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For a just and sustainable society

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ECONOMIC REFORM AUSTRALIA (ERA)

ERA is a non-party-political organization, formed in 1993 as a union of the Economics Review Association and other economic 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.

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If you have not done so yet, we invite you to consider renewing your ERA membership as soon as possible. This will save us from having to send you a reminder notice down the track. Relevant information is located on page 2.

News and views from New Zealand

Taking the rise out of housing

Dennis Dorney

I have mentioned before that housing is one of the most important topics on any party manifesto because of its impact on each of the three main areas in which any political issue must fall, namely financial, social and environmental. The social implications of being homeless are obvious enough, and our tendency to build new homes on precious farming land is deplorable given how extravagant of land is the Kiwi dream of a house on a quarter acre. The effect on the economy of borrowing to fund that house is apparently not so obvious – at least judging by the attitude of the main NZ political parties.

Bearing in mind that a mortgage is the largest single financial commitment that a family or individual will undertake and that it will dominate their budget for more than half their working life, you might think that the question of mortgage debt weighs heavily on the minds of our politicians. Apparently not.

When an economy is working ‘normally’ (and the inverted commas are justified because we will probably never again see this ‘normality’) all debt will fall due to the government, the commercial sector or as the private debt of the average Kiwi. In practice all debt must be paid by the man in the street, who increasingly in these days of austerity, both lives and sleeps there. He pays government debt through higher taxes and commercial debt through higher prices, though to be fair if commercial debt is invested wisely prices may be kept within the bounds of inflation. In a world of scarcer and dearer raw materials, that outcome is becoming rare. Nevertheless, of all the options commercial debt is the least objectionable.

However following the collapse of the housing boom in 2008 the commercial sector is not taking on debt because the economy is stagnant and the public has no appetite for more debt. To the contrary, with interest rates at the lowest in a long time and inflation at 1% many people are choosing to pay down debt. It is true that the Government itself is taking on new debt at the rate of about $350 million per week, but not to stimulate the economy. It looks as though the Government is also taking advantage of cheap interest rates to pay down existing debt. Whether this is a sound long term policy remains to be seen but the short term effect is that we have a shrinking economy, that looks set to be in recession for a long time.

Unbelievably house prices are rising again, admittedly mainly in Auckland, which is almost the only growing city in NZ, and Christchurch, where the earthquake has created an acute housing shortage. It takes a government of rare genius to organise a house-price boom during a recession. Naturally the natives are getting restless. This has given the Labour Party the chance to show that it is a credible opposition and still loves the worker, something that has not been very conspicuous in the past.

Having scratched around for any policy that might make it relevant, it has stumbled on the fact that there is nation-wide a housing deficit of about 100,000 homes. This was no surprise to many but an utter shock to the politicians. Without drawing attention to the fact that most of this shortage occurred on their watch, Labour has promised to build houses at the rate of 10,000 a year and although I don't trust them, this is a promise that they must keep or be consigned to the dustbin of history.

Instead of the boring pseudo-debates between two parties, essentially both neo-liberal, we now have a point of real divergence between the two. The position of the Government, conservative to its bones, is to leave it to the market to provide the required houses. The fact that this has not happened in the last 20 years doesn't matter. That it is actually more profitable to sit on vacant land in a rising market rather than build houses, because speculation raises the land price not the house price, doesn't matter. And that the wrong houses are being built in the wrong places, because that is what profit dictates, also doesn't matter – or didn't until the polls showed a distinct drop in the Government's popularity.

The Labour position is that it will borrow money for the required houses, presumably as required and that the fall in unemployment will generate the extra taxes to enable the government to pay off those debts. To my mind this is pure Keynesian economics and, although this is to be preferred to the free market alternative, the assumptions that the debt will be repaid in full must have failed often enough or we would be Keynes supporters still.

The first and best NZ Labour Government faced exactly the same situation when it came to power in 1935 during the Great Depression and solved the problem by borrowing from its own Reserve Bank at 1% interest to embark on a massive rebuilding program. The idea itself was borrowed from the Social Credit movement, popular at the time, and it worked. What a pity that the present Labour party cannot detach itself from the present monetary system to do something truly revolutionary.

Modelling and Food Security
Greg Reid

The main approaches used to model future food production are either economic or agronomic. Economic modelling uses demand and supply relationships which assume that an increase in price of a commodity will lead to an increase in production either through technology improvements or additional farmland. This approach is used to confidently predict that Australia will double food production by 2050 despite climate change and despite absolute restrictions to the supplies of water and arable land.

Agronomic modelling uses inputs from climate trends and the specific requirements of individual agricultural products. Rice fails to produce grain if temperatures exceed 36 degrees centigrade during flowering and wheat is similarly affected by temperatures over 34 degrees. Agronomic modelling takes into account many physical factors and predicts a considerable decline of food production in a warming world.

Economic modelling projects what <u>might</u> be produced as though money can substitute for finite resources. Agronomic modelling projects what <u>can</u> be produced provided that rates of resource depletion are governed only by production needs.

Both modelling systems fail to grapple with impacts on the individual units of production ie farms. Farming is a risky business. Narrow margins and increasing climate variability mean that losses in poor seasons are often much larger than profits in good seasons. Debt is the enemy of the farmer and is exacerbated by high capital costs for machinery and infrastructure. To be a farmer is to be a gambler but climatic and social trends lengthen the odds.

The average age of farmers in Australia is 56 years old with an average debt around $1m per farm and this is not ideal when you are close to retirement. Debt is not only a barrier to adopting new technology but younger generations are unwilling to take on even larger debts to buy out the older generation. The result is a growing wave of corporatisation of farm enterprises. Corporate entities are able to run multiple farms in different climatic zones and so spread risk. Unfortunately corporate entities supplant the farm as the primary focus of preservation. By prioritising cash flows companies run down natural resources that do not appear on the balance sheet.

The corporate trend in agriculture is also felt in poorer countries where subsistence farmers are contracted to produce cash crops though the outcome is usually disastrous in terms of deforestation, erosion, depletion of aquifers and increasing soil salinity.

Food security is not about maximising short term production or profit but about ensuring long term reliable supply in the face of changing climate. Current modelling methods ignore how climate change drives corporatisation in agriculture which in turn is a major factor undermining long term food security. Intervention in the market is necessary to create positive incentives to preserve food producing resources. The alternative is increasingly volatile food markets and declining global production.

The Murray-Darling water market is an example of a mechanism intended to preserve a key resource but unfortunately this type of intervention can lead to perverse outcomes. High efficiency water use requires power for pumping. Currently, power prices are rising faster than water prices and the result is many farmers are reverting to low pressure flood irrigation that wastes water.

To avoid perverse outcomes, incentives are needed that adequately reward resource conservation rather than just shifting costs.

Food security is an issue grossly underestimated in rich countries like Australia. We would do well to remember that food is a commodity that goes to the highest bidder. Many countries are finding they may produce enough food but they are not the highest bidder. It is already a cruel reality that your next meal of rice is possible only because someone else went hungry. Australians should not assume that we will always be at the head of the queue.

Countries that have absolute food shortages are faced with soaring prices and political instability. It is no accident that the wars, rebellions and terrorist campaigns in the world today are mostly in countries with insufficient food resources. These countries may be distant but Australia is not immune to the impacts on global markets and politics.

If modelling is to be of value in policy design it can neither be too economically simplistic nor too technically focused, since both approaches do not include the dynamics of natural resources and social trends. It is not necessary to absolutely quantify the later two factors. Instead it is only essential that policy incorporates adequate incentives to align environmental and social trends with long term food production. An example would be stewardship payments supporting sustainable land management and water use efficiency. Of course incentives have costs but then after all we cannot eat money.

Greg Reid is an ERA member who lives in NSW

Corrected rights of life
Gerhard Weissmann

Modern economic beliefs remain as primitive as those of Adam Smith and John Maynard Keynes, which were formed along the mechanistic lines of the Newtonian mechanics of the eighteenth century. Options to improve our national situation today are limited by three factors, which are (a) the numbers of people that have to be accommodated, (b) the reserves of mineral and natural resources (clean air, water, raw-materials) that remain available to the national economy, and (c) most importantly, a lack of wisdom of governments to manage the conflicting demands for private wealth on the one hand and the equitable distribution of life support factors on the other.

Current economic beliefs have not served our planet at all well. We don't even understand how our generation "developed" this planet into its present mess. The First World is largely living at the cost of impoverishment in the Third World. It demands to be supplied - at zero cost of the material and at low digging up costs - with resources which are mined out of national regions like Australia, South America and Canada. In their pursuit of economic ideologies, our governments disrupt our lives and our society, and in the process arable areas are destroyed. Yet more economic growth is held out as a panacea, while the cost of correcting the existing environmental damage further erodes national wealth through their substantial inflationary pressures.

These are the consequence of having to meet such items as the cost of pest eradication, the provision of potable water, soil rehabilitation and the loss of land to salt and deserts. All around us we observe that the forests and fish stocks are collapsing, the atmosphere is being loaded with indigestible and toxic chemicals, and human population controls are non-existent. It will only take the failure of a basic food crop like potatoes or rice to cause a major collapse of civil order. All that in spite of - or because of - computer modelling, because the down-side of economics is never factored into the models.

As a guide for better management we could use a better interpretation of the "Laws of nature", like Murphy's Law (which is related to the Second Law of Thermodynamics). That Law says "if anything can go wrong, it will go wrong", or if anything can degrade, it will go that way. If that is the real outcome of development, to degrade the quality of resources and the natural environment through economic activity, then the grand total of that activity, the annual Gross National Product, is a true measure of the speed with which humans are able to destroy their habitat and that of other species around them in their drive for human wealth creation.

We must therefore ask our government not "How can we become more efficient?" but rather whether there is a way in which we may have an input into the decision making processes without having more of this so-called development forced upon us? Why are we made to compete with each other, to accept unnecessary disruption of our lives, for such harebrained ideas as "balancing the Budget"? Australia is arguably the richest country in the world with assets of about a A$1 million per capita, as revealed by the World Bank in September 1995. Are we incapable of keeping exploitative development in check simply because our government will not permit any change in direction?

If we want Australians not to deliberately destroy this continent to serve the rest of the world's economic community, and to provide for the future of our own nation, we will have to re-discover that there is *no* development without devastation in places where the supplies are extracted and where waste can be deposited. Those in power, in science and in government, certainly have forgotten about that side of development. We might have to re-write the basic law of development in a form closer to reality.

It is not possible to have development and life *unless* there is a continuous and steady supply of high quality useable energy from the sun. And the laws of physics state that material and energy on the earth can be converted from one kind into another *if and only if* in the process total entropy is increased. It is the increase in entropy that drives the conversion.

It is a necessary condition for economic activity that material and energy will be used up. This can be simply interpreted as "we are living in an entropy increasing field" (Weissmann, 1988-96).

That means that even our "solutions" require more inputs than they yield.

Economic activity, including human labour, consists of nothing other than converting high quality minerals, fuels, arable soils, water, air, into low quality waste, hence making the remaining reserves scarcer, driving up prices, causing inflation, destroying living space and existing old established social structures. Economic growth, therefore, means not more development but more destruction! Would it therefore not be more intelligent to *limit* such exploits to an absolutely unavoidable minimum? Whatever humanity does will reduce the quality of materials and energy available to it on this planet. Unless there is a deliberate "intelligent" change towards longer term durability, there will be no alternative.

People are now indoctrinated into a desire for ever more growth. The irrationality of this belief emerges from the fact that human population numbers began to escalate at the onset of the industrial and agrarian age - the recent "age of development". Social quality began to decline as people abandoned the intelligent pursuit of biological balance with their environment and put their faith in the power of money.

Further "development" does not lead to "new global civilisation" but, since the carrying capacity of the earth seems to have been reached, heralds the onset of the collapse of ecosystems and impoverishment of the entire human species, hence the collapse of existing civilisations as is occurring in North Africa, Syria, Palestine and other nations.

If my proposition of the "New Law of Development" were to become accepted, then it might become clearer that the ultimate ethical behaviour for humankind would be to leave things alone, *not* to make tracks on the moon, *not* to demand further exploitation and so-called "development", *not* to expect that everything exists only for the purpose of conversion into wealth for a few. It may drive home to people that the way we live and chase growth contributes substantially to the degradation of the earth and all who live upon it.

If we were really concerned about accepting responsibility for that decay, we would limit our numbers as fast as possible. We would abandon our current economic mindset. And we would lock up the bankers and money managers.

In the interest of better "house-keeping", it would be wise to observe our surroundings and, if there are substantial signs of deterioration, to demand from our governments that such devastation be taken as evidence that we are putting our future in jeopardy. The economic mindset of governments is in large measure responsible for perpetuating the deterioration. The upside of any economic shrinkage is that it will slow the decay. And the state of the local environment will be an indicator of the true health of the nation.

So it is up to us, each one of us, to compel our governments to abandon their obsession with increasing economic activity, to throw out their forecasting computers, to refuse locking us into a Cyber-Age lest our continent and this planet become uninhabitable for us. This would not only be wise but essential if we wish to avoid the collapse of our nations and civilisation.

If we believe that economic rationalism is indeed destroying - rather than enhancing - our lives, then we will have to look for the means to change our governments' minds. We could use persuasion by declaring the pursuit of economic ideologies to be unethical, like smoking in public. However, since many governments seem to be uninterested in ethics, the problem would shift to getting governments adopt more ethical behaviour in spite of their beliefs.

First, there are rarely held events called elections, where manipulated masses choose from a short list of individuals who are mental captives of power. A more equitable system of candidatures and elections would need to be devised.

Next, the infrequency of elections and the broad raft of policy proposals that are offered on those occasions gives rise to the claim for so-called "mandates" to do certain things when no such mandate was intended. "Citizen Initiated Referendum" would be one way to offer the opportunity for direct input to urgent, selected, single topics at any time, not only at elections.

Lastly there is the legal process for people with a grievance to take a government to court for abrogating its duty of care for the people. To do that, however, transgression of some rule has to be proven. The Westminster System has no written rules, hence no direction about how a government is to govern. Since governments seem to be in doubt about whose welfare ought to be their concern, it arguably becomes necessary to write such a rule into the Constitution. Thus, I would like to propose that the following sentence be added to the Australian Constitution:

> "It is the responsibility of any government (federal, state or local) to make the long and short term well-being of its electorate and hence its living space the first consideration before any others".

Thus Budget considerations, security, trade, and law and order would all become secondary to the well-being of the nation and its living-space. That means, for instance, that permitting wood chipping of old growth forests or exporting natural gas (which put the future of a living-space and hence the nation's status at risk) would be an indictable offence for a government and its ministers. The growth of the population also would be strictly controlled.

Although less circumspect members of governments would vehemently oppose such perceived "infringements" of their powers, a government that operated in the interest of maximising the real welfare of its electors would be more secure than one which ignores justified, reasoned demands.

Naturally, many powerful corporations would also oppose such moves. However it is simply unethical for citizens to allow those in receipt of the supposed benefits of the free market, privatization and competition policies to destroy the nation's fabric and living-space. It may just be an attempt to stem the flow of the inevitable, but not even to have tried - to give in without a whimper - seems intolerable.

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As the earth has reached the limit of its carrying capacity, conventional economic mindsets and further "economic growth" will ever faster erode our environmental support. It seems that a few powerful individuals deliberately employ economic processes to achieve two things: on the one hand to suppress the clamour of the masses by locking them into a "work ethic" mindset, and on the other hand to provide *monetary* wealth for a few to survive the gradual collapse of governments and the resulting onslaught of economic refugees. A re-think of economics is therefore now urgent!

Many well informed observers believe the earth has now passed beyond this limit. If this is so, then much effort will need to be devoted to devising ways in which the damage that has been done already may be reversed.

Gerhard Weissmann is an ERA member who lives in SA

Selling Australia's Resources
Darian Hiles

It's accepted that oil and minerals in the ground are owned by Australians. So how do we transfer ownership to mining companies? "Gifting" them and then applying taxation and royalties is, as we will see below, a poor commercial practice that is now creating problems with public disclosure and accountability.

It's time that the government accepted its management responsibility for our resources. Rather than gifting and then applying taxation and royalties as an afterthought, it should be selling the minerals in the ground to mining companies at a price based on the undeveloped mineral value plus the cost of monitoring extraction according to publicly-acceptable standards, subsequent remediation and any additional infrastructure requirements.

A simple domestic parallel is when the contents of a house are for sale. Buyers choose to come and explore but the owner will determine what they can take and will also estimate the value, which is usually a preset (contract) figure or negotiated at the gate. For expensive items, buyers may even travel from interstate: they take into account the potential value and explore at their own risk.

But under the current Australian taxation and royalty systems, the buyer takes first and then may make some recompense. This discourages public disclosure and accountability, and the analogy of selling home contents shows the commercial nonsense of this approach. A sale, on the other hand, allows the owner to manage the transaction, as any respectable owner must.

Mining directly affects local conditions and must be balanced against other options and opportunity costs. A domestic buyer may have an eye on the piano but another member of the family may not want to sell that particular item. But if a sale is agreed, the buyer isn't allowed to damage the house when taking it out.

Independent cross-discipline and intra-government assessment is essential for resource extraction. Individual industries and companies can only assess opportunities within their own market, whereas mineral extraction has impacts well beyond the minerals themselves.

At a broader level, Australia should seek to promote the establishment of international bodies for marine resources and ocean health to develop standards and monitor international waters so that explorers and miners do not move to less regulated and easier-to-pollute areas, as this is likely to damage Australia's opportunities and destabilise international waters with adverse long-term political, environmental and economic impacts.

It all comes back to implementing proper, accountable commercial practice. The government is putting Australia at a disadvantage if it does not follow this simple due process of responsible ownership transfer.

Darian Hiles is president of the SA division of ERA

Where does money come from?

Philip Lawn

In this electronic age, money virtually comes from nowhere. If you happen to be a currency-issuing central government – that is, a central government that owns and issues the nation's currency – you can always find the money required to make purchases. You and I can get hold of money, but we have to produce something of value and exchange it with someone or some entity already in possession of money. You and I can't create money out of nothing. That's counterfeiting, and it's illegal. Banks can create money out of nothing, but they always create a financial liability of the same value. Hence, banks don't create 'net' financial assets (i.e., financial assets over and above financial liabilities). They just create new financial assets that are always matched by new financial liabilities. A currency-issuing consolidated central government (incorporating Treasury and Central Bank) is in a league of its own. It can create 'net' financial assets because when it creates money for itself in order to spend, it doesn't create a financial liability against itself in the sense that the ability of the consolidated central government to create and spend more money into existence is not reduced. If the Federal Government creates $100 million for its own spending purposes (i.e., to acquire $100 million of real stuff), it doesn't owe $100 million to anyone or anything. It may have to use some real resources to create the $100 million. If the value of the resources is $1 million, it will have acquired $99 million of real stuff. The $99 million of real stuff acquired is called 'seigniorage'. It's an old term. It's not a term used to mislead or trick people. Yet it's a term that even economists don't know about, let alone our Federal Treasurer and his advisors.

Remember the eastern states floods of 2009 and 2010? The Federal Government had to acquire around $9 billion worth of real stuff to undertake flood reconstruction projects. People then said, including our Prime Minister, that the cost to the Federal Government of flood reconstruction was $9 billion. They were all wrong. The true cost to the Federal Government was the market value of the real stuff that the Federal Government had to expend to: (i) acquire $9 billion of spending power (negligible in an electronic age); (ii) determine how best to spend it (bureaucratic planning); and (iii) then spend it (i.e., put the $9 billion worth of real stuff to appropriate use). Even if the value of the real stuff expended was $1 billion (it would have been much less), the cost to the Federal Government would only have been $1 billion. The $8 billion difference would have been the Federal Government's seigniorage.

You can now see the extremely privileged position enjoyed by a currency-issuing central government that is not enjoyed by you, me, or other entities (including state and local governments). Everybody but the Federal Government uses the nation's currency and are therefore subject to a budget constraint. The only constraint faced by the Federal Government is the real stuff available for sale, which is always limited by the fact that we live in a world of scarce resources and a limited technical capacity to convert some of these resources into real goods and services (which means every national economy has a limited productive capacity). So when I say that the Federal Government has no budget constraint, what I'm saying is that they can spend as much as they like, but they can't purchase as much as they like. The Federal Government might have access to a bottomless pit of Australian dollars, but it does not operate in a Garden of Eden. There's only so much stuff available for sale no matter how much money the Federal Government can create for itself.

What happens if the Federal Government spends too much – i.e., it pushes total spending within the economy beyond the economy's productive capacity? It's spending becomes inflationary. In this situation, it can reduce its own spending or, if it is determined to maintain high spending levels (e.g., in order to ensure an adequate provision of health and education services), it can reduce the private sector's spending. It does the latter by taxing the private sector. Indeed, from a macroeconomic perspective, taxation by a currency-issuing central government does nothing but enable it to spend in a manner that is not unduly inflationary. It's not done to finance its own spending because a currency-issuing central government has unlimited access to the nation's currency. It has no need to impose taxes to finance its spending.

What if the electorate doesn't like having some its spending power reduced in order to allow the Federal Government to provide critical infrastructure in a non-inflationary manner (i.e., doesn't like being less able to afford more and more useless gadgets in order to ensure adequate health and education services)? It can always vote it out of office. But that's a political issue, not an economic issue. It has also become an ideological issue for some small-minded people who believe that the economic role of government should be as small as possible (whatever that means). Thanks to them, we have more consumer junk in our houses than ever while at the same time governments close hospital wards, run-down the nation's education infrastructure (Gonski Review), and leave 648,000 Australians on the unemployment scrapheap (as at November 2012). Sadly, a lot of these small-minded people happen to be economists, despite the fact that economics is supposedly "the study of how to efficiently allocate society's scarce resources". It is plain to see that much of the economics profession wouldn't know 'allocative efficiency' if it fell over it, let alone 'ecological sustainability' and 'distributional equity'. It is also plain to see that mainstream economics is driven by ideology – indeed, by people who have no interest in studying the world as it is, but the world as they would like it to be.

Assoc Prof Philip Lawn is an ERA member and ecological economist attached to the Flinders Business School, Flinders University of SA

Aspects of modern monetary theory

John Hermann

Following the advent of the global economic crisis, there has been a growing recognition and understanding of the claims made by a relatively recent school of economic thought known as Modern Monetary Theory (MMT), which is a development of what used to be called Chartalism. Considering that there are ongoing economic crises within both Europe and North America which relate directly to the issues addressed by MMT, it seems timely to look at some of MMT's claims and how an MMT perspective might assist in resolving those crises. Firstly we will review money and government debt.

Two types of money

There are two widely used forms of money: (a) **State fiat money**, which is money created by a sovereign monetary authority (usually a central bank) and acceptable for the payment of taxes. The main forms being currency (coins & notes, which have been declared to be legal tender) and creditary banking reserves (exchange settlement funds); and (b) **Bank credit money**, which is money created by commercial depositories (banking institutions) as retail deposits, and exchangeable with legal tender.

There is an important subdivision of state fiat money, known as **banking reserves**, which is the conjunction of currency held by banking institutions and their deposits in the central bank. The two components of banking reserves are interchangeable. Currency held by the public is usually referred to as currency in circulation.

Central (sovereign) government debt

A government which is economically sovereign creates and issues the currency used by its citizens. And traditionally it also creates and issues securities, which are instruments of debt sold to the private sector on the open market. When government securities are sold to the non-bank private sector, money is extracted from the economy in exchange for another (generally liquid) financial asset, so that the financial wealth of the private sector remains unchanged.

MMT asserts that such public debt is fundamentally different to private debt, in that it is always possible for a government which issues currency to roll the debt over - in perpetuity - and to pay any interest due on that debt. According to MMT there is no constraint, at least in principle, on the ability of a sovereign government to effect such payment. For a sovereign government there is no "central government debt problem" as such, the latter term indicating a misunderstanding held by those with a poor understanding of macroeconomic principles.

Spending, taxing and borrowing

Contrary to what many neoclassical economists believe (and would have others believe), a sovereign government engages in taxing and borrowing only ostensibly for the purpose of raising revenue. Although central governments *behave* as if taxing and borrowing is undertaken in order to raise revenue, the MMT interpretation is that this is not what really happens. Thus government does not need to raise revenue for the purpose of funding specific cost items, because new money is injected into the economy whenever it spends.

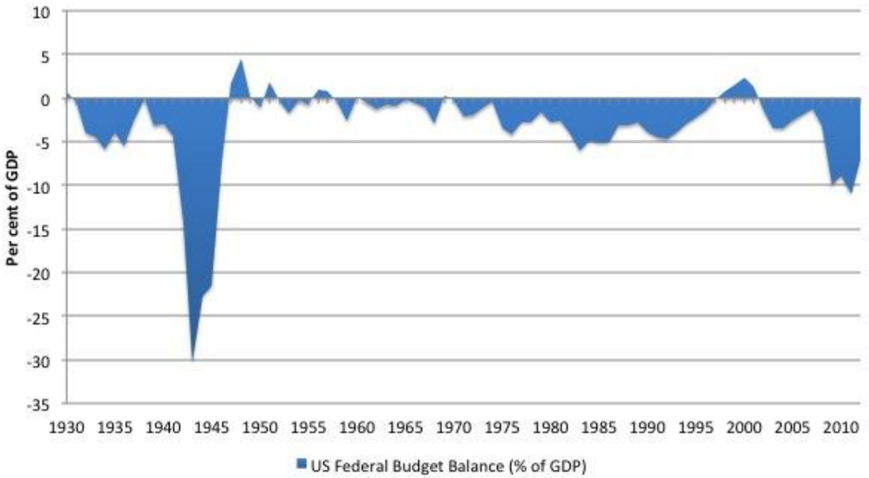
Spending introduces new money into the economy, while taxing and borrowing remove money from the economy. Although at first sight there might appear to be a chicken-and-egg relationship in these fiscal flows, MMT asserts that the causal relationship is for spending to come first, and for taxing and borrowing to follow. If this relationship postulated by MMT is accepted, then it follows that the real and largely hidden purpose of taxing and borrowing is to recapture the money which a central (sovereign) government spends into the economy, in order (a) to keep a lid on inflation, and (b) to ensure that money moves around the economy with sufficient velocity.

Central government and the lower levels of government

The lower levels of government (state, provincial and municipal) do not issue their own currencies and - in Australia at least - do not impose income taxes on those whom they govern, although they are accustomed to imposing a range of other taxes, duties and levies. Their fiscal constraints are therefore quite different to those of the central government. A lower level of government - in common with the private sector - is obliged to be more careful in its budgeting than is a (sovereign) central government, which may safely run a budget deficit in perpetuity (and arguably should do so, according to MMT ideas).

Deficits are the norm

The following graph of the U.S. federal budget balance over 82 years (care of a blog by Bill Mitchell -- http://bilbo.economicoutlook.net/blog/?p=22551) reveals that budgets have been in deficit for around 85% of the time. In other words, deficits are the norm and surpluses are the exception. I suspect that much the same picture would emerge with a more extended time-span. The history of budget balances indicates that the oft-held belief that running a sequence of budget deficits will have dire inflationary consequences for the economy is not grounded in reality. And MMT advocates insist that any drive to achieve a budget surplus in circumstances where there are idle resources and reduced aggregate demand is economic vandalism, because it leads to unnecessary austerity and can only hinder economic recovery.



Accounting conventions

Banking operates according to a set of accounting conventions, which are rules designed to match the receipt/loss of a certain type of asset by a banking institution (depository) with the receipt/loss of a liability of equal magnitude. The asset of particular concern is newly created bank credit money, which arises when a bank advances a new retail loan or when a cheque drawn on the central bank is deposited.

It is generally held by economists that banking reserves should be regarded as central bank liabilities. On the other hand, it may be argued also that it is inappropriate to attempt to make a central bank, as the creator and destroyer of state fiat money, conform to the accounting rules which apply to commercial banks.

Central government's account with the central bank

Every central government maintains one or more accounts with its central bank. In Australia for example the federal government does its banking with the Reserve Bank of Australia (RBA). Thus the cheques written by an Australian government department are drawn on the RBA. The situation in New Zealand is a little different, as revealed by the following statement found in a part of the RBNZ website (http://www.rbnz.govt.nz/education/0114246.html):

> Although the government ultimately does all of its banking with the Reserve Bank (via its Crown settlement account, or CSA), it uses an account held at

Westpac for its transactions with the public. That's why payments from the government, e.g. unemployment benefits, are paid using Westpac cheques. The transactions in this account are totalled up and the balance is transferred to the CSA at the end of the banking day.

The general account of a central government with its own central bank records in monetary terms the government's various fiscal operations - specifically spending, borrowing from the private sector, tax receipts, and all other receipts. When a central government spends, its general account is debited accordingly. And when it borrows from the private sector or acquires tax (or other) receipts, its general account is credited accordingly.

There is general agreement that central government spending entails the creation of new retail demand deposits and an increase in the money supply (as measured by the monetary aggregate M1), while central government borrowing, taxing and the receipt of other income entails a reduction in the money supply. A more interesting issue is the fate of the banking reserves, which generally tag along with retail deposits in the broader economy. While the precise mechanics differs from country to country, in each case there exists some combination of (a) immediate removal of those reserves, in exchange for an increase in the government's general account, (b) use of the reserves to temporarily purchase highly liquid (risk free) financial assets, and (c) use of the reserves to temporarily create deposits in commercial banks (which deposits, however, lie outside the money supply M1). Items (b) and (c) are holding options, and those reserves are retrieved in a piecemeal manner as and when required according to the need to offset government spending operations, once again involving the removal of those reserves whenever the general account requires to be increased. The practice of maintaining holding investments and/or commercial bank deposits exists only for the purpose of regulating (minimising fluctuations in) the volume of banking reserves during the course of a financial year.

Are government deposits in the central bank money?

The economic mainstream hold that government entries or "deposits" in its own central bank account are a form of state fiat money, moreover one which is interchangeable with reserves. There is an alternative viewpoint, which is consistent with MMT ideas, which holds that such "deposits" are not money in any real sense of the word, but are merely accumulated credits in an operating account. An operating account records a financial reality, but it does not need to be regarded as a form of money. The rationale for this perspective is:

(a) One of the essential requirements of any entity which acts as money is that it is used by (traded, loaned and borrowed between) a sufficiently large number of marketplace players who have similar status and objectives in regard to those operations. Banking deposits in the central bank satisfy this criterion, since all of the players are in competition with each other with the common objective of maximising financial profit. In contrast, a central government maintains an account with its central bank for a quite different purpose, and its spending has a different objective, to that pertaining to commercial banks; and

(b) There are other examples within the financial system of accounts which are not regarded as being stores of spendable money, such as commercial banks' internal operating accounts.

On this basis it may be held that the central government stands alone - that is, not in competition with any other entities possessing accounts with the central bank. Indicators of this difference lie in the fact that *a central government sells bonds but never needs to buy bonds, and also borrows money but never needs to lend money*. If all of this is held to be true then arguably the entries in the government's general account are not money.

John Hermann is the ERA network editor

Locke's unscientific economics
David Faber

In the late 17th century the English metallic medium of circulation was being clipped out of existence. Gresham's law* was in operation for all to see as damaged silver coin passing current at face value drove sound coin out of circulation. The market price of silver bullion had risen above the mint price, the price paid in coin by the Royal Mint. The solution, said Treasury Secretary Lowndes, was to devalue the coinage. The method was to increase the face value of a coined ounce of silver from the current legal standard of 5 shillings 2 pence to its market price of 6 shillings 3 pence, thereby removing the premium accruing to the clippers. This would allow the coinage to circulate by removing the incentive to clip and melt it down.

The philosopher John Locke argued against this in the teeth of logic and evidence in the name of the sectional interest of those `with estates in money' who principally stood to gain from an enhancement of the bullion content of the clipped coinage. Locke argued that the damaged coinage ought to be revalued, that its bullion content be effectively raised to restore a sacrosanct *status quo ante*. Locke's monetary theory was bullionist. He argued that the bullion content of the coinage represented its `intrinsic value.' In what may be considered an example of Gresham's law applied to logic, bad argument drove out good. Locke, the politically well connected and rhetorically savvy professional wrangler, trumped Lowndes, the practical civil service economist.

The matter was put to the test to the delight of the clippers and currency speculators, who melted and exported the restored coinage, which continued as a dysfunctional and dubious medium of exchange. The Great Recoinage failed to repair the circulating medium. Domestic commerce was disrupted to the point of civil disturbance. Moreover the ability of the State to pay for military operations on the continent in the battle for world hegemony with Louis XIV was embarrassed. `No specific, intended goal of recoinage was achieved except for Locke's abstract and novel one of turning a mint standard into an immutable fact of nature'.[i] The anti-empirical policy recommended by the great empiricist was objectively a total and abject failure as a fiscal policy measure,[ii] precisely because its objective was exquisitely ideological. The silver standard was effectively shattered by the Great Recoinage. Silver coin remained in disrepair throughout the eighteenth century. Only perversely was Locke to be a progenitor of the gold standard arrived at in the nineteenth century, when as the historian of the pound sterling reports 3 pounds 17 shillings and 10 pence – halfpenny came to be regarded as a magic price for gold, a dogma which would wreak its own baleful influence into the twentieth century.[iii] Locke was not a scientific economist but rather a father of one of the key shibboleths of bourgeois culture. The economic consequences of Mr Locke led onto those of Mr Churchill.[iv]

Yet Locke continues to be hailed in some quarters as a founder of `scientific' economics. In fact he was primarily an important forefather of the weakness of conventional economics for special pleading for vested interests. The purpose of this article is to rehearse this under-appreciated historical case, drawing some sceptical conclusions; principally that our philosophical emperor, if not naked, is under dressed. It is further maintained that Locke the ideologist is a much more interesting historical figure than the traditional John Locke of liberal hagiography, the public spirited academic and apostle of the Enlightenment[v]. Rather he was an intellectual activist of the revolutionary Whig party which formed first around Shaftesbury and successively around John Lord Somers and the parliamentary magnates who implemented the revolutionary settlement after 1688.[vi]

In 17th century England, the pulse of commercial life was quickening, and this led to a birth of economic debate on the mysteries of the market emerging from former customary relationships. Indeed `the increase in the number and kinds of market exchanges, with money as their measure, was perhaps the most striking social fact in the latter half of the century…Definitions of money also provided the context for a struggle for economic power, first between public authority and private entrepreneurs and subsequently between conflicting economic groups. Much of the fighting was waged through competing descriptions of reality…'[vii] This was certainly the case with Locke's economics, and it is in these terms that its bruited scientific quality must be assessed.

When `Locke carried the day…money borrowed at ten or fourteen shillings to a guinea was repaid in guineas of twenty shillings.'[viii] A contemporary, Henry Layton, had made precisely this charge that Locke `extends his Care to Creditors and Landlords, not regarding the Cases of Tenants or Debtors; Men for this four or five years last passed have borrow'd many Thousand Pounds in Clipt Money, but he notes no unreasonableness or injustice in compelling them to pay such Debts again in Heavy Money, perhaps of twice the weight.'[ix] In the event the English silver currency, with an estimated face value of 4.7 million pounds, was reduced by reminting at the old standard to around 2.5 million pounds, inducing `the folly and disaster', predicted by Locke's critics, of a catastrophic restriction of the money supply.[x]

Marx understood that Locke was the spokesman for an emergent new class, composed of diverse sections of the old and the new order. In his economic writings `Locke was an advocate of the new bourgeoisie in all its forms, the manufacturers against the working classes and paupers, the commercial class against the old fashioned usurers, the financial aristocracy against the state debtors…' Marx had no difficulty in citing to this effect the economist Sir James Steuart, who was of the view that the Great Recoinage had profited the state qua tax collector, `as well as the creditors upon their capitals and interest' at the expense of the general public. But Marx went further. He maintained that Locke `went so far as to prove in his own work [as a philosopher] that bourgeois reason is the normal human reason…'[xi] This is the foundation statement of a sociological critique of the *Essay on Human Understanding*. Locke is identified as the titan who forged the received opinions of his class, that famous `common sense', which as Russell famously expostulated, the English have had to the preclusion of all others ever since.[xii] The author of the *Essay* was an agent of cultural coalescence of the bourgeoisie. It is a function apparent also in the *Letters on Toleration* of 1689, in which Locke features as the moderator of the religious divisions which had historically undermined efforts to consolidate a unifying class interest of the upper and middle orders of British society.[xiii] For Locke was terrified by the memory of the Civil War he had lived through in his youth, when he held that the lower orders had been brought into play `in the Male-administration of neglected or mismanag'd Government' and `the usual Struggle and Contest' between `the Landed-man and the Merchant…'

> For the Labourer's Share, being seldom more than a bare subsistence, never allows that Body of Men time or opportunity to raise their Thoughts above that, or struggle with the richer for theirs, (as one common *Interest*) unless when some common or great Distress, uniting them in one universal ferment, makes them forget respect, and emboldens them to carve to their Wants with armed force: And then sometimes they break in upon the Rich, and sweep all like a Deluge…[xiv]

Nor were such concerns about the entry of the masses into politics unprecedented. They had been central to the politics of the Civil Wars. When the parliamentary governor of Hull Sir John Hotham and his son defected to the King in 1643 the son explained their concern that if the Civil War went on `the mutinous people of the whole kingdom will presently rise in mighty numbers' and `set up for themselves, to the utter ruin of all the nobility and gentry.'[xv] Indeed the King at the outset of the conflict with Parliament had made much of this perceived popular threat to the political elite in rationalizing his defence of monarchical prerogative in the context of socioeconomic unrest, publishing in his Answer to the Nineteen Propositions of the Commons the claim that an attack on the Crown would only encourage the common people, the *mobile vulgus,* to `set up for themselves call parity and independence liberty, destroy all rights and properties, all distinctions of families and merit' and plunge the whole nation into `a dark equal chaos of confusion.'[xvi] Because of these fundamental concerns arising out of the trauma suffered by the ruling class during the Civil Wars, they had no stomach during the crises of the Restoration (the Popish Plot, the Rye House Plot and Monmouth's Rebellion) for another fight with the Crown.[xvii] The conservative reaction in Britain to the French Revolution was of a piece with such concerns,[xviii] as is the modern neoliberal and conservative counter-revolution in defence of the indefensible born to rule mentality and economic free market dogma.[xix] All such ideologies seek essentially to reserve socioeconomic and political decision making to elite circles expressive of the prerogatives of private economic power at the expense of the public sector. The historical significance of Locke's economic thought, not to say his opus generally, lies in this cultural domain.

Far from being a pioneering public spirited scientist above partisan concerns who in his economic writings `forcefully suspended all judgements of theology, morality and justice, to consider the economy as nothing more than an intricate mechanism'[xx], Locke was a highly political economist. The enduring prejudice that political and ethical concerns are mere `externalities' to economic thought was a significant but hardly scientific aspect of Locke's economic ideology, and is itself political in nature.

The views he published at Somers' behest during the Coinage Crisis after the Glorious Revolution dated from his early years in the Shaftesbury household when a bill embodying the merchant Sir Josiah Child's proposals to restrict the rate of interest was introduced into the Commons in April 1668. Child's *Brief Observations concerning Trade & Interest of Money* rationalized the aspirations of the East India Company which was experiencing difficulty in recapitalizing after the Second Anglo-Dutch War. The low interest rate Dutch economy was an object of envy and admiration. Child found it opportune to reason from the particular to the general, adopting the broad stance that `the Abatement of Interest is the Cause of the Prosperity and Riches of any Nation.' Locke by contrast argued that far from being the `Cause of Riches' interest was `only the Effect of them.' Locke worked on his paper on interest until 1674, only publishing it as embodied in his writings on money during the Recoinage crisis. The Recoinage crisis was a monetary crisis of the early modern British economy. It affected the prime form of contemporary money, the coinage, a bullion based form of commodity money circulating at a face value in money of account. It thus incorporated a fiat element in terms of the issuing authority of the state as coiner incorporating utility and exchange value as a medium of exchange. Coinage was an historical form of money very different from the fiat money of today. Locke's insistence that the bullion content of the clipped coinage be restored was rooted in the mistaken `common sense' view that bullion was money. In fact only bullion monetized by the state as coin was money.

For essential context see Dickson *The Financial Revolution.* Dickson found that during the Recoinage crisis Somers' government did not know what to do, and needed someone to be dogmatic to spare its blushes. Locke was prepared to be that dogmatist, and answered Somers' call for advice. My study is essentially an historical study in how economic dogma passes current as science. It presupposes that money is an evolving historical phenomenon.

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*** Editorial addendum:** Gresham's law is an economic principle that states: "When a government compulsorily overvalues one type of money and undervalues another, the undervalued money will leave the country or disappear from circulation into hoards, while the overvalued money will flood into circulation." It is commonly stated as: "Bad money drives out good", but is more accurately stated: "Bad money drives out good if their exchange rate is set by law."

[1] Appleby *Economic Thought & Ideology in 17th C England*, Princeton 1978 p235-6
[1] Monetary historians Sargente & Velde report `Locke's writings about the coinage belie his reputation as an empiricist philosopher...But politically Locke triumphed over Lowndes the empiricist.' *The Big Problem of Small Change* Princeton 2002
[1] See Feavear cited in Appleby p239
[1] For discussion of the Gold standard debate between the wars see Skidelsky *JM Keynes: The Economist as Saviour1920-37* MacMillan 1994 p153-207
[1] See Woolhouse *Locke: A Biography* Cambridge 2007 updating Cranston *John Locke* Longmans 1957
[1] See Haley *The First Earl of Shaftesbury* Clarendon 1968 & Ashcraft *Revolutionary Politics &Locke's Two Treatises of Government* Princeton 1986
[1] Appleby p199 & 201
[1] Marx *A Contribution to the Critique of Political Economy* CH Kerr & Co Chicago 1904 p93-4
[1] Cited in Appleby p234
[1] Appleby p235. Sargente & Velde quote similar figures p286
[1] Marx *A Contribution to the Critique of Political Economy* CH Kerr & Co Chicago 1904 p93-4. For a reading of the *Essay on Human Understanding* in much these terms focussing on `The Ideal of Bourgeois Man' see Wood *The Politics of Locke's Philosophy* Berkeley 1983. For a brief apology for Locke's epistemology see Jeffrey's *John Locke: Prophet of Common Sense* Methuen 1967 and extensively pere index in Russell *History of Western Philosophy*
[1] Sargente & Velde point out that Locke, far from being modern, de facto `reverted to the medieval "communis opinio"'; op cit p263. The point, well made as to Locke's economics, is prima facie extensible to his philosophy.
[1] Locke of course argued in general and universalistic terms, but addressed himself to the middle classes. See Marshall *John Locke, Toleration & Early Enlightenment Culture* CUP 2006 wherein it is noted that Locke argued that tolerance and moderate government of religious diversity pacified society and legitimized authority p546-8
[1] See Kelly ed *Locke on Money* OUP 1991 p290-91
[1] Kenyon *The Civil Wars of England* Knopf NY 1988 p40
[1] Ibid p37
[1] Ibid p244-5

[1] Ibid p245
[1] The classic original statement of modern traditionalist political conservatism is of course Burke's *Reflections on the Revolution in France.* John Howard described himself as a `Burkean social conservative.' For an accessible example of contemporary hard line neoliberalism see Judith Sloane's columns in *The Australian.*
[1] Letwin *The Origins of Scientific Economics: English Economic Thought 1660 -1776* Methuen London 1963 p147

How neoliberalism trashed your life; made the super-rich even richer

George Monbiot

How they must bleed for us. In 2012 the world's 100 richest people became $241 billion richer (1). They are now worth $1.9 trillion: just a little less than the GDP of the United Kingdom.

This is not the result of chance. The rise in the fortunes of the super-rich is the direct result of policies. Here are a few: the reduction of tax rates and tax enforcement; governments' refusal to recoup a decent share of revenues from minerals and land; the privatisation of public assets and the creation of a toll-booth economy; wage liberalisation and the destruction of collective bargaining.

The policies which made the global monarchs so rich are the policies squeezing everyone else. This is not what the theory predicted. Friedrich Hayek, Milton Friedman and their disciples - in a thousand business schools, the IMF, the World Bank, the OECD and just about every modern government - have argued that the less governments tax the rich, defend workers and redistribute wealth, the more prosperous everyone will be. Any attempt to reduce inequality would damage the efficiency of the market, impeding the rising tide that lifts all boats (2). The apostles have conducted a 30-year global experiment and the results are now in. Total failure.

Before I go on, it should be pointed out that I don't believe perpetual economic growth is either sustainable or desirable (3). But if growth is your aim - an aim to which every government claims to subscribe - you couldn't make a bigger mess of it than by releasing the super-rich from the constraints of democracy.

Last year's annual report by the UN Trade and Development Conference should have been an obituary for the neoliberal model developed by Hayek and Friedman and their disciples (4). It shows unequivocally that their policies have created the opposite outcomes to those they predicted. As neoliberal policies (cutting taxes for the rich, privatising state assets, deregulating labour, reducing social security) began to bite from the 1980s onwards, growth rates started to fall and unemployment to rise.

The remarkable growth in the rich nations during the 1950s, 60s and 70s was made possible by the destruction of the wealth and power of the elite, as a result of the Depression and the second world war. Their embarrassment gave the other 99% an unprecedented chance to demand redistribution, state spending and social security, all of which stimulated demand.

Neoliberalism was an attempt to turn back these reforms. Lavishly funded by the very wealthy, its advocates were amazingly successful: politically (5). Economically they flopped.

Throughout the OECD countries, taxation has become more regressive: the rich pay less, the poor pay more (6). The result, the neoliberals claimed, would be that economic efficiency and investment would rise, enriching everyone.

The opposite occurred. As taxes on the rich and on business diminished, the spending power of both the state and poorer people fell, and demand contracted. The result was that investment rates declined, in step with companies' expectations of growth (7).

The neoliberals also insisted that unrestrained inequality in incomes and flexible wages would reduce unemployment. But throughout the rich world both inequality and unemployment have soared (8). The recent jump in unemployment in most developed countries - worse than in any previous recession of the past three decades - was preceded by the lowest level of wages as a share of GDP since the second world war (9). Bang goes the theory. It failed for the same obvious reason: low wages suppress demand, which suppresses employment.

As wages stagnated, people supplemented their incomes with debt. Rising debt fed the deregulated banks, with consequences of which we are all aware. The greater inequality becomes, the UN report finds, the less stable the economy and the lower its rates of growth. The policies with which neoliberal governments seek to reduce their deficits and stimulate their economies are counter-productive.

The impending reduction of the UK's top rate of income tax (from 50% to 45%) will not boost government revenue or private enterprise (10), but it will enrich the speculators who tanked the economy: Goldman Sachs and other banks are now thinking of delaying their bonus payments to take advantage of it (11). The welfare bill approved by parliament last week will not help to clear the deficit or stimulate employment: it will reduce demand, suppressing economic recovery. The same goes for the capping of public sector pay. "Relearning some old lessons about fairness and participation," the UN says, "is the only way to eventually overcome the crisis and pursue a path of sustainable economic development." (12)

As I say, I have no dog in this race, except a belief that no one, in this sea of riches, should have to be poor. But staring dumbfounded at the lessons unlearned in Britain, Europe and the United States, it strikes me that the entire structure of neoliberal thought is a fraud. The demands of the ultra-rich have been dressed up as sophisticated economic theory and applied regardless of the outcome. The complete failure of this world-scale experiment is no impediment to its repetition. This has nothing to do with economics. It has everything to do with power.

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6. The UN reports: "The overall effect of these changes in the tax structure made taxation more regressive. Indeed, a review of tax reforms in OECD countries did not find a single country where the tax system became more progressive (Steinmo, 2003: 223)." UNCTAD, 2012, as above.
7. "Redistribution through fiscal measures may therefore be in the interest of society as a whole, especially where inequality is particularly pronounced as in many developing countries. This is supported by the experience in developed countries, as investment rates were not lower - but indeed often higher - in the first three decades of the post-war era, even though taxes on profits and top incomes were higher than after the widespread fiscal reforms implemented subsequently. There are strong reasons to believe that the willingness of entrepreneurs to invest in new productive capacity does not depend primarily on net profits at a given point in time, but on their expectations regarding future demand for the goods and services they can produce with additional capacity. This is of particular importance when considering the overall effect of an increase in corporate taxes. Provided that higher tax revenues are used for additional government expenditures, companies' expectations of a growth in demand will improve. This demand effect is independent of whether the additional government expenditures take the form of government consumption, public investment or social transfers. When the level of fixed investment is maintained as a result of favourable demand expectations gross profits will rise − and generally so will net profits, notwithstanding the initial tax increase. In the process, additional income and employment will be created for the economy as a whole." UNCTAD, 2012, as above.
8. "The proposition that greater flexibility of the aggregate wage level and lower average wages are necessary to boost employment, as they lead to a substitution of labour for capital in the economy as a whole, can be directly refuted, given the strong positive correlation between investment in gross fixed capital formation (GFCF) and employment creation that exists in developed countries (chart 6.3). This correlation contradicts the neoclassical model: in the real world, companies invest and disinvest in capital and labour at the same time, and the level of their investment depends on the overall state of the economy, which determines their demand expectations. This implies that, in the macro-economic context, capital and labour can be considered substitutes only to a very limited extent." UNCTAD, 2012, as above.
9. "Just ahead of the new big jump in unemployment in developed countries − from less than 6 per cent in 2007 to close to 9 per cent in 2010-2011− the share of wages in overall GDP had fallen to the lowest level on record since the end of the Second World War (i.e. to 57 per cent, down from more than 61 per cent in 1980). This should be a wake-up call. If unemployment rises more than during any other recession that occurred during the last three decades, even though the share of wages in GDP has fallen, there must be something fundamentally wrong with an economic theory that

justifies the rise of inequality mainly in terms of the need to tackle persistent unemployment." UNCTAD, 2012, as above.
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Source: George Monbiot Website <http://www.monbiot.com/2013/01/14/bang-goes-the-theory/> Also published in The Guardian (UK), 15th January 2013

Concentration of corporate and elite power at the root of economic and ecological crisis

Susan George

Susan George provides an introduction to TNI's State of Power 2013 report, exposing how the unprecedented concentration of corporate and elite power is at the root of our economic and ecological crisis

Towards the end of 2011, three young, smart and tenacious mathematicians specializing in complexity theory at the Zurich Polytechnic published the paper the rest of us had been waiting for - except, to be truthful, we didn't even know we'd been waiting for it. Nobody had ever assumed it might be possible to put the powerful structures of corporate control in an unarguably rigorous scientific framework.1

That is what Stefano Battiston, James Glattfelder and Stefania Vitali, or BG&V, did with their Network of Global Corporate Control and TNI is gratefully borrowing from them in this pamphlet. Naturally we had good sources for our Infographics series before and we're using them again—lots of lists of the Biggest and the Richest had been published earlier from reliable sources such as the UN or major corporations themselves (e.g. Merrill-Lynch) or magazines serving that very clientele like Forbes.

But BG&V skewered the Davos Class - my name for those who personify the interconnected nature of the world's most powerful corporations; interchangeable individuals with common interests and goals that make them a genuine international, nomadic social class.

The mathematicians did it by mapping the topography of the corporate universe just as astronomers map the suns, planets, constellations and supernovae of the night sky and they demonstrated how they are interconnected through direct and indirect ownership.

One percent control 40% of TNCs

Starting with a vast data-base of 43.000 TNCs (Transnational Corporations) they reduce this huge sample to a core group of 1300 of the largest, most powerful companies with strong links to each other, links guaranteeing that three-quarters of all the ownership ties remain in the hands of the core firms themselves.

This group is further refined to 737 companies that control 80% of the value of all 43.000 companies in the initial sample. The next refinement produces a “super-entity” of 147 companies, with near total control over itself plus 40% of the value of all the TNCs.

But it’s the annex that supplies the real kicker in the form of a list of 50 companies that exemplify what BG&V call the “knife-edge” property—that uncomfortable perch where things can go one way or the other, in the right or wrong direction.

If all is well with the economy the structure looks strong and healthy. But if a single one of these hugely interconnected companies gets into trouble, the dominoes are set up to fall and it can be Lehman Brothers or worse, all over again. Who, then, figures on this exclusive list? Of the 50 corporations, only two are involved with the real economy—Walmart and the China Petrochemical Group—the rest are all banks, mammoth insurance companies or other financial firms.

The actors of the Davos class are not conspiring or conniving nor are the structures of their power relationships the result of some intentional design—they simply reflect the Way Things Are. And the way things are is extremely dangerous, especially on the edge of the corporate knife.

Money and Oil

The exceptional concentration of the financial sector figures prominently in this issue of the State of Power and for good reason. Partly it’s because of the concentrated nature of the sector, as BG&V so brilliantly illustrate.

But there are other reasons to worry about the concentration of corporate power and one of them is, paradoxically, climate change. Finance, properly oriented, could be helping us to invest in a massive transition to clean energy and transport throughout the world. But check out the infographics on the inter-linkages between finance and big oil and gas, as well as with gas-guzzling vehicles’ producers and you will see a different light shine on the subject.

The tableau of links between the Boards of Directors of the largest banks and the largest energy companies does not give the impression that these interests are about to take up arms against each other, to put the matter as gently as possible. It looks, rather, like a flagrant case of ‘I scratch your back and you scratch mine’.

The enormous profits of the oil and gas giants and the enormous profits of the banks ensure that they will defend each other mutually and will also defend the status quo. Meanwhile, these extractive industries guarantee that global warming will continue. In fact, the boldest experts say that we may as well stop even discussing how to avoid it. Unless governments by some miracle stop defending at once both the banks and the extractive industries, the planet is going to change more and more rapidly. The conversation now has to be about adaptation for the most vulnerable.

Inequality back on the public agenda

This doesn't mean that citizens should stop resisting power and give up, quite the contrary. Other infographics will remind readers that all too often, corporate power leaves State power in the shade.

The power of the richest .01 percent of the population has also become a permanent scandal. Most of the High Net Worth Individuals—and the crème de la creme Ultra-High Net Worth Individuals--are in the US or Europe. This tiny segment of the population pays lower taxes than at any time since the 1920s and that, at least, we can hope to change. Economists as famous and as listened-to as Joseph Stiglitz are now explaining how huge inequalities "hold back the recovery".

Barack Obama is in his second term and could perhaps be persuaded to do something about the stagnant US economy and win tax increases on corporations and the rich, difficult as the Congress may be. In Europe, where for the moment austerity reigns, it's easy to show that austerity policies do not and cannot work, if by "working" one means bringing about recovery (preferably in a good and green way) and creating more jobs.

Even the IMF is announcing--sometimes in roundabout and veiled terms --that it's being forced by circumstances to rethink its policies.

Power of resistance

Infographics readers have every reason to continue to resist and to create more centers of tension, helping others to see how the cards are now stacked against ordinary people and how they can create a mass consciousness of this injustice. Whatever the destiny of Occupy Wall Street, it made a permanent contribution by making the "1%" part of the international conversation. All of us at TNI hope that this issue of The State of Power will help more and more people to understand that our real problems stem from the 0.1%, indeed the 0.001%.

1. Vitali S, Glattfelder JB, Battiston S (2011), *The Network of Global Corporate Control*. PLoS ONE 6(10): e25995. doi:10.1371/journal.pone.0025995

Susan George is one of Trans National Institute's most renowned fellows for her long-term and ground-breaking analysis of global issues. *This article by Susan George was originally published on http://www.tni.org under a Creative Commons Licence http://www.tni.org/article/corporate-power-and-crisis, Jan 22, 2013*

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." Mark Twain

"I can't imagine economists admitting how little they actually know. Admitting it to themselves would hurt their ego, and admitting it to others would hurt their job prospects." Joseph Mattes

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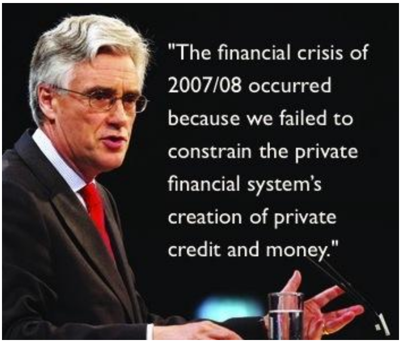
Debt, Money & Mephistopheles: How do we get out of this mess?
Andrew Jackson



On the 6th February 2013, the chairman of the FSA, **Lord Adair Turner** (above), gave a speech at Cass Business School, entitled *"Debt, Money and Mephistopheles: How do we get out of this mess?"* The subject of the speech was the way in which the economy might be brought out of recession.

This post is the authors attempt to pick out some of the key points of Lord Turner's speech, and provide a brief commentary where required.

Turner' speech starts by noting that for monetary policy to achieve a specific target (i.e. growth, low and stable inflation, unemployment, etc.) the correct tool is required:

> "The question is by what means can we and should we seek to stimulate or constrain aggregate nominal demand. Before the crisis the consensus was that conventional monetary policy, operating through movements in the policy rate and thus effecting the price of credit/money, should be the dominant tool, with little or no role for discretionary fiscal policy and no need for measures focused directly on credit or money quantities. Post-crisis, a wide spectrum of policy tools is already in use or under debate."

One such tool is: "overt money finance (OMF) of fiscal deficits – "helicopter money", permanent monetisation of government debt." Turner points out that such a policy was proposed by Milton Friedman in his 1948 paper, *A Monetary and Fiscal Framework for Economic Stability*:

> "As the title implies, one of his concerns was which fiscal and monetary arrangements were most likely to produce macroeconomic stability - meaning a low and predictable rate of inflation, and as steady as possible growth in real GDP. He was also concerned with financial stability, which he perceived as important per se and because of its effects on wider economic stability.
> His conclusion was that the government should allow automatic fiscal stabilisers to operate so as "*to use automatic adjustments to the current income stream to offset at least in part, changes in other segments of aggregate demand*", and that it should finance any resulting government deficits entirely with pure fiat money, conversely withdrawing such money from circulation when fiscal surpluses were required to constrain over

> buoyant demand. *Thus he argued that, "the chief function of the monetary authority [would be] the creation of money to meet government deficits and the retirement of money when the government has a surplus*". Friedman argued that such an arrangement – i.e. public deficits 100% financed by money whenever they arose – would be a better basis for stability than arrangements that combined the issuance of interest bearing debt by governments to fund fiscal deficits and open market operations by central banks to influence the price of money."

An important assumption in Friedman's analysis however, is that:

> "all money is base money, i.e. that there is no private money creation … This in turn is because in Friedman's proposal there are no fractional reserve banks. In Friedman's proposal indeed, the absence of fractional reserve banks is not simply an assumption, but an essential element, with Friedman arguing for "*a reform of the monetary and banking system to eliminate both the private creation and destruction of money and discretionary control of the growth of money by the central bank*".

This is also the UK Positive Money proposal. Turner continues:

> "Friedman thus saw in 1948 an essential link between the optimal approach to macroeconomic policy (fiscal and monetary) and issues of financial structure and financial stability. In doing so he was drawing on the work of economists such as Henry Simons and Irving Fisher who, writing in the mid-1930s, had reflected on the causes of the 1929 financial crash and subsequent Great Depression, and concluded that the central problem lay in the excessive growth of private credit in the run up to 1929 and its collapse thereafter… made possible by the ability of fractional reserve banks simultaneously to create private credit and private money".

The ability for private banks to create money makes the current banking system inherently unstable. As Henry Simons, one of the original authors of the Chicago Plan put it:

> "in the very nature of the system, banks will flood the economy with money substitutes during booms and precipitate futile efforts at general liquidation afterwards". He therefore argued that "private institutions have been allowed too much freedom in determining the character of our financial structure and in directing changes in the quantity of money and money substitutes".

As Turner explains, this leads to a great paradox - one of the father figures in the Chicago school of economics, Henry Simons, "believed that financial markets in general and fractional reserve banks in particular were such special cases that fractional reserve banking should not only be tightly regulated but effectively abolished."

Turner does not agree that the current banking system should be abolished, arguing that a) debt contracts have arisen naturally as a way of fulfilling human desires, and b) that the current banking system allows maturity transformation which is economically beneficial. As this post is merely an outline of the points Turner raises in his paper we will not delve too deeply into the counterarguments to his points, other than to note that both debt contracts and maturity transformation are possible under both the UK Positive Money proposals and the Chicago Plan, and as a result these are not grounds for rejecting monetary reform.

In the next part of his speech Turner argues that: "The financial crisis of 2007 to 2008 occurred because we failed to constrain the financial system's creation of private credit and money; we failed to prevent excessive leverage." This explanation of the crisis derives directly from the work of economists such as Hyman Minsky.

Turner then goes on to point out that since the crisis banks are making new loans less quickly than old loans are being repaid, both as a result of banks not wanting to make new loans and also due to a lower demand for new loans from the private sector. This in turn:

> "depresses both asset prices and nominal private demand, threatening economic activity and income, and making it more difficult for firms and individuals actually to achieve desired deleveraging. Such an attempted deleveraging was as Irving Fisher argued fundamental to the process by which the financial crisis of 1929 turned into the Great Depression. And as Richard Koo has argued, it is core to understanding the drivers of Japan's low real growth and gradual price deflation over the past two decades."

In Koo's persuasive account, Japan from 1990 suffered a "balance sheet recession" in which the dominant driver of depressed demand and activity was private sector (and specifically corporate sector) attempts to repair balance sheets left overleveraged by the credit boom of the 1980s. In such "balance sheet recessions" Koo argues, the reduction of interest rates … has very limited ability to stimulate credit demand since firms' financing decisions are driven by balance sheet considerations. As a result, Koo argues, economies in a deleveraging cycle will face deep recessions unless governments are willing to run large fiscal deficits…" So while the Japanese experience would have been much worse without these deficits, they do not actually reduce the overall level of debt in an economy, instead they simply shift it from the private sector to the public sector. The problem is that public sector debt can also have negative effects if it gets too large, limiting the potential effectiveness of government spending financed by borrowing. As Tuner notes:

> "Post-crisis deleveraging, while essential for long-term financial stability, thus creates an immensely challenging macroeconomic environment.
>
> - Monetary policy acting through short or long term interest rates loses stimulative power.
> - Fiscal policy offsets may be constrained by long-term debt sustainability concerns.
> - And slow growth in nominal GDP makes it more difficult to achieve attempted deleveraging in the private sector, or to limit the growth of public debt as a % of GDP.
>
> The danger in this environment is that other countries could suffer not just a few years of slow growth, but the sustained decades of slow growth and rising public debt burdens which Japan has suffered. It is in this environment that we have to consider the two questions posed earlier.

- What are the appropriate targets of macroeconomic policy?
- And what policy tools should we use to achieve them?"

In the next section of the speech Turner argues that it may be desirable to target some combination of growth and prices changes with monetary policy (unlike the case today where only the change in the price level (i.e. the inflation rate) is explicitly considered). Moving on to look at the response to the crisis, Turner notes that:

> "All of the policy levers [low interest rates, QE, funding for lending etc]… work through interest rate, credit and asset price channels. In different ways they induce agents to change behaviour – by substituting money for bonds: by reducing medium and long-term interest rates and stimulating a search for yield: by directly or indirectly reducing the cost of credit supply: or by enabling banks to supply a higher quantity of credit as a result of lower capital or liquidity ratios. But the effectiveness of each of these transmission channels may be constrained if post-crisis deleveraging produces the "balance sheet recession" behaviours described by Richard Koo in Japan."

In addition, Turner makes the point that many of the current policy levers have possible negative side effects. As well as potentially increasing the probability of complex forms of speculation and creating beggar thy neighbour policies through their effects on the exchange rate, most of these policies only increase demand if they incentivise further private sector indebtedness. Yet:

> "We got into this mess because of excessive creation of private credit and money: we should be concerned if our only escape route implies building up a future excess."

In short, he is saying you can't solve a debt crisis brought on by people being overly indebted by getting the very same people to go further into debt:

> "An exclusive reliance on monetary, credit subsidy, and macro-prudential policy levers to stimulate nominal demand thus carries significant long-term risks – a danger that, in seeking to escape from the deleveraging trap created by past excesses, we may build up future vulnerabilities"

With the current set of monetary tools unlikely to have the desired impact on growth, Turner looks at alternative measures to stimulate the economy (i.e. government spending/tax cuts). As he puts it:

> "The argument for fiscal stimulus is that it operates in a more direct fashion, cutting taxes or increasing public expenditure, putting spending power directly into the hands of individuals or businesses."

However, if public levels of debt are already high, then this increase in government spending may not be as effective as it otherwise might be. The answer, Turner contends, is "overt money finance" (OMF). OMF (as outlined by Ben Bernanke in a 2003 speech, "Some thoughts on monetary policy in Japan") would work in the following way:

- "He proposed "*a tax cut for households and businesses that is explicitly coupled with incremental BoJ purchases of government debt, so that the tax cut is in effect financed by money creation*"

- He suggested that it should be made clear "*that much or all of the increase in the money stock is viewed as permanent*"
- He argued that consumers and businesses would likely be willing to spend their tax cut receipts since "*no current or future debt service burden has been created to imply future taxes*"…
- And he argued that the policy would likely produce a fall in the Japanese government debt to GDP ratio, since the nominal debt burden would remain unchanged while "*nominal GDP would rise owing to increased nominal spending*" And while his main illustrative proposal was for a tax cut, he noted that the same principle of a money financed fiscal stimulus "*could also support spending programs, to facilitate industrial restructuring, for instance*""

Bernanke's description of a money financed deficit thus makes clear its potential advantages over either pure monetary policy or pure funded fiscal deficits as a means of stimulating nominal demand:

> Compared with the [other] monetary policy options … it is more direct and certain in its first order effect. Monetary, credit support, and macroprudential policy levers work through the indirect mechanism of stimulating changes in private sector borrower and investor behaviours, and may therefore be ineffective if behaviour is driven by deleveraging during a balance sheet recession". OMF, because it finances an increased fiscal deficit, results in a direct input to what Friedman labelled "the income stream". As Bernanke notes, this means "that the health of the banking sector is irrelevant to this means of transmitting the expansionary effects", making concerns about "broken channels of monetary transmission" irrelevant. But unlike the funded fiscal policy stimulus considered in Section 6, the stimulative effect of a money financed increase in fiscal deficit will not be offset by crowding out or Ricardian equivalence effects, since no new interest bearing debt needs to be publicly issued, and no increased debt burden has to be serviced in future.

As a result, OMF is bound to be at least or more stimulative than an increase in funded fiscal deficits. As Friedman put it in 1948 "*the reason given for using interest bearing securities* [i.e. for running a funded fiscal deficit] *is that in a period of unemployment it is less deflationary to issue securities than to raise taxes. That is true. But it is still less deflationary to issue money*"

Essentially therefore OMF is a combination of fiscal and monetary policy levers; and the fiscal aspect of its character seems to make it quite distinct from QE which is unaccompanied by increased fiscal deficits and is intended to be reversed at some future date." Turner then points out that in fact QE, if it is never reversed, would be similar (but not identical) to OMF. Many have argued that government creation of money is bound to be highly inflationary, and Turner also has anticipated these concerns and addresses them in detail.

Further details of Lord Adair Turner's speech will be found in the source article:
http://www.positivemoney.org/2013/02/adair-turner-debt-money-and-mephistopheles-how-do-we-get-out-of-this-mess/