WA, which identified low rates of referral and take-up of financial management courses (20% among child-protection income management clients). 55% of surveyed financial counsellors thought compulsory income management negatively impacted upon the financial capabilities of clients.

14. We fear compulsory income management will have long-term mental health impacts. Consultations by the Australian Indigenous Doctors Association in 2008 revealed widespread feelings of humiliation and shame among NT recipients. We also note international research indicating heavy-handed policies like forced income management tend to further stress disadvantaged families, potentially increasing family breakdown.

15. We note the considerable cost of this policy, estimated at \$4,600 per recipient annually in Playford and the four other sites. By comparison, employment agencies are provided with only \$500 per long-term unemployed worker to address barriers to employment. The NT scheme has cost more than \$500 million over five years.

16. We are concerned that criteria for determining "vulnerability" are vague and subjective. The Commonwealth Ombudsman's 2012 report on this topic found only 14% of decisions to place recipients on this category in the NT surveyed were "supported by the

relevant evidence and met policy objectives". Aborigines have been over-represented in this category in the NT, forming 95% of recipients. We fear something similar in Playford, where there exists a significant aboriginal community.

17. We consider problematic the 'financial hardship' trigger for 'vulnerability'. Financial hardship is widespread among welfare recipients. Not because of widespread incompetence or irresponsibility but because of inadequate welfare payments, expensive rental markets, lack of public housing, and cost-of-living pressures. 18. We regard the financial hardship trigger as a kind of double jeopardy, punishing recipients twice. First, forcing recipients to survive on below-poverty-line payments. Second, deeming them to suffer financial hardship because of low payments, thus forcing them onto income management.

19. We fear compulsory income management will have negative consequences for those requiring emergency assistance, like domestic violence victims. The Australian Law Reform Commission's paper on this topic expressed concerns about victims being less likely to reveal their circumstances to Centrelink, and thus being unable to access emergency services like Crisis Payments, for fear of being placed onto income management.

20. We are concerned that the Playford community has not been properly consulted about this policy: neither when its federal representative, the member for Wakefield, wrote to the prime minister in 2010 recommending Playford as a site for the expansion of compulsory income management; nor during the months before the scheme began operating in July last year.

21. We call for the federal government's compulsory income management to be replaced with more addiction programs,

financial counselling, and other support services that have been under-funded.

22. We call for the more cost-effective and less heavy-handed Centrepay system to be further promoted.

23. We call for welfare payments to be increased to liveable levels, which will dramatically improve quality of life for struggling families and individuals.

We call for an alternative policy vision that respects the competence, dignity, and rights of recipients and targets the real causes of disadvantage.

For further information about the campaign against compulsory income management, or to endorse the open letter, email: simpla.playford@gmail.com.

Why Europe's austerity experiment is doomed to fail **Steve Keen**

I've spent the past two weeks in Europe, with speaking engagements in Italy, Greece and Austria. This was my first visit to Greece, and my first chance to get an admittedly superficial tourist's view of what a country with Great Depression levels of unemployment looks like.

It didn't look like anything in particular until the drive from Athens, Greece's capital & largest city, to Thessaloniki, its second largest. Then it struck me: the roads were near empty -- as the toll booth shown in Fig 1 illustrates.

My host Nikos reckons he has done a million kilometers over the years on this 500km drive, and he confirmed that roads which were now virtually empty were once full of cars, and especially trucks -- that mobile sign of a thriving economy.

This is a very different manifestation of economic stagnation than the mental picture I had of it from the

historical record of the Great Depression, when the overwhelming



Fig 1: Toll booth - Greece's main highway at 5pm

impression was of crowds: crowds lined up at soup kitchens, crowds outside dole offices. Today, the 28 per cent of Greek's workforce that is unemployed is mainly at home (if they have homes), and surviving on electronically transmitted dole payments. The social organisation of the unemployed that marked the Great Depression is not apparent today -- though the political shifts are beginning.

Parties of both the Left and the Right that are opposed to EU austerity policies made dramatic gains in the recent European elections, and in Greece, if an election were held this week, the mainstream parties that are identified with the Troika's austerity program would be thrown out of office.

Despite this, the EU bureaucrats who have crafted the "Stability and Growth Pact" and its "reduce public debt at all costs" program are digging in, insisting this is the only way for Europe to overcome its economic malaise.

The narrative is that irresponsible government spending led to the crisis,

and “fiscal consolidation” -- a drastic reduction in the level of public debt thanks to years of budget surpluses -- can end it. Greece in particular has been told to run budget surpluses of 4.5 per cent of GDP for the next decade or so, and to have a long-term target of a 4 per cent surplus every year. And Greece has no choice but to shoot for this target, since its budget must be approved by the EU.

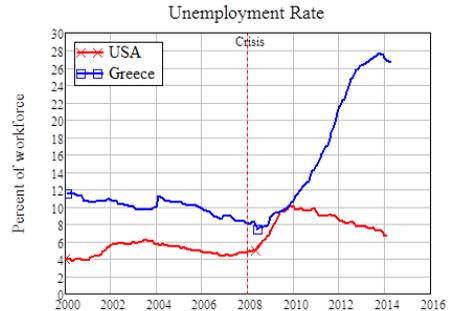
So how does this narrative stack up against the facts? Firstly, there’s no doubt that Greece is in a real Great Depression. Twenty-eight per cent of the workforce is unemployed, a staggering figure, since the modern ILO definition of unemployment is much more restrictive than that which was used in the Great Depression to record the USA’s peak level of 25 per cent.

But even on this data, the narrative doesn’t entirely fit the “Greek is a basket case” narrative.

Unemployment in Greece was 8 per cent when the crisis started in 2008, well below the 12 per cent peak in 2000, and it had been trending down (it continued to fall in the early days of the crisis). In the USA, unemployment was higher in 2008 than in 2000, and rose rapidly to reach 10 per cent in late 2009 -- the same level as for Greece (see Figure 2). So Greece had been improving over the early 2000s while the USA had been treading water, and the downturn in the USA was much sharper and faster than in Greece.

From then on however, the “basket case” narrative looks convincing: US unemployment started to fall from that date, while Greek unemployment

skyrocketed to a staggering peak of 28 per cent in late 2013. So Greece is in a second Great Depression, while America is emerging from a serious crisis, but not something on the scale of the 1930s.



www.debtdeflation.com/blogs

Fig 2: U.S. vs Greece – recession versus depression

It’s also true that Greece began the crisis with a very high level of public debt: 110 per cent of GDP in 2008, versus half that for the USA (see Figure 3). But there was no trend to Greek public debt before then -- it was marginally higher in 2006 than in 2000, and much the same level in 2000. This was true of the US as well. So it’s hard to blame government spending for the false prosperity before the crisis in either country.

Instead, the rise in public debt began *after* the crisis in both countries -- and this occurred earlier in the US than in Greece. The blowout in Greek public debt began in earnest in 2010, two years into the crisis -- when government debt in the US had already begun to taper. Its fell sharply in 2012 but is now rising even more sharply, while government debt in the USA is actually falling as a percentage of GDP.

The change in debt data puts some

flesh on this picture -- and it runs counter to the EU narrative that

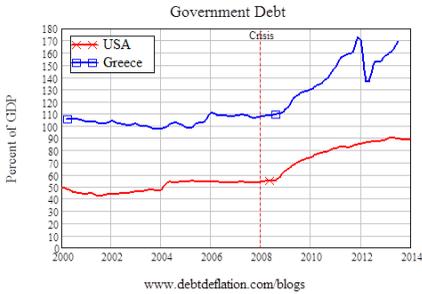


Fig 3: Greece had large public debt before the crisis, but there was no growth relative to GDP

reining in public debt should be the priority. Frankly, what should the first priority is what works -- and the US is the success story here. Did it get its public debt in order first? No way: the rise in public debt in the US began after the crisis, as did Greece's. The US talked about austerity - with the famous Sequester - but fortunately that was avoided so that the US government never imposed austerity measures. And yet paradoxically - *if the EU's analysis is correct* - the US public debt to GDP ratio tapered while Greece's exploded.

The raw statistics here underplay the drama in public spending in Greece from 2010 onwards, as the economic timeline details, with severe austerity measures being invoked from the end of 2010 (when the level of unemployment also began to skyrocket). So Greece's post-crisis deficits occurred because revenue fell faster than spending was cut - not because the government was running stimulatory deficits as were the Americans.

Growing government debt thus appears to be more a symptom of the crisis than a cause. Its rise began

after the crisis in both countries, not before; and the one that hasn't

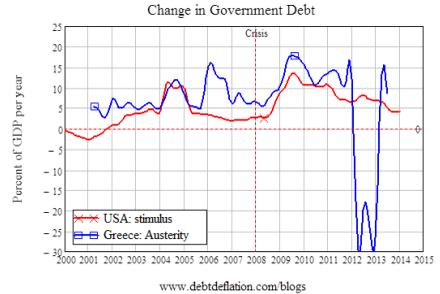


Fig 4: Change in public debt: positive for the U.S., negative for Greece in 2012-13

deliberately attempted to reduce government spending by austerity is the one whose public debt ratio is no longer rising.

What about my hobby-horse, private debt? Now there's a story to tell: whereas there was no trend to public debt before the crisis in either country, private debt rose at a rapid rate in both countries - and the USA's debt level was much higher at 170 per cent of GDP when the crisis began, versus 110 per cent for Greece. After the crisis, US private debt peaked at 175 per cent of GDP, and then fell to just below 160 per cent, while Greek levels have rose another 20 per cent and then flat-lined at about 130 percent.

“One of the most fundamental insights is that banks simultaneously create new credit and new money ex nihilo [from nothing]. And that is one of the most fundamental, important things for people to be taught, and also economic undergraduates should be taught, about the nature of how monetary economy with banks works.”

Lord Adair Turner, former chairman of the UK Financial Services Authority

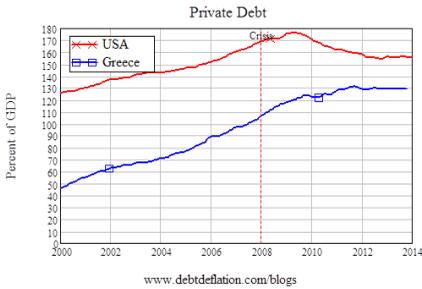


Fig 5: Pre-crisis rising private debt – U.S. (upper line) and Greece (lower line).

The change in debt data paints a compelling picture (see Figure 6). The two countries were remarkably similar until 2010: before the crisis, the rate of growth of private debt increased from a low of under 5 per cent of GDP in the early 1990s to a peak of 15 per cent of GDP on the eve of the crisis. Then the plunge in private debt growth began -- though earlier in the US, with Greece still booming to a peak of 19 per cent of GDP in 2009. Both then dived from leveraging to deleveraging, with private debt growth turning negative in 2009 in the US and 2011 in Greece.

But in 2010 the US took a distinctly different course: the rate of deleveraging slowed and America smoothly moved towards rising private debt once more. Greece, on the other hand, continued the plunge into negative private debt growth, and since late 2012 private debt in Greece has been falling at a rate of over 10 per cent of GDP per year.

Conventional wisdom thinking on this would see Greece's example as one of laudable frugality (puzzle: why has this not led to prosperity?) but in our credit-driven world this means a collapse in the means of payment and hence an economic collapse.



Fig 6: Same pattern in change of private debt until Greece's collapse in 2010, when Greece's collapse began

That is borne out by the correlation data between change in private debt and the level of unemployment shown in Figure 7 for the US and Figure 8 for Greece, where I've inverted the unemployment scale to make it easier to see the negative correlation -- unemployment falls when the rate of change of private debt rises (and no, this isn't an example of 'correlation isn't causation' spurious correlation).

In the US, the plunge into the Great Recession began when the rate of growth of private debt slowed down in 2008, and the turnaround began in 2010 when the rate of growth of private debt started to rise.

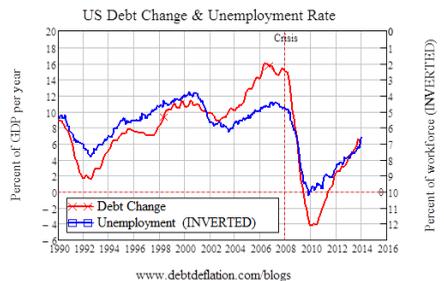


Fig 7: U.S. change in private debt and unemployment after 1990 (correl = -0.9)

In Greece, on the other hand, it's been all downhill from late 2008, when unemployment hit a record low

of 7.5 per cent and private debt growth peaked at 19 per cent of GDP per year, right until late 2012 when the rate of deleveraging peaked at -12 per cent of GDP per year. Since then it's risen a bit, to about -8 per cent per year, and the rate of unemployment has levelled out at a still staggering 27 per cent of the workforce.

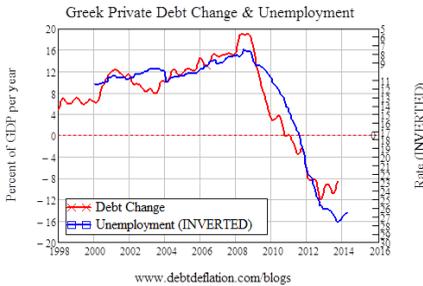


Fig 8: Greece change in private debt and unemployment since 2000 (correl = -0.94)

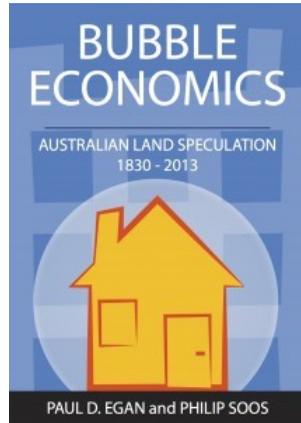
The takeaways from this statistical comparison are that private debt dynamics are what drive the economy, and that public sector austerity fails because it forces the private sector to continue deleveraging. The EU-imposed austerity program is the reason why Greece and Spain are experiencing a Great Depression now, rather than the obvious (if fragile) recovery that is underway in the US. It is a classic own goal by the orthodox-economics-obsessed bureaucrats in Brussels.



Prof Steve Keen is an ERA patron, author of the book *Debunking Economics*, and of the blogsite *Debtwatch*, and is chief economist for the Institute of Dynamic Economic Analysis.

Source: Steve Keen's blogsite <http://www.debtdeflation.com/blogs/2014/06/23/why-europes-austerity-experiment-is-doomed-to-fail/>

Bubble Economics: by Paul Egan and Philip Soos
World Economics Association (WEA)



In *Bubble Economics*, Paul Egan and Philip Soos explore a depressed Australia in the 1840s, 1890s and 1930s. They detail patterns of boom-bust credit and asset cycles which heralded financial instability, particularly following speculation in commercial and residential land markets.

A financial stability model is put forward to predict economic downturns which is based on Georgist, post-Keynesian and behavioural finance schools of economic thought, informed by data from 1830 to 2013.

The trends in Australia's current trade settings, residential property market and banking sector are ominously similar to the key precursors to Australia's 'Great Depression' of the 1890s – a recession or depression may now be imminent.

Egan and Soos expose 'rentier economics' in the land down under and discard the dominant neoclassical paradigm, bringing a fresh perspective to the intense debate about Australia's economic future.

CBA and ASIC to face a Royal Commission?

ERA Review Editor



In a report appearing in the online newsletter *The Conversation* on 26 June, Michael Quilter (Department of Accounting and Corporate Governance, Macquarie University), drew attention to a senate inquiry which called for the Commonwealth Bank (CBA) and corporate regulator ASIC to be investigated by a Royal Commission.

The recommendation follows evidence of serious misconduct by the bank's financial arm, Commonwealth Financial Planning Limited (CFPL) and what the Senate Economics References Committee chairman Senator Mark Bishop described in a press release as "appalling" conduct that included forgery.

"The conduct of a number of CFPL advisers was unethical, dishonest, well below professional standards and a grievous breach of their duties.

"The way in which vulnerable trusting people were targeted shows that the CFPL planners involved had a callous disregard for their clients' interests. That a major financial institution could have tolerated for so long conduct that included apparent criminal activity is not easy to accept."

ASIC also faces criticism of allowing itself to be "complacent" with the

Committee saying its "slow response to the CFPL case and lack of scepticism is hard to explain". And ASIC has responded with a statement [1] in which it has accepted much of the criticism levelled against it.

The CBA has also previously apologised [2] and has acknowledged the committee's report in a statement [3] but refuted Senator Bishop's statements. Liberal Senator David Bushby has also tabled a dissenting report.

The inquiry has handed down 61 recommendations, mostly aimed at enabling ASIC to efficiently carry out its responsibilities. ASIC's investigations into the CFPL matter eventually resulted in some advisers being banned, more than 1000 customers receiving compensation and enforceable undertakings entered.

There was further investigation after evidence of inconsistencies emerged between ASIC and the CBA about the payment of compensation to CFPL clients who had lost money. The committee sees the CBA as keeping not only its clients and ASIC in the dark, but also the committee itself. It is concerned that there are others caught up in the CFPL affair that have yet to be fairly compensated.

1. <http://www.asic.gov.au/asic/asic.nsf/byHeadline/14-142MR%20ASIC%20statement%20on%20Senate%20Economics%20Committee%20report?opendocument>

2. <https://www.commbank.com.au/about-us/news/on-the-record/2014/commonwealth-bank-response-to-four-corners-fairfax-investigation.html>

3. <https://www.commbank.com.au/about-us/news/media-releases/2014/cba-acknowledges-senate-committee-report-and-dissenting-report.html>

Source: *The Conversation*, 27 June 2014
Article written by Michael Quilter.

Government budget deficits and the national debt

John Hermann

The claim of the current Australian federal government that there is a public debt crisis and that there has been a 'budget emergency', along with its subsequent program of austerity budgeting and its drive to achieve ongoing budget surpluses, reveals that its members either do not have a grasp of sound macroeconomic principles, or that they are disingenuous and have a hidden agenda, or conceivably both.

Whatever the truth, we recognise a range of myths and fairy stories about federal government deficits and debt which have been falsely presented as facts. Regrettably, the opposition party is little better in its understanding of real world economics. Both major party groupings are obsessed with the objective of achieving and maintaining budget surpluses, which they seem to regard as a measure of fiscal rectitude. The purpose of this article is to provide a reality check.

Australia's public debt is far smaller than its private debt

In order to gain a realistic understanding of Australia's debt position, it is helpful to examine the available debt statistics. Figure 1 is a comparison of the aggregate of private debt (mainly a conjunction of mortgage debt, credit card debt and private corporate debt) and federal government debt (i.e. the stock of privately-held government securities), from 1955 to the present. The statistics have been extracted from the blog-site of Prof Steve Keen [1], and were obtained from figures issued by the Audit Commission and

Reserve Bank of Australia. Australia's current (2014) private debt exceeds seven times government debt (eight times using figures provided by the Bank of International Settlements [2]).

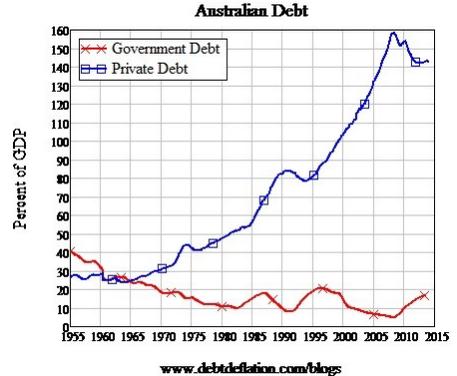


Fig 1. Comparison of Australian government debt (securities held by the private sector) and private debt -1955 to present.

Clearly, the overall trend for government debt (aka Treasury securities) over this time-span is a gradual decline in magnitude (as a percentage of GDP), while the overall trend for private debt has been a large increase in magnitude.

Australia's public debt relative to other countries

Figures 2(a) and 2(b) compare the changes in private and government debt for Australia and the U.S. over the shorter time-span from 1990 to the present [3]. For both countries we see that government debt tended to fall as private debt grew in the period before the global financial crisis of 2007-8, and that these changes were reversed in the period after it. Also noticeable is the fact that Australian government debt was always around one seventh (or less) of U.S. government debt, as a fraction of GDP.

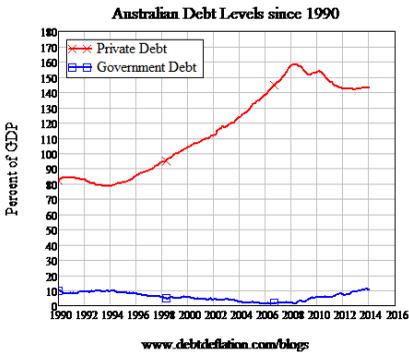


Fig 2(a). Australian government debt and private debt -1990 to the present.

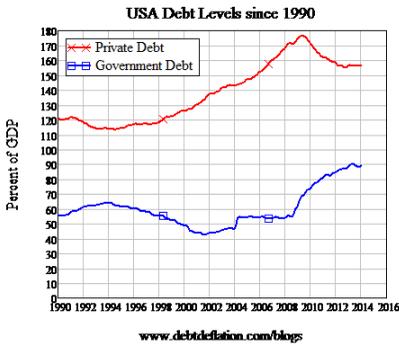


Fig 2(b). U.S. federal government debt and private debt - 1990 to the present.

And we also know that Australian government debt is one of the lowest in the world, relative to GDP. This feature of our economy is apparent from an examination of the net debt to GDP ratio for a range of countries, as depicted in the bar chart (Figure 3).

Central government is different

The freedoms and constraints which apply to any central government which creates and issues the nation's currency and has a floating currency exchange rate (sometimes described as a sovereign government) are quite different from those which apply to the lower levels of government, to

households, and to the private sector more generally. Unlike the latter categories, we know that a currency issuing central government (CICG) may run a budget deficit in perpetuity, even a very large deficit, without any crisis eventuating.

It should be noted that the governments of those countries making up the Eurozone, as well as the governments of the individual states and territories of Australia and North America and the provinces of Canada, are not currency-issuing bodies and so are more constrained than are their respective central governments. For these lower levels of government it is true to say that they should aim for balanced budgets in which their revenue equals their spending, as a long-term average.

Interest on public debt

It is a myth that taxpayers fund the interest payments on a CICG's public debt, notwithstanding that interest is a budgeted item. That is, these interest payments should not be seen as being funded from tax 'revenue'. One way of viewing the situation is to regard the interest payments as being effectively factored in as a small component of the issue of future securities. Such securities may always be rolled over - in perpetuity - because a CICG has an unlimited ability to issue Treasury securities at a price ensure their purchase.

In like manner, a CICG's central bank has unlimited liquidity, i.e. can always create state fiat money (currency and banking reserves) in the process of buying Treasury securities from the private sector at an offered price which ensures their sale. In principle, these CICG securities and state fiat

money are interchangeable entities.

Taxes destroy spending power

More generally, the insights provided by modern monetary theory (MMT) reveal that taxpayers don't actually fund *anything* associated with CIGG spending. If it wishes to, a CIGG can behave as if the taxes it imposes on its citizens are recycled for spending purposes, and most governments find it convenient to present this image to its taxpayers. However, the reality is that the taxes imposed by a CIGG exist primarily to destroy private-sector spending power in sufficient volume to nullify the inflationary effects of its own spending.

When a CIGG taxes the private sector, the spending power destroyed in this process simply goes out of existence. Putting it another way, the money received from taxation is not stored anywhere as useable money, and the money supply is technically reduced with each repayment of CIGG tax. In this context, it should be noted that a range of strategies have been devised by different countries for minimising short-term fluctuations in both the money supply and banking reserves. This destruction of spending power by a CIGG complements its ability create spending power out of nothing (and as much as it likes, and whenever it likes) for its own spending purposes.

The purpose of Treasury securities

The unlimited capacity of a CIGG to find spending power to pay for real goods and services extends to any outstanding public debt it may have, and so it may be argued that a CIGG has no real debt at all. A debt which never needs to be paid back because

the borrower has unlimited spending power and may roll it over forever, and because the borrower has an unlimited capacity to pay any interest owed, is effectively not a debt at all.

The sale of bonds and other Treasury securities by a CIGG also should not be placed in the same category as private debt because a CIGG does not actually need to finance a budget shortfall. Apart from providing the private sector with risk-free financial assets, the primary purpose of issuing Treasury securities is to provide the central bank with the means to drain excess bank reserves created when a CIGG operates a budget deficit (which equates to a net injection of spending power into the economy), thus allowing the central bank to set and defend a target short-term interest rate.

Moreover, the financial system and large investing bodies (institutional investors like pension funds and mutual funds) have an absolute need for zero-risk government securities, in order to adequately carry out their risk management and liquidity management. To remove this form of government debt is to deprive those bodies of an adequate mix of financial investments embracing high risk, medium risk and low (or zero) risk.

The 'crowding out' theory

The argument most often given for restraining government borrowing is that it tends to "crowd out" private sector borrowing, leading to an increase in interest rates. However there is ample evidence to demonstrate that a crowding out effect does not apply to most CIGG borrowing. Counterarguments to the crowding-out story go like this. Firstly, budget

deficits exert downward pressure on the short-term interest rate. In such circumstances, the central bank must sell government securities in order to drain excess bank reserves, thus helping to push the short-term interest rate up to the target rate.

Secondly, CIGG's don't compete with the private sector for funds – a CIGG can access funds available from the nation's unlimited supply of currency.

Thirdly, any funds removed by the sale of government securities (to enable the central bank to defend the target short-term interest rate) are the same funds which the CIGG has injected into the economy through its own spending. In other words, the spending power injected into the economy by a CIGG merely ends up as securities held by the private sector. None of this reduces the funds available for private-sector borrowing purposes.

And fourthly, banks don't really need reserves in order to lend. Lending by banks is constrained by each bank's net worth, not by its reserves. The explanation underpinning the money multiplier theory is a fable.

The only situation where a CIGG budget deficit would be able to crowd out the private sector is when the CIGG net spends to a level which pushes total spending within the economy beyond the economy's productive capacity. This would lead to inflationary pressure, which - under our present system - requires the central bank to quell it by raising the target short-term interest rate (note that this raising of interest rates is artificial - it doesn't occur naturally). No advocate of MMT would recommend that CIGG should net spend in

this way. They argue that the net spending of a CIGG should always be such that it achieves a range of economic, social, and environmental goals. Since those goals should include full employment, it also involves net spending by a CIGG such that their total spending equates to the full employment level of GDP – not one dollar more, nor one dollar less.

The credit rating agencies

If neoliberal lobbyists cannot win the battle to justify an attack on deficit spending using the “crowding out” story and the fear of higher interest rates, they have a second weapon in their armoury – the widespread fear of the downgrading of government bonds by the credit rating agencies. However as has been demonstrated in various articles by Prof Bill Mitchell [4,5], the three largest credit rating agencies have not only made monumental mistakes over the years, but also have been paid handsomely by the companies they have been rating. This does not merely pass the smell test, but it has all the hallmarks of straight out corruption.

To date there have been no criminal prosecutions of the wrongdoers within these organisations. On the basis of their appalling track record, Mitchell recommends that the rating agencies should simply be made illegal, rather than the alternative of regulating them out of existence or legislating to make them pay cash for their mistakes.

Mitchell also refers to the experience of the Japanese government following the large-scale fiscal stimulus that it applied to its ailing economy - first announced in November 1998. The day after this announcement, the

Moody's agency began a series of downgradings of Japanese government yen-denominated bonds from AAA to eventually A2 (i.e. below that given to Botswana, Chile & Hungary).

The then Japanese finance minister stated "They're doing it for business. Just because they do such things we won't change our policies ... and the market doesn't seem to be paying attention". Moreover the government continued having no problems finding buyers for their securities, which are entirely yen-denominated and sold mainly to domestic investors.

What this story demonstrates is that a sovereign government can usually afford to thumb its nose at the rating agencies, whose ratings are widely supposed to be a measure of the risk of default by a company or government on their securities. In other words, securities issued by a sovereign government which are denominated in its own currency and issued to its domestic investors are understood and accepted by the market as having zero risk of default.

Budget deficits are the norm

For sovereign countries, the historical record reveals that deficits are the norm and surpluses are exceptional. And with very few exceptions, any surpluses that appear are short lived. In the U.S. for example, around 85% of federal budgets over the past century have been in deficit. This tendency for economies to operate in deficit mode necessarily translates into an equivalent level of sustained CIGG debt.

We can be thankful that CIGG's are running budget deficits most of the time. Budget deficits keep unemploy-

ment low (they can be large enough to eliminate unemployment altogether); help CIGG's to provide the critical public goods needed and demanded (which private-sector firms require to assist them in making profits); and inject the net financial assets into the economy which the private-sector needs for its positive net saving (and necessary in order to financially stabilise economies).

The fact that 85% of U.S. federal budgets have been in deficit simply indicates that, for around 85% of the time, the U.S. private sector has wanted to positively net save out of current income. Either the U.S. federal government would have increased its spending to fill the spending gap that would have been left by the private sector (a desirable budget deficit) or it would have tried to run a budget surplus (by cutting spending and/or increasing taxes) and, since this lowers GDP, there would be reduced tax revenues.

So that at the end of the day the U.S. government would have been obliged to operate a budget deficit despite any budget objective to do otherwise (an undesirable budget deficit).

The former situation is what happened in Australia when the most recent Labor government implemented its stimulus package; the latter situation is what happened in the second half of Labor's time in office (when they thought it was time to run the budget back to surplus). And there can be no doubt that the latter result will be attempted by the current government.

Bank creation of money

The money supply can vary for all sorts of reasons. Major factors are

(a) the creation of money by the banking system, in response to the demand for credit money by both the wider public and businesses, (b) the willingness of commercial banks to lend and spend, (c) the demand of the public for currency (coins and notes), and (d) the operation of fiscal policy and monetary policy.

These days, banks are permitted to create as much credit money as their net worth will allow (specifically, their capital adequacy ratio must not fall below a value prescribed by banking regulations, if they wish to remain solvent). This is one reason why monetary authorities abandoned notions of directly targeting the money supply decades ago, and instead focused on monetary policy (manipulation of short term interest rates via open market operations).

Banks differ from CIGs in that when they create a financial asset, they create a precisely matching financial liability. Hence, they do not create 'net' financial assets. Only a CIG can do that.

Budget surpluses are destructive

Irrespective of what is happening in the foreign sector, if a CIG attempts to run a budget surplus, it necessarily drains reserves from the banking system. The resultant competition amongst the banks for (overnight) funds pushes the short-term interest rate up. In normal circumstances, whenever interest rates rise unduly, the central bank is forced to buy CIG securities (via open market operations) in order to defend its target interest rate.

And if a CIG was disposed to use budget surpluses to impose upon the

economy a sustained regime of contracting public debt, leading ultimately to zero public debt, then open market operations would become increasingly difficult to implement because there would be a growing shortage of government securities for the central bank to purchase (the stock of securities would tend to zero over time, at which stage the central bank would lose all control of monetary policy).

Although the RBA (Reserve Bank of Australia) has never encountered the problem of having no Treasury securities whatsoever to purchase, their shortage during the Howard/ Costello years of government - which was brought about by several years of budget surpluses - produced much angst amongst many private-sector institutions and corporations. And in response, the federal government financially guaranteed many private-sector financial assets as a way to counter the effects of the Treasury bond shortage.

The real dire effect of a CIG budget surplus is that it forces the private sector to reduce its net savings and/or to replace some of its assets with riskier assets, and to borrow in many instances, in order to maintain its spending desires (Australia from 1996 to 2007). This is a financially unsustainable regime. It eventually forces the private sector to abandon many of its spending desires and to focus on its net savings (paying back its debts). If this happens, private-sector spending quickly collapses. CIG surpluses are a sure way to set an economy up for financial collapse. It is notable that Australia's last major recession in 1990-91 followed a

budget surplus in 1989.

CICG's don't hoard surpluses, even if they behave as if they do. How can you hoard something that you have an infinite supply of? Any amount of the nation's currency can be spent into existence by a CICG at any time. Surpluses do nothing other than to reduce spending on the public goods and infrastructure needed to ensure that future generations will be productive enough to meet their demand for goods and services. And attempting to ensure that future CICGs will have enough money to spend in the future is absurd - they will have it anyway.

Australia and the global financial crisis

Federal governments should be aware that budget surpluses create private-sector deficits, which are financially unsustainable. The notion of a 'sustainable budget surplus', which has been circulated by the current federal government and the media, is nonsense. The only budget position that is sustainable over the long run is a deficit. That said, budget surpluses can look good for a while. If achieved, they can enable misguided Treasurers to beat their chest (e.g. Peter Costello). Since, to achieve a budget surplus, the private sector must maintain its spending desires (but abandon its savings desires), Thus GDP will remain buoyant and unemployment relatively low for a while. However this always sets up the economy for a crash.

Peter Costello can still boast of his budgetary 'success' because the GFC occurred just after the Coalition government lost office in 2007. Very few people blamed Peter Costello because he had vacated the scene.

He was also fortunate in that the 1996-2007 period was one where Australians were willing to take on huge debts in order to maintain their spending.

A booming property market enabled the perceived level of serviceable debts to be larger than was the reality, and so Australians borrowed beyond what they could service. The same occurred in the U.S. and many parts of Europe. This meant that the economy fell off a higher cliff - a cliff which the global economy almost fell off in 2001 (it would have been a lower cliff at that point in time).

Australia did not feel the worst of the global financial crisis (GFC) because the government in 2008/9 decided to implement one of the most vigorous stimulus packages in the world. The Labor government at that time have been unjustly blamed by many for a mess that was actually created by the previous Coalition government.

In regard to how the rest of the world responded to the GFC, the U.S. federal government did not institute a similar fiscal stimulus, while the E.U. governments were incapable of any fiscal stimulus because each of them had given up monopoly ownership and issuance of their currency and so were budget constrained.

The structure of the Eurozone also has a lot to do with the difficulties experienced by E.U. countries since the onset of the GFC. The European Central Bank (ECB) is incapable of acting in the way that the central banks of all sovereign countries operate. Eurozone countries have been pushed into the bond crisis because financial markets fear a lack of liquidity. And this fear cannot be

allayed because the ECB is simply not permitted to act as a lender of last resort and to create new credit money in order to purchase bonds. This in turn has seen higher bond yields on the debt of Eurozone countries, And as a result of this bond crisis, the constituent governments have been

persuaded to impose spending cuts and budget austerity.

Concluding comments

The major differences between the orthodox (neoclassical) and heterodox (mainly postKeyensian and MMT) viewpoints as they pertain to the role of debt in the economy are as follows.

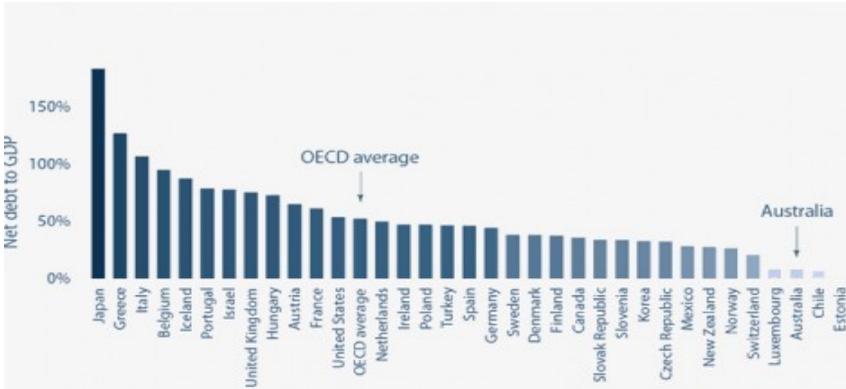


Fig 3. Comparison of net government debt (to GDP) for a range of countries.

Orthodox viewpoint:

1. Economies tend towards a stable equilibrium configuration.
2. Private borrowing, spending and saving decisions are always driven by “rational expectations”.
2. Banking and money flows don't affect economic performance.
3. Private debt growth does not affect economic performance.
4. Public debt (deficit spending) must be minimised since it leads to rising inflation and rising interest rates.

Heterodox viewpoint:

1. Economies generally operate far from equilibrium.
2. The idea of rational expectations is a fiction unsupported by evidence.
3. Banking and the creation of new money by banks matter because they contribute to purchasing power

and economic performance.

4. Private debt growth (in relation to GDP) must be restrained because if excessive it will set the economy up for a crash.

5. The volume of CICG debt (aka Treasury securities) should rise to whatever level is required for the operation of a healthy economy.

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