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Economic Reform Australia Review

For a just and sustainable society

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ERA intends to form an online discussion group on banking & financial reform. Details about issues of concern and how to register interest - by signing an associated petition - can be found on the banking reform section of the ERA website.

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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.

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$30 joint membership for partners) 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 are entitled to vote at ERA meetings and participate in organized activities.

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ERA membership renewal for 2013

If you have not done so yet, please renew your ERA membership as soon as possible. A reminder notice is about to be sent to unfinancial members. You will cease receiving the Review if you have not renewed by the end of August.

Debts that can't be paid, won't be repaid
Michael Hudson

An excerpt from a paper published for the conference *Paradigm Lost: Rethinking Economics and Politics*. Prof Hudson is attached to the University of Missouri (UMKC).

A common denominator runs throughout recorded history: a rising proportion of debts cannot be paid. Adam Smith remarked that no government ever had repaid its debt, and today the same can be said of the overall volume of private-sector debt. One way or another, there will be defaults – unless debts are paid in an illusory fashion, simply by adding the interest charges onto the debt balance until the sums finally grow to so fictitious a magnitude that the illusion of viability has to be dropped.

But freeing an economy from illusion may be a traumatic event. The great policy question therefore concerns just how the various types of debts won't be paid. The choice is between forfeiting property to foreclosing creditors, or writing debts down at least to the ability to pay, and possibly all the way down to make a fresh start. Somebody must lose, and their loss will appear on the other side of the balance sheet as another party's gain. Debtors lose when they have to forfeit their property or cut back other spending pay their debts. Creditors lose when the debts are written down or go bad.

The balance of gains and losses in such foreclosures depends – in narrow accounting terms – on the value of collateral being transferred. But from an economy-wide perspective the resolution of a debt overhead needs to be looked at as a long-term dynamic. Any such analysis turns on the role of specific classes of debtors and creditors within the economy – the 99% and the 1%, the "real" economy and the financial sector. It is not simply a matter of what contracts say ("A debt is a debt, and all debts must be paid.") The effect of debt on the economy's overall cost structure is most important – including the international dimension cited earlier with regard to the extent to which debt service and debt-leveraged housing prices and other output increase the cost of living and doing business.

Writing down debts reduces the overall economy's financial costs. Keeping debts on the books retains these costs. So when the financial sector (or the 1%) insists on maintaining the debts that have been run up – and supporting the debt-leveraged price of real estate pledged as collateral – securing its past "savings" gains are incompatible with maintaining a viable economy. The debt overhead becomes an expense that must be shed if the economy is not to shrink – and if it does shrink, more debts will go bad and a deteriorating spiral will set in.

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Perception of this long-term macroeconomic dynamic is what has led the past few centuries of legal trends and political ideology to favor indebted labor and industry, and indebted governments as well. It explains why debtors' prisons have been closed, and bankruptcy laws become increasingly humanitarian to enable debtors to make a fresh start. This idea of clean slates is only recently being extended to the economy-wide scale, starting with government debts to global creditors.

Today's financial trend threatens to reverse this pro-debtor reform tendency. Without acknowledging the economic and social consequences, the "business as usual" approach is a euphemism for sacrificing economies to creditors. It seeks to legitimize the disproportionate gains of banks and their rentier partners who have monopolized the past generation's surplus. And it is to protect these accumulations that the FIRE sector has spent part of these gains to become the dominant voice in government, including the courts, as well as academia. The aim in practice is to impose austerity and economic shrinkage on the private sector, while the public sector sells off its assets in a voluntary pre-bankruptcy.

The internal contradiction in this policy is that austerity makes the debts even harder to pay. A shrinking economy yields less tax revenue and has less ability to create a surplus out of which to pay creditors. Debt repayment is not available for spending on current goods and services. So markets shrink more.

This is not an inevitable scenario. Governments are sovereign with regard to their creditors. They still posses the alternative power to wipe out the debts – along with the savings that are their counterpart on the opposite side of the balance sheet. The German Currency Reform of 1948 remains a model. But it calls for creditors to take a loss.

This has happened again and again in history for the past five thousand years. Until recently it was the normal result of financial crashes – the final stage of the business cycle, so to speak. But as economies have been financialized, creditors have gained political power – and also the power to disable realistic academic discussion of the debt problem. What they fear most of all are thoughts of how to avoid today's arrangements that have given them a free lunch at the rest of the economy's expense.

Source; http://michael-hudson.com/2012/04/debts-that-cant-be-paid-wont-be/

Prof Michael Hudson is president of the Institute for the Study of Long-term Economic Trends (ISLET) in New York and London. Among his books are *SuperImperialism: The Economic Strategy of American Empire*; *Global Fracture: The New International Economic Order*; *The Bubble and Beyond*; and *Finance Capital and its Discontents*.

Money, taxes and what we can afford

Dan Kervick

People sometimes seem to suggest that the Western democracies are at the end of the road economically. They claim that these governments are spent, broke, tapped out. They insinuate that Western nations can no longer afford to carry out ambitious projects of the kind they organized in the past, and must downsize or dismantle many of the governance systems and public enterprises they currently operate. They insist that these democracies must hand over yet more of their nations' destinies to the financial and corporate baronies that dominate the private sector, and give the latter a free hand to arrange whatever kind of future they might deign to mash up for us as a by-product of their voracious struggles for private gain and glory.

This line of argument is quite wrongheaded and fundamentally illogical. There is no way that a democratic political community can be poorer than the parts of that community, and contemporary developed nations remain stupendously rich by global and historical standard. Those riches all lie available for potential use by mobilized, organized and ambitious democratic societies.

Contemporary democracies in the developed world are by no means poor, but are lacking only in morale, political will and determination, and audacious visions of the future. This failure of will is due in part to the fact that our plutocratic landlords have used the mass media that they own to demoralize and humiliate the public, to divide and distract its discontents, to sow confusion and disinformation, to sponsor unthinking brutality and barbarism, and to convince us to hate our fellow-citizens and hate democracy more than we hate the landlords who buy us and sell us.

To restore clarity, let's first reflect on some of the basics of economic and political organization. How can *any* organized political community afford *any* of the things it seeks to do?

Begin with the fact that there are certain large and important tasks that only governments can carry out well, and that these tasks both cannot and should not be entrusted to the hurly-burly business of private sector entrepreneurs seeking their own self-interest in the competitive capitalist ruckus. Such tasks might call for government direction and enterprise because they require an organizational scale and geographic reach that private firms can't achieve; or because they require the mobilization of publicly owned resources that private firms don't control; of because the end results they are meant to produce are diffuse good that can't easily be divided up and packaged as separate products to be sold in markets to multiple buyers; or because these end results are the kinds of things we want to distribute evenly, and not according to market imperatives based on ability to pay; or because the values the tasks are meant to realize are the fruits of humane wisdom and deep historical experience, and thus exceed the moral capabilities of the mercenary and philistine forces that drive most entrepreneurial profit-seeking.

To carry out these important tasks, the public will often have to shift control of many of the needed resources from private hands to public hands. For example, suppose the public decides to build a network of new schools and put them into operation. It will need resources. How can it get them?

One primitive option would be for the public to obtain the resources it needs by resorting to taxation in kind. There will exist some people or firms who already own bricks, and concrete, and steel, and glass, and books – or that at least own the resources needed to make these things. And some people will already possess the skills that enable them to perform the kinds of work that are needed to turn these material resources into schools. So the government could simply require those private individuals and companies to hand the material resources over to the public, and it could also demand that the skilled workers provide their labor services to the public free of charge.

But this approach would be unfair and oppressive. The taxation in kind system is unfair because even though the schools are a public need and building them is a public project, only some people would be required under this system to contribute their limited property, time or energies toward the project, while others would free-ride on those contributions. The system is also oppressive in its treatment of labor, since impressing the few into work for the sake of the many is a practice close to slavery.

What we would like to do is share the costs of the school project fairly, and take equal amounts of the needed resources from each citizen – or rather take those resources in proportion to the citizen's ability to contribute. But not everyone has a little bit of concrete, or a little bit of glass, or some of the necessary labor skills. So what to do? An alternative approach would be to tax only *some* of the needed resources from the people who possess them, and then *pay* those same people for the rest of what is needed. But with what do we pay them? We could pay them with ordinary goods and services of the kinds that almost everybody wants and needs, and we could tax these latter goods and services from everyone else. Everyone could chip in a little bit of whatever it is they have – food, televisions, movie tickets, gasoline, plumbing services – and then those things could be exchanged for the concrete, glass and construction labor that the public needs to build its schools.

While this is certainly fairer, it represents a dauntingly complex logistical and bureaucratic undertaking. The added costs of administering that comprehensive taxation and distribution plan seem wasteful. And the results will still probably not be as fair as we want, since not everyone owns the kinds of goods that are generally wanted. One thing we might try to do instead, then, is distribute certain certificates or vouchers to the people who are providing the concrete, glass, bricks, labor, etc. for the schools – vouchers that they could exchange almost *anywhere* for *whatever* it is they want, and whose exchange value is roughly equal to the value of the goods they are providing to the public, minus the value of their own fair contribution. But to make this work, we need to guarantee that almost everyone is willing to accept these vouchers in exchange for some good or service they provide. For that to work, the vouchers must have some value for the people who receive them.

But this is precisely what we have with a publicly administered and legally backed monetary system coupled with a supporting system of monetary taxation. We can issue a large sum of tokens or certificates, and demand that each person delivers back to the public a certain quantity of these tokens, according to any system that seems fair. In this way we can create a demand for the tokens.

We can then pay the suppliers of the building supplies and construction labor with the tokens. The tokens will have value to the recipients because there is now a broad general demand for the tokens, and so those recipients will find a market for the tokens among people who need to obtain some to pay their tax obligations. In order to make the system work we only need to credibly commit to taking something from people who do not deliver up the required quantity of tokens. To discourage shirking and make the system work effectively, we should probably commit to taking something from any given person of substantially more value than the anticipated exchange value of the quantity of tokens that comprise that person's tax obligation.

This approach probably solves most of our administrative problems by letting the broader public work out most of the distributional details among themselves. Instead of taxing some of the goods we want from a construction company and taxing other goods from many other people with which to pay the construction company for the rest of what we want, we just give the company tokens that have acquired value by being attached to tax obligations that are simpler to manage bureaucratically. Then we let the construction company exchange the tokens with others for goods and services of the company's choosing. This tax-driven monetary system is a good way for the public to provision itself with goods and services that are also provided by the same public, especially when the units of the goods and services that are needed cannot be provided in equal shares by all members of the population, but where it is nevertheless considered desirable that the rule for provision be just, and that everyone contribute a fair amount to the provision.

But the method described is only one way of organizing the public mobilization of resources for public purposes. We don't need to focus on the monetary system in order to understand the fundamental reason why the citizens of a country can always afford major investments in infrastructure and long-term strategic projects when they have the material resources and labor power they need to build the infrastructure and carry out those projects. Money is just a tool for conveying resources from one place to another. Ultimately, what the country *spends* on the projects it carries out is not the money it uses to move resources, but the resources themselves. The country can afford to use its resources for the desired purposes when the value generated for the nation by achieving those purposes would be greater than the combined value of the resources consumed and the pains of the labor expended, and when that value is greater than the value of anything *else* the country could do with the resources instead.

As we noted, in order to carry out its purposes the public usually has to shift control of resources it needs from private hands to public hands. This might be somewhat easier for a country that runs its own currency system, but it can always be accomplished one way or another by a resource-rich country with an effective government, and no monetary innovations or special monetary cleverness or insight are needed for the task. Even if the United States of America, for example, were dependent on an external monetary system that it did not control (for example, if Americans used the Euro), the US would still not be "out of money" or "broke", since a whole political community is not constrained by the present distribution of private property within that community. The US would just have to harness the resources it needs the old-fashioned way via the tax system, relying on whatever monetary tools it happens to use to make payments and collect taxes. Every country can always afford to employ unemployed resources and unemployed people, and if its privately-owned economic systems show themselves manifestly incapable of doing that job completely and effectively, then government must be used to summon these resources into action. Anything less is a waste.

So the reason we can *afford* to develop and improve our countries has little at bottom to do with the monetary system. We can continue to develop and improve our countries because we haven't run out of material resources and human resources; because we haven't run out of the capacity to invest our nation's resources intelligently in building a better future; because real progress is better than stagnation and decline; and because our systems of governance are still effective enough to accomplish the job so long as they are prodded and animated by an energetic, organized and mobilized public that knows what it wants.

However, once we run out of intelligence, or run out of the willingness to cooperate, then it won't matter any longer how rich we are in resources and people, or what kind of monetary system we have. Social isolation, ignorance, lack of community spirit, lonely rage, and the prevalence of radically individualistic laissez faire outlooks that atomize and weaken the public are all forms of national poverty. If we continue to succumb to pervasive corporate entertainment-system messages that encourage us to think anti-socially and individualistically, to despise our remaining democratic institutions and our fellow-citizens, to worship interpersonal domination and subordination, to disdain equality, to wallow in shallow and imbecilic barbarism, and to value forlorn self-assertion over cooperation, then we will horribly degrade the value of the resources we still possess in abundance.

Dan Kervick has a PhD in Philosophy from the University of Massachusetts, and is an active independent scholar specializing in the philosophy of David Hume. He also does

research in decision theory and analytic metaphysics. He currently works in the book industry for the Baker & Taylor Corporation, and lives in Bow, New Hampshire.

Where does money come from?
A comment by Alan Ecob

Assoc Prof Philip Lawn's article (ERA Review, Vol 5, No. 2) is a pleasantly easy-to-read account of how central governments may create money out of nothing. But they are not the only ones who may do this. In this issue (p.29) Lord Adair Turner notes "the ability of fractional reserve banks simultaneously to create private credit and private money". This doesn't require that all such banks be involved. Just two 'big-hitters' can do it, exchanging 25-year term derivatives to yield increased present private money, with the increased debt run out into the never-never (and then again) and off balance sheet.

Also in this issue in Susan George's article on *Concentration* is reportage of BG&V's conclusion that a mere fifty Transnational Corporations exercise something approaching 40% control over the global total of 43,000 on their database (p.26). Of the fifty, only two are involved with the real economy. The rest are banks and financial enterprises. These 48 would have to go close to comprising what conceptually at the holding (consolidated accounting) level is the global financial sector.

Is it not obvious that these 48, all functioning in accordance with the same policy/profit paradigm, effectively determine what happens with all the major world currencies – creating increases, de-leveraging, affecting exchange rates, etc. – all in their perceived best interests, negotiating with each other where necessary to avoid upset to their premium positions? In relation to this reality, the most that individual governments can do is to operate within the limits that become available/possible to them.

Alan Ecob is an ERA member living in NSW

News and views from New Zealand

Trustee Savings Banks
Dennis Dorney

I am not aware of ever reading about Trustee Savings Banks in the ERA newsletters. They appear to have been true Banks in the sense that they possessed all the money creating capacity of other banks and were owned by shareholders. The essential difference is that the shares were owned by the depositors who paid an up-front fee to join the bank. The fee, which was modest, became their share, rather as in Credit Unions - which however don't have full banking privileges. The shares could not be traded on any stock market but remained with the owner for as long as he/she was a member of the Trustee Savings Bank. Also the shareholder had no voting rights or any power to influence decisions made by the Directors, who were appointed as trustees (hence the name) on a voluntary basis. Since the Directors presumably took only some kind of honorarium, any profits were distributed for Charitable purposes.

The first trustee savings bank was established by Reverend Henry Duncan of Ruthwell in Dumfriesshire for his poor Parishioners in 1810. After a slow start that - and other Trustees Banks - prospered and became the model for similar Banks which were also created early in New Zealand's history. As New Zealand's population grew, and people became more mobile, Trustee Banks agglomerated into larger and fewer units until they became an attractive take-over target for the conventional Banks.

Of particular interest to me is the history of the first such Bank in Dunedin, the Dunedin Savings Bank. The establishment of the Bank was sanctioned by the Government under the Savings Bank Act 1858, which however failed to make provision for the disbursement of surplus profits for charitable purposes, which was a key objective when the Bank was established. This was rectified in 1878 with the passing of the Dunedin Savings Bank Profits Bill. The Bank's first gift of 7,515 pounds was donated to the Otago Benevolent Trust in 1879, which in today's terms is over $1 million. Interestingly an amendment to the Act in 1885 allowed Trustees of Savings Banks to lend up to one third of its deposits to local authorities, limited the Fractional Reserve Ratio to 9:1 and capped the permissible interest rate. What would they say to that today?

For the next 110 years the Bank steadily grew and with expansion came the establishment of branches, the first in South Dunedin in 1925. To reflect its Otago wide reach, the Bank changed its name to the Otago Savings Bank and subsequently became Trust Bank Otago, reflecting the changes that were occurring elsewhere in New Zealand.

In 1988 all eleven NZ savings banks were corporatised by the government under the Trustee Banks Restructuring Act 1988 and ownership of each bank was vested in a regional community trust. At this stage two banks left the group, Taranaki Savings Bank (TSB) becoming a successful conventional Bank. The remaining 9 banks merged into one bank (Trust Bank New Zealand) although they continued to trade under their regional names. The community trusts remained as individual shareholders in the new organisation, with shares distributed as a percentage of shareholder funds. The corporatisation would appear to have changed these banks from being owned by depositors to being owned by shareholders who could freely buy and sell shares. The Otago Community Trust's 100% shareholding in Trust Bank Otago Ltd was exchanged for a 13.5% holding in Trust Bank NZ Ltd (TBNZ).

In 1994 the Otago Community Trust sold half its shares in TBNZ, presumably on the open market and in 1996 sold the remaining half to Westpac which then purchased TBNZ for $1.2 billion dollars, which would appear to have valued the Community Trust at about $ 150 million. The sale ended a 132-year ownership of trustee savings banks by the NZ community. With the demise of the Dunedin Savings Bank and its descendents, the money obtained from the sale is now controlled by the Otago Community Trust, which continues to distribute funds (in excess of $115,000,000 at the last count). to ‘charitable’ groups, including sports, which in NZ is clearly regarded as a ‘charitable’ purpose.

What a travesty it is that trustee savings banks in New Zealand that were conceived with such benign intent have been sold off in one hit to a commercial bank whose sole aim is profit. What a chance was missed when those savings banks amalgamated and left themselves exposed to takeover. Now the remains of their assets are used to support causes of doubtful merit, when instead we could have had a publicly owned Otago Bank managed at minimal cost and its profits returned to the benefit of all? Why should the Savings Bank not have used its money-creating ability to repay, at low interest, all the debts of our local government (currently standing at $NZ600 million)? And why should the Province ever in future need to borrow from the rapacious private Banks?

Dennis Dorney is an ERA member living in the Otago region of New Zealand

Australian banks and credit unions
John Hermann

In the previous article, Dennis mentioned that New Zealand credit unions do not have full banking privileges. It would be interesting and useful to know how they differ from Australian credit unions in this respect.

The Australian Banking Act 1959 specifies that "only the Reserve Bank and bodies corporate that are ADIs may carry on banking business", where ADI is an acronym for authorised deposit-taking institutions (meaning banks, credit unions and building societies). Only ADIs are legally entitled to describe their business as 'banking'.

Australian banks and non-bank ADIs are both supervised and monitored by APRA (the Australian Prudential Regulatory Authority). And they operate their payments through deposits (exchange settlement funds) held in accounts with the Reserve Bank of Australia, even if those deposits are not held directly but via a special financial service provider. Thus ADIs are the only financial institutions in Australia that are enabled to practice fractional reserve banking.

Decades ago the credit unions in many countries did not 'create money'. But now many do, even though their basic practices have not changed. Why? Because previously retail deposits in credit unions were not included in the calculation of the money supply, and now they are. For example, in a public statement put out by the Board of Governors of the U.S. Federal Reserve (http://www.federalreserve.gov/faqs/money_12845.htm) we are told:

> M1 is defined as the sum of currency held by the public and transaction deposits at depository institutions (which are financial institutions that obtain their funds mainly through deposits from the public, such as commercial banks, savings and loan associations, savings banks, and credit unions).

Notwithstanding some misleading obfuscation in regard to the issue of the ownership of money, this statement makes it unambiguously clear that U.S. non-bank deposits have been included in M1.

In regard to the Australian scene, and as pointed out in my previous article (ERA Review, v3, n56, 2011), the RBA manager responsible for computing monetary aggregates (Chris Stewart) has explained that the shunting of non-bank deposits into M3 rather than M1 is mainly due to the inconvenience and undue cost entailed in collecting Australian M1 statistics for non-banks - given their relatively small impact - rather than for any theoretical reasons.

Entrepreneurial Bank

Craig Walter

Preliminary

The proposal for an Entrepreneurial Bank stems from personal experience of being unable to bridge the gap between Research and Development and capitalisation of a project that involved $55,000 of public funds, personal equity and years of wasted development. This project involved a brilliant translation technology of commercial and social significance (e.g. indigenous language development, education cities, trade, etc), but currently remains in limbo.

The project was assessed and approved for investment by the SA Playford Centre but subsequent conditions required a completed project that included dictionary development (correct at the time, but there were also issues with the intellectual property rights - later changed after we backed out).

Investigation has revealed that many other innovations have met a similar fate. Venture capitalists are often unprepared to back innovations which are not already market ready.

Innovators and budding entrepreneurs are often forced to turn to overseas sources for backing. If successful, this can result in manufacturing and industry being lost to Australia, with the transfer of intellectual property rights and the 'lion's share' of profits moving overseas.

Overseas companies and individuals are aggressively seeking new ideas over the Internet, while similar Australian initiatives are weak. Moreover there are more than a few scam operators amongst these contenders, and in the USA alone it is estimated that over $US90,000,000 per annum has been scammed from people hopeful with ideas.

Ideas and innovations concerning environmental protection and social betterment, and innovations of civil value, have little chance of seeing the light of day as they do not represent an immediate return to private capital. Even though an extensive range of programs are available in theory for innovators and entrepreneurs, as cited in a communication by former premier Mike Rann, there is compelling evidence of lost opportunities and wastage of effort.

Our traditional manufacturing base is facing a challenge from globalisation, making the need to diversify and encourage innovation across a broad range of technical and social domains essential. Politicians and other leaders use the cry of innovation as one way to garner public support for education funding (always on the public's mind), but such high sounding rhetoric is often far removed from supporting the entrepreneurial framework required.

Australia requires state and/or national business support for funding as a springboard to set innovation in motion, due to specific demographics unlike (say) the USA or China that have powerful inertia of their own. One need only turn to countries like Sweden to see how innovation is embraced, despite their lack of physical resources and their small population. A real collaboration between Government (society) and industry is required.

Many years has elapsed since my proposed project first appeared, and in the meantime innovation programs like InnovateSA have lost funding. Does this indicate that only lip-service is being given to this vital issue and that we are resigning ourselves only to being the world's 'mining pit'? Even worse, advocates for innovation and bold proposals have sometimes been denounced by government representatives as unrealistic dreamers.

Information provided by a Program Nova (SA) executive is encouraging and startling. Around 400 inquiries were made to Program Nova in its final year of operation, after it had succeeded in bringing $28.4 million dollars into the SA economy over a time-span of three years. The funding statistics for 20 high potential start-ups are: 9 had no funding, 5 used their own funds (one was able to get a bank loan), 3 won grants (such as AusIndustry, Grape and Wine Industry), and 3 sold equity to business angels'. According to Greg Macpherson (formerly with Nova), 'those that couldn't get any funding went nowhere'. Equity capital was unable to fill the gap because the start-ups could not demonstrate a completed product or portray people using it. A senior executive of Playford Capital also mentioned to me that only one percent of innovations make it to market. Regrettably, it seems Program Nova was truncated at precisely the wrong time - just as one company was about to secure a $10 million export deal!

Discussions with marketing companies have indicated that, by and large, innovators are being thwarted by the lack of funding, rather than by issues relating to the merit and value of their inventions. And although former premier Rann's letter suggests that equity capital is the answer, the data from various development programmes reveals that only 7% of business developments use equity capital, indicating that government is on the wrong track.

Broad Proposal

An Entrepreneurial Bank's (EB) role would be to provide funding with an emphasis on those start-up innovators and inventors whose ideas have been impartially assessed by an expert panel as having merit. Its role should not exclude providing funding for new ideas created by established businesses. It is envisaged as an Australia-wide enterprise with a central base.

Initially the EB would reflect a collaborative arrangement between the government and venture capitalists. The EB would become self-sustaining as successful businesses paid 'dividends' back to the EB. And importantly the EB would be an icon, sending a signal to local innovators and our community and potential investors about a mind shift towards an entrepreneurial culture.

The EB may be thought of as an innovation in its own right, and paves the way for greater innovation and overcoming the barriers to development. The call for 'Innovate or Perish' in newspaper articles is not answered under current Programs to the extent it should be or could be. Pools of static capital are not being utilized for commercial and social advancement.

One of Australia's previous strengths was the extended investment of resources in enterprises by government until the tertiary stage of development occurred. A possible financial configuration of an EB would embrace some combination of the following:

* Use of part of the interest returned to the Reserve Bank;
* Government subsidy (initial stages);
* Private sector sponsorship;
* Levy enterprises or inventions are funded by the EB in due course;
* A national Innovation and Inventors Lottery;
* Overseas investors;
* Venture capitalists;
* Donations;
* Environmental Innovations funding;
* Use of static capital (eg, superannuation funds);
* Self-investment;
* Shareholding;
* Consultancy;
* Revenue from gambling machines;
* Use of Innovation think tanks.

Summary

An EB will bring together many varied stakeholders and provide returns in tune with their needs. The basis of the EB entails many different 'investors' with a wide cross section of involvement. An EB would develop a steady income stream outside of any return for its investment, e.g. it would be able to write off failed projects without impacting its future. This would require pools of investments which return dividends/interests to the EB. It would operate within this investment stream - paying people and providing grants without expecting a return. Any return would be a bonus. Thus the EB would not be in the game of trying to directly pick winners. If interest rates are (say) 2%, then to start a seed program the EB would need $1 billion invested to bring $20 million.

The bank could be structured as a charitable trust so that super funds and banks could invest up to one billion dollars and get a tax write off over (say) 5 years. Once the EB possesses the money, it is invested back with banks and fund managers so that they don't have a larger negative cash flow.

The formation of an Entrepreneurial Bank is about ushering in greater vitality in innovation and industrial development in Australia and has global implications. It is about collaboration between government and enterprises until innovation is self sufficient. It is also about collaboration between public and private entities, and will receive support from the public as it perceives the long-term benefits to society, the environment, industry, and employment.

The EB proposal requires a definitive case study, including a phase wise program for its establishment. It possibly could be developed along the lines of a foundation. Suggestions are invited for potential funding support in order to develop the concept. An internet web site could be created as a promotional tool for garnering support.

Craig Walter is an ERA member living in SA, and is convenor of the South Australian Venture Capital Board

Herman Daly on globalization

Jim Manwaring

If you read nothing else on the subject of globalization, you must read these few paragraphs by Herman Daly. I think he really nails it. If you get what he is saying – and you will – you will probably blurt out with me: "Why have we gone along with this for 30 years? We must be mad."

This is from a paper presented in Oslo, Norway in 1999. If you wish to read the whole paper, Google Herman Daly and click on "Five Recommendation for Sustainable Economic Development". Below is his fourth recommendation on globalization:

(4). Move away from the ideology of global economic integration by free trade, free capital mobility, and export-led growth -- and toward a more nationalist orientation that seeks to develop domestic production for internal markets as the first option, having recourse to international trade only when clearly much more efficient.

At the present time global interdependence is celebrated as a self-evident good. The royal road to development, peace, and harmony is thought to be the unrelenting conquest of each nation's market by all other nations. The word "globalist" has politically correct connotations, while the word "nationalist" has come to be pejorative. This is so much the case that it is necessary to remind ourselves that the World Bank and the IMF exist to serve the interests of their members, which are nation states, national communities-- not individuals, not corporations, not even NGOs.

The Bretton Woods institutions have no charter to serve the one-world without borders cosmopolitan vision of global integration --of converting many relatively independent national economies, loosely dependent on international trade, into one tightly integrated world economic network upon which everyone depends for even basic survival. If the World Bank and the IMF are no longer committed to serving the interests of their members, then whose interests are they serving?

Globalisation, considered by many to be the inevitable wave of the future, is frequently confused with internationalisation, but is in fact something totally different. The word internationalisation refers to the increasing importance of international trade, international relations, treaties, alliances etc. International, of course, means between or among nations. The basic unit remains the nation, even as relations among nations become increasingly necessary and important. Globalisation refers to global economic integration of many formerly national economies into one global economy, mainly by free trade and free capital mobility, but also by easy or uncontrolled migration. It is the effective erasure of national boundaries for economic purposes. International trade (governed by comparative advantage) becomes, with the introduction of free capital mobility, interregional trade (governed by absolute advantage). What was many becomes one. Where there had been a guarantee of gain from trade to each nation, now there is only a gain to the world as a whole, with the possibility that some nations may lose as others gain.

The very word "integration" derives from "integer", meaning one, complete, or whole. Integration is the act of combining into one whole. Since there can be only one whole, only one unity with reference to which parts are integrated, it follows that global economic integration logically implies national economic disintegration. By disintegration I do not mean that the productive plant of each country is annihilated, but rather that its parts are torn out of their national context (dis-integrated), in order to be re-integrated into the new whole, the globalise economy. As the saying goes, to make an omelette you have to break some eggs. The disintegration of the national egg is necessary to integrate the global omelette.

The model of international community upon which the Bretton Woods institutions rests is that of a "community of communities", an international federation of national communities co-operating to solve global problems under the principle of subsidiarity. The model is not the cosmopolitan one of direct global citizenship in a single integrated world community without intermediation by nation states. Who conferred upon these institutions the right to unilaterally change the very reason for which they were created?

To globalise the economy by erasure of national economic boundaries through free trade, free capital mobility, and free, or at least uncontrolled migration, is to wound fatally the major unit of community capable of carrying out any policies for the common good. That includes not only national policies for purely domestic ends, but also international agreements required to deal with those environmental problems that are irreducibly global (CO_2, ozone depletion). International agreements presuppose the ability of national governments to carry out policies in their support. If nations have no control over their borders they are in a poor position to enforce national laws, including those necessary to secure compliance with international treaties.

Cosmopolitan globalism weakens national boundaries and the power of national and sub national communities, while strengthening the relative power

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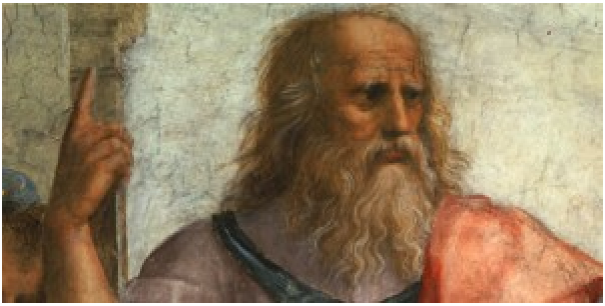
of transnational corporations. Since there is no world government capable of regulating global capital in the global interest, and since the desirability and possibility of a world government are both highly doubtful, it will be necessary to make capital less global and more national. I know that is an unthinkable thought right now, but take it as a prediction -- ten years from now the buzz words will be "denationalisation of capital" and the "community rooting of capital for the development of national and local economies", "minimum residence times of foreign investments", "Tobin taxes", etc., not the current shibboleths of export-led growth stimulated by whatever adjustments are necessary to increase global competitiveness. "Global competitiveness" (frequently a thought-substituting slogan) often reflects not even a real increase in resource productivity, but rather a standards-lowering competition to reduce wages, externalise environmental and social costs, and export natural capital at low prices while calling it income.

Jim Manwaring is an ERA member living in NSW

"Let it be done" - an alternative narrative for building a nation

J.D. Alt



Somehow a great confusion has arisen. It has divided our nation into feuding, bickering camps, caused many to view their own government as a ruthless competitor, and is now seriously threatening us with, among other things, a frightening deluge of collapsing bridges. The confusion is about money - what it is, where it comes from and, most important, whether there is enough of it to pay for all the things we need as a nation.

Presently, we have convinced ourselves there is *not* enough money to pay for the things we need. The logic that tells us this seems intuitively obvious: American businesses and households, at any given time, hold a given amount of Dollars (which are exchanged back and forth amongst the businesses and households as the economy churns along) and - obviously - there is a *limit* as to how much the sovereign government can tax those businesses and households in order to collect some portion of those Dollars for its own spending. Many citizens believe the government is collecting too much in taxes - an excess which *reduces* the Dollars available to be exchanged back and forth in the private economy. Thus, "out of control" sovereign spending is in *competition* with the businesses and households for a given pie of Dollars. Even worse, when the sovereign government *borrows* Dollars from that pie, to make up for what it can't collect in taxes, it is obligating the citizens to pay even more taxes in the future!

In this narrative, the key to economic growth and prosperity is for the sovereign government to (a) strictly limit its financial borrowing and (b) collect *fewer* taxes, leaving more Dollars in the private economy for creating jobs. Limiting or shrinking tax collections, however, reduces the Dollars available for public spending - and we are therefore trapped in a perpetual antagonism between the public spending we think is necessary or desirable and the number of Dollars we believe the sovereign government can, or should, reasonably collect in taxes.

This narrative is built upon an understanding of money that goes back to Aristotle:

"For (the purpose of barter,) the various necessaries of life are not easily carried about, and hence men agreed to employ in their dealings with each other something which was intrinsically useful and easily applicable to the purposes of life, for example, iron, silver, (gold) and the like. Of this the value was at first measured simply by size and weight, but in process of time they put a stamp upon it, to save the trouble of weighing and to mark the value." (*Politics*, Book 1, Part 9, Translated by B Jowett)

In this story, then, money is originally gold (or silver) coinage which has been stamped or "minted" by some authority attesting to the quantity of metal contained in the coin. Typically, these coins were stamped with the visage of a reigning monarch or sovereign - the implicit assumption being that it was this sovereign authority which established the confidence in the accuracy of the stamp.

The story continues along these lines: As the citizens traded and did business amongst themselves, the gold coins became the currency of exchange. At some point, those who had acquired a great quantity of coins needed a safe place to store them. Banks were created for this purpose, and bank-notes were the paper receipts for the gold coins placed on deposit. Soon the paper bank-notes themselves were used as money, with people accepting them in exchange for goods and services because of the actual gold backing them up in the bank's vault. Whether paper or metal, however, the *only* way the sovereign could acquire some portion of this money for its own spending was to impose taxes (or fines and fees) upon the citizens.

It is easy to see how our present narrative is a continuation of this story about gold coinage - in spite of the fact that in the modern world today there is no national currency that is backed by either gold or silver. All sovereign monies today are "fiat" currencies (a term we'll examine in a moment.) Gold coins, which are still minted for commemorative purposes, are simply decorative chunks of precious metal - a kind of jewelry - which are purchased with fiat money. The U.S. Dollar has had no connection to gold or silver for over four decades. Nevertheless, the implicit *story* about gold coinage stubbornly persists, leading to the fuzzy reasoning that U.S. Dollars (and other fiat currencies) continue somehow to "operate" in the same way as gold coins: (1) Dollars are "struck" by the government (which officially establishes their value); (2) Dollars are owned by citizens and (3) kept in banks which loan them out to people and businesses. The sovereign government itself—to obtain the Dollars it needs to pay for its public spending programs and expenses—must get those Dollars either by collecting taxes from the citizens, or borrowing Dollars from the bankers.

This narrative gives taxes a very specific and narrow meaning: Taxes are how the sovereign government acquires the Dollars it needs for sovereign spending. If it cannot obtain enough Dollars through taxes, then it must borrow Dollars. This is the basic logic of our present political dialog, and it seems to be a logic that is irrefutable.

Fiat Money

There is, however, an alternative history of money with even deeper historical roots: (Philip Grierson, in his book *The Origins of Money,* traces its source to the early Wergeld fines which prevented blood feuds in early tribal societies.) This alternative story leads to a strikingly different logic about taxes and sovereign spending. This is the story of "fiat" money.

The definition of "fiat" is "*an order issued by legal authority."* In Latin, the term means "let it be done." Unlike gold and silver coins, then, which had value because of the value of the precious metal they contained, fiat money has value because an Emperor or sovereign power *declares* that it has value. But how does the sovereign establish and enforce this value? What is the declaration that creates "money" people will willingly accept in exchange for real goods and services?

Before answering these questions, it is important to note that many people today - especially those who consciously embrace the gold-based narrative we first described - do not believe that fiat money is "real." Here is an example of the typical "understanding" about fiat money that is presented by this perspective:

*"In a **fiat money system**, money is not backed by a physical commodity (i.e.: gold). Instead, the only thing that gives the money value is its relative scarcity and the faith placed in it by the people that use it." (Kwaves.com)*

This view sees fiat money as something the sovereign government "prints" to make up for what it needs but doesn't have. "Printing money," without anything of "real" value to back it up (even though it is something the sovereign has the authority to do) is thus considered to be deceptive and vaguely criminal, considerations that give rise to indignant recriminations whenever it appears the sovereign government might be stooping in that direction. It has also been demonstrated throughout history, and become a part of economics "101", that when governments print *too* much fiat money, the purchasing power of the money declines, robbing the citizens of wealth. Powerful barriers have thus been erected to guard against the sovereign's potential treachery with regard to its ability to "print" money.

Unfortunately, these perceptions and the barriers erected represent a fundamental misunderstanding of what fiat money actually is and how it functions. Given that we are, in fact, using a fiat money system today, this misunderstanding has much to do with the great confusion in our current monetary dilemma. It is worth some effort, therefore, to try to shed light on the misunderstanding.

Let's return to our earlier questions: How does the sovereign establish and enforce the value of the fiat currency it issues? What is the declaration that creates "money" people will accept in exchange for real goods and services?

The declaration consists of two parts that work in tandem: First, the sovereign declares that it shall, on some regular basis, collect taxes from its citizens. Second, it declares that the *only* thing it will accept as payment for taxes due, is the "money" the sovereign - and *only* the sovereign itself - shall issue. This money becomes the sovereign "fiat" currency: Citizens willingly accept it in exchange for real goods and services because they know:

a) They are going to need some of this sovereign currency to pay taxes, and
b) They know they will be able to use the sovereign currency to purchase goods and services from other citizens for exactly the same reason.

The central question that arises from this tandem relationship is: if the government of the United States, for example, *issues* the fiat U.S. Dollars (prints them, or keystrokes them onto an electronic ledger), how do the citizens get hold of the Dollars so they have them to pay their taxes with? The answer is both obvious and startling: The sovereign government has to *spend* the Dollars after it issues them. And what does it spend the Dollars on? It buys things from the citizens - goods and services which the citizens - willingly provide in exchange for the Dollars because they *need* the Dollars to pay their taxes with.

In a fiat money system, then, sovereign spending happens *before* taxes are paid! It is literally, by logic, not possible for it to happen the other way around. Furthermore, the fiat Dollars the sovereign spends are not Dollars it has collected in taxes, but rather Dollars it has *issued* specifically for the purpose of its spending. Finally, and most important: taxes are collected *not* to provide the sovereign with Dollars to spend, but rather to ensure the citizens will continue to *need* the fiat Dollars and, therefore, continue to be willing to sell their goods and services in exchange for them.

Why sovereign spending isn't "printing money"

Let's dig a little deeper and try to see why sovereign spending, as described above, is not the same as "printing money".

Let's ask this question: what exactly *is* a fiat Dollar? What does it represent? We know clearly what it does *not* represent: it doesn't represent some quantity of gold or silver stashed away in a vault. When the sovereign prints a fiat Dollar it is not printing a "fake" Dollar that is pretending to have some value it really doesn't. The fiat Dollar also does not represent an authoritarian command by the sovereign that citizens *will* use it as legal tender to exchange goods and services. Citizens, in fact, are allowed to use any money they please - as evidenced by the recent popularity of "bitcoin" transactions on the internet. What, then, is the fiat Dollar representing, and how does that representation give it value?

What a fiat Dollar represents, in fact, is a debt of the sovereign government. It is an I.O.U. What does the sovereign owe to the bearer of a fiat Dollar? It owes one Dollar's worth of tax credit. A fiat Dollar, then, is nothing more - and nothing other than - a *promise* by the sovereign government to accept that I.O.U. as a payment for taxes the citizen owes the sovereign. It is because of this promise - made in tandem with the declaration that citizens must pay taxes on some regular basis - that the sovereign's I.O.U. becomes something the citizens desire to have. When sovereign spending occurs, then, the citizens provide the sovereign with real goods and services, and the sovereign pays the citizens with its I.O.U.s.

There are several important things to see here:

First, what the sovereign desires to have is not the return of its I.O.U. when tax time comes - what the sovereign desires are the real goods and services it obtains from the citizens in exchange for its I.O.U.s. These could be many things: roads and bridges, jet planes and battleships, medical and air-traffic-control services, weather and GPS satellites…. (The complete list is quite long, and might add up to many, *many* trillions of Dollars worth of stuff!)

Second, what the sovereign is committing itself to *owe* by printing its I.O.U. is something it has an infinite supply of: tax credits. Further, the sovereign itself - by imposing regular taxes on the citizens - creates the demand for the thing that its I.O.U. promises to owe. Sovereign spending, then, is not constrained by the number of I.O.U.s the sovereign is able to issue - it is constrained *only* by the real goods and services that the citizens are willing and capable of providing in exchange for the I.O.U.s.

Third, when the sovereign receives back its I.O.U.s as the citizens pay their taxes, the transaction is simply the cancellation of an I.O.U. on one side of the ledger, and the extinguishing of a tax obligation on the other: a line is drawn through the tax obligation, and the I.O.U. is torn up. The next time the sovereign needs to buy goods and services from the citizens, it simply issues a *new* I.O.U. and the process starts over again.

Fiat Dollars, then, function similarly to the electrons in a DC electrical circuit: they flow *from* a positive source (the sovereign government) *to* a negative ground (tax collections) - and, along the way, they cause some kind of work to be done. Unlike the battery in a flashlight, however, which will eventually run out of electrons, the sovereign government is capable of *continuously* producing fiat Dollars - *as long as* there continues to be citizens willing and capable of providing real goods and services in exchange for the fiat Dollars it produces.

Fourth, the sovereign government has to spend *more* fiat Dollars than it collects back in taxes. If this were not the case, the citizens, by logic, would be flat broke each time they paid their taxes. Instead, the sovereign spends more than it collects, with the result that the citizens build up a store of the Dollars which they then use in exchanging goods and services amongst themselves (the private sector economy). Most of these excess Dollars are kept in banks, which leverage them with loans that create "bank money", a leveraging that greatly increases the flow of "money-energy" and work done in the private sector.

Finally, depending on how the bookkeeping that tracks this flow of energy is structured, it could *appear* as if sovereign spending under a fiat money system is driving the sovereign government gravely into debt. It is easy to see this appearance arising if we insist on measuring sovereign spending with the belief that the spending is paid for with tax Dollars: From this perspective, any Dollar the sovereign spends over and above what it collects in taxes creates a "deficit". But if, instead, we measure sovereign spending with a correct understanding of fiat money, we can see this "deficit" actually represents something quite different than government debt: it represents the *difference* between the number of fiat Dollars the sovereign has paid in its spending, and the number of fiat Dollars it has collected back in taxes. In other words, it represents the financial wealth the citizens have retained from the sovereign spending *after* extinguishing their tax obligations.

The misunderstanding about fiat money, then, derives from the fact that fiat money fundamentally changes - and, in fact, *reverses* - the relationship between taxes and sovereign spending which existed in a gold-based monetary system.

It is easy to imagine, of course, a sovereign government that grossly misuses the power of its fiat currency. For much of human history, in fact, the goods and services that sovereigns purchased from their citizens did not create or provide a collective benefit for the citizens themselves, but rather served directly to enhance the personal power and aggrandizement of the head of state. To one degree or another, this problem still exists even in well-developed and strong democracies, like the United States. It is a problem that reinforces the "gold-based" money narrative by inviting the notion that authoritarian *mis*rule can be controlled by (a) insisting on the appearance of a "gold-based" currency, and then (b) starving the sovereign authority of its tax income. A moment's reflection, however, reveals this strategy to be exactly analogous to sawing off the tree-limb one is sitting on.

Fiat currency, in itself, is not the problem. In fact it is potentially the solution - but to implement that solution requires a functioning political democracy.

Two Narratives to choose

In truth, then, there are two different narratives about money—and about taxes and sovereign spending - we can choose between. The first, which seems to be the preference of today's political leaders and economic commentators alike, tells us that for all practical purposes we are broke: It is mathematically impossible for the sovereign government to collect enough taxes to pay for all the things we can document that we are going to need for our collective benefit - and the government *appears* to already have borrowed more Dollars than it can ever pay back. The things we need - like new bridges, more efficient electrical grids, the next generation of air-traffic control technology - will have to wait. It isn't clear, though, how long the wait will be, or what, exactly, is going to change to enable the government to *ever* collect enough taxes to pay for these things in the future. We're just stuck, and all we have to look forward to is the endless bickering between conservatives and progressives about who's to blame.

The second narrative paints a dramatically different picture. In a pure fiat money system, the sovereign government doesn't *need* to collect taxes in order to spend - it only needs to collect taxes to ensure that the citizens continue their willingness to provide real goods and services in exchange for fiat Dollars. This means two overwhelmingly positive things:

First, it means taxes can become "smart". Since they are not collected for the purpose of financing sovereign spending, they can be thought about and defined with a completely different set of goals.

They can be structured to create positive incentives to encourage all manner of collective, and even personal, benefits. They can be structured to penalize and discourage all manner of actions which bring us collective harm. In addition to maintaining the "value" of the nation's fiat money, then, taxes can become an implementation of national policy goals across a broad range of social and environmental issues.

Second, choosing to correctly understand and manage a pure fiat money system means the sovereign government can begin *immediately* to pay citizens to create the public goods and services we deem necessary and desirable as a nation—the only constraint being whether the real resources (labor, materials and technology) are actually available to achieve them.

For example, let's take those 18,000 "fracture critical" bridges that CBS News now tells us exist throughout our national highway system - bridges that could collapse catastrophically if a single rusted bolt or strut gives way (like the one north of Seattle that recently sent three cars and their passengers into the Skagit River.) Are the civil engineers available to *immediately* begin evaluating and designing the necessary repairs or replacements for each of these 18,000 bridges? I believe quite a few of those engineers, at the moment, are only working part-time. Is the steel and concrete available for the construction to actually be implemented? (The Total Industry Capacity Utilization in America is currently only 76%) Are the cranes required to lift the steel available for lease?

(I see them lined up by the thousands, mutely reaching for the clouds, in contractor rental lots across the country.) Are the drivers and welders and concrete finishers available for hire? A lot of them, I believe, are currently collecting unemployment checks.

Under our alternative narrative, then, there is no *need* to sit around wringing hands and bickering over where the tax Dollars are going to come from: Each of the defective American bridges that we play Russian Roulette with every day could be redesigned, rebuilt, and painted blue - for "new" - within, say, 24 months. It's literally just a matter of saying, "Let it be done."

Next time you drive over a bridge, think about which narrative you think our nation should be using.

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Source: http://neweconomicperspectives.org/2013/06/let-it-be-done-an-alternative-for-building-what-america-needs.html

How's that euro thingy working out? An update
L. Randall Wray

European integration was a grand plan, perhaps driven by lofty motives. I don't take a position on that since I'm not European. But as I have argued from the very beginning, the set-up of the EMU was fatally flawed. At the very least, they "put the cart before the horse" - adopting the euro before they achieved fiscal integration under a fiscal authority with sufficient sovereignty to protect the member nations.

Indeed, the whole set-up seemed to have been flawed by design and desire. The idea was that permanent austerity is the path to growth. You see, since none of the EMU members was sovereign in the currency sense (each adopted a foreign currency), they'd have to adopt austerity individually. And then the European Parliament was not given a proper Treasury, so its spending required contributions from the non-sovereign states.

It would be like asking Uncle Sam to operate solely on hand-outs from Mississippi. And then if Mississippi got in trouble they'd be deep in the soup since Uncle Sam would not be able to help out. Good luck with that.

The only way any individual state could relieve the austerity would be by operating a beggar-thy-neighbour mercantilist policy to suck demand out of the other states. Germany excelled at that.

So while the whole idea behind unification was to prevent the un-neighbourly behaviour that had led to two World Wars within Europe, the construction of the EMU was guaranteed to promote it. The EMU promoted self-interested behaviour by any member willing to pursue it, and Germany reaped most of the rewards.

Add on top of that the wisdom of unleashing the depravity that modern financial institutions are known for with free "capital" movements and you had the makings of a guaranteed financial crisis. The icing on the cake was to make individual nations responsible for their out-sized financial institutions.

Without fiscal sovereignty the first serious financial crisis would blow up the budget of some member nation. Ireland? You betcha. The rest would be history, as the rest fell like dominoes.

And so it is wrong, now, to point the finger at Troika-imposed austerity for problems on the periphery. Permanent austerity was always the plan. This is not new. It is the way that non-sovereign governments must operate in the absence of a sovereign centre. And there is still no sign that the fundamental flaw of the EMU will be resolved. So, how's that Euro thingy working out? Not so good. And it won't get better.

The problem was never one of profligate Mediterraneans with lax fiscal policy. No Euro nation should ever have run chronic deficits of any size; none should have run up any significant debt ratio. By design, these are not sovereign countries in the currency sense - they abandoned their own sovereign currencies years ago in favour of a foreign currency. And like any nation that gives up its sovereign currency, every one of them lost the ability to run chronic budget deficits.

What is a bit surprising is that it lasted as long as it did. Part of the answer is that financial institutions run amuck were able to bubble up economies for quite a while - just as they did in the USA. Further, there was the "confidence" fairy - a belief by markets that if the you-know-what hits the fan, the ECB will violate its mandate and bail-out. Finally, there is the rather high probability that creditors were fools - unable to understand the difference between a sovereign currency issuer and a government that uses a foreign currency.

The final act will play out over some period of time. First the PIIGS, then France, Austria, Finland and the Netherlands. But it will get to Germany. Germany! Yes, the mother of all fiscal rectitude. Its own debt ratio is orders of magnitude too high for a country that gave up its currency. (Remember Argentina? Adopted the currency board—essentially the same thing as adopting the euro. It always met the Maastricht criteria - unlike Germany - and collapsed into crisis all the same.) And Germany's success depends on demand from the rest of Euroland - demand that is quickly collapsing.

The EMU can be saved. But saving it will require that the ECB do something that goes against its DNA. The EMU was set up with its restrictions precisely to ensure that there would never be a rescue by the ECB. The separation of Euro-wide monetary policy (interest rate setting) from fiscal finances was to be inviolable. The ECB has done more than I thought likely. However, you cannot run a monetary union without fiscal authority relying on a reluctant central banker to go against its programming.

Hence, it is not at all clear that the EMU will be saved.

Source: http://neweconomicperspectives.org/?s=euro+thingy

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Budget structural reform without austerity
John McAuley

Recent Reports by Federal Treasury and the Parliamentary Budget Office affirm the Budget as structurally defective and this is now acknowledged by the Treasurer (and previously asserted by the Opposition).

The differences of opinion now are the causes and the remedies. I regard the Budget to be structurally defective when the community's legitimate and desired levels of government expenditure on disability/aged care, education, health, transport, defence, natural disasters, countering Global Financial Crises, plus the NBN and other essential infrastructure, cannot be financed within the next foreseeable three years on the existing tax-revenue resources whilst simultaneously reducing government debt. To do so without risking downgrades to the Commonwealth and the States by rating agencies and inadequate national social welfare and economic prosperity, is impossible.

Needed remedies are firstly, better expenditure scrutiny and secondly, reversion to an earlier slender tax on the massive volume of mostly tax-free financial transactions which make up most of the Australian 'economy'. There needs to be an expert body of engineers, statisticians etc to publish and apply scientific, consistent methods for the prioritisation of all major government expenditure, leaving final decisions to government as befits a democracy. This would reduce waste and opportunities for corruption, improve transparency and coordination with public authorities and the private sector.

Austerity is self-defeating. Raising the $10% Goods and Services Tax (GST) rate or extending GST into health, education etc would be retrograde and not assist the Commonwealth Budget. The GST is already an iniquitous tax. It directly impacts on employment, incentives, economic growth, imposes burdensome paperwork and collection costs to the million or so reluctant tax collectors, and causes hardship to lower income earners.

By contrast, a low rate of financial tax would only have indirect, dispersed and minimal effects compared with the corrosive GST which would be replaced in whole or part. As a rough tentative guide, a 1 cent % tax on debits to bank accounts for example, would yield around $15 billion per annum, 2 cents % tax would yield $30 billion pa, and even higher revenues on credits. Such taxes would divert funds from speculation to productive activities, increase jobs, and discourage international currency raiders.

These reforms would restore government Fiscal Policy from its structural impasse and enable it to effectively reform as the single instrument available to maintain and raise Australia's employment, economic prosperity and wealth in the face of future national emergencies and disasters.

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Editorial comment: This tax reform makes a lot of sense and has been advocated by ERA for many years. Note that some heterodox economists have argued that we don't need to be too concerned about federal deficits and reducing federal government debt.

The end of neoliberalism
Philip Lawn

The neoliberal era is over. Neoliberalism fails in the long-run. It had its moment in the sun when the natural environment was something that could be plundered a little more without major economic repercussions and when wages, conditions of employment, public infrastructure, and environmental standards, which had been built up over 30 years following WW2, could be diluted and dismantled with little social unrest. Globalisation has also kept the masses happy by providing cheap goods that were once produced at greater expense in the developed world. However, the rising cost of production simply reflected our preparedness to pay more for goods to ensure a cleaner environment and to allow people to earn decent wages and endure decent working conditions. Thanks to rising productivity at the time, the increased cost of production was far exceeded by the value of the additional benefits.

With this in mind, is it really true to say that Asia produces goods more efficiently. No! Cheaper production does not mean more efficient production. China uses more energy, emits more greenhouse gases, and requires more labour hours to produce a similar item as one produced in Australia. Production is cheaper in China because wages and compliance costs are so low. As manufacturing has declined in the developed world, employment levels have been kept buoyant (until 2008) by transferring the services from the non-paid sector of society to the market place. We now pay each other to scratch each other's backs. A lot of the rise in GDP over the past 30 years hasn't been the result of a lot more production – it has been the result of production that was never captured by the national accounts now appearing in the national accounts. Meals used to be prepared free of charge in the household; child care used to be done free of charge in the household; and people used to mow their own lawns, wash their own dogs, and perm their own hair. We now pay for all of this because we don't have time to do it ourselves because we are too busy providing a service that used to be done free of charge in the household! A case of a cat chasing its own tail and appearing as beneficial economic activity in the national accounts. If we are so much better off, why was it that when I was a kid, my family (2 adults and 2 kids) lived comfortably on the income of one full-time working adult on a modest wage, yet a family of the same size today requires both adults to be working full-time?

This aside, there simply isn't room for more neo-liberal attacks on standards to enable businesses to cut their costs – sometimes referred to as deregulation. Deregulation in the form we saw in the 1990s in Australia never had anything to do with boosting productivity, which in any case stalled during the Howard years. Nor is it a time for destructive austerity measures – but, then again, it is never time for such measures. Neoliberalism is destroying Europe. I'm apolitical and believe the recent Gillard Labor Government had its failings. But under an Abbott Government (assuming Abbott wins the upcoming election), times will be tough and will be made tougher by his government. An Abbott Government will quickly become one of the most hated governments of all time, simply because their policies will fail disastrously. There will be protests in the streets.

The Howard-Costello years coincided with a global economy that went gang-busters. John Howard was one of the luckiest PMs of all time. However, his policies and governments like his elsewhere in the world took the world down the path to where it is now. A return to a Howard-like government will have devastating consequences for Australia. That's what we'll get with Tony Abbott. You can't deal with modern problems with ideology – that is, by waving an ideological wand. Today's problems require real solutions in a world where the extraction of many non-renewable resources has peaked, where we have to drastically cut greenhouse gas emissions, and where any level-headed policy that adds an iota to the cost of production results in production shifting to a low-wage, low environmental compliance-cost location, and all because international trade is now governed by the principle of absolute (cost) advantage, not comparative advantage.

I have no problem with capitalism, but capitalism as we know it and how it has been conducted for most of the past 250 years has not been based on 'good' economics. It has been based on chrematistics. Neoliberals hate economics. Abbott tells us that the carbon tax and the resource rent tax are bad economic policies. If this is so, he should rewrite ECON101 textbooks. Neoliberals hate economics because economics is about the efficient allocation of scarce resources. This requires costs to be internalised (to be borne by those who impose costs on others) and for economic rents to be confiscated (because they constitute unearned income and distort incentives and reward unproductive forms of investment). Capitalism has been largely characterised by government policy designed to enable individuals and firms to externalise costs and capture economic rents. That works, albeit ineffectively in so many ways, only while we live in a world where costs can be easily passed on and where capturing economic rents does not have major economic and distributional effects. That's why most avoidable costs have been passed on in the form of extinction of other species (can't vote or protest), future generations (can't vote or protest), and the disadvantaged – the latter once being the working class of developed nations (who eventually won the right to vote, protest, and organise itself) and now the Third World (most of which can't vote, protest, and organise itself - e.g. China). But species extinction and environmental stress is affecting us now; we are now the future generation being affected by two centuries of unjust, dirty, and ecologically destructive growth. There's no easy way out now. There used to be. We have entered a new era and neoliberalism will not provide any relief whatsoever.

Time, scarcity, and over-population have caught up with the failings of neo-liberalism - failings of chrematistics and the denial of biophysical limits.

Oikonomia and Chrematistics

(taken from http://www.gaianeconomics.org/chrematistics.htm)

We can trace back to Aristotle the distinction between the social and natural resources economies (*oikonomia*), and the money economy (*chrematistics)*. The term *oikonomia*, from which the term ‘economics’ is derived, is concerned with the management of the resources of the household for the benefit of all its members over the long run. If the term ‘household’ is expanded to include the ecological resources of the land and its peoples, its institutions, language, shared values and history, we can visualise an economics designed to benefit the community as a whole. *Chrematistics*, on the other hand, relates to the manipulation of property and wealth so as to maximize short-term monetary exchange benefits to the individual owner. We conclude, in *The Politics of Money*, that no community or civilisation can exist without *oikonomia*, the natural and social resources economies which sustain human life on earth. However, *chrematistics*, the economy of short-term personal monetary gain, has come to dominate human society. Its cancerous growth now threatens the human species with extinction. Ordinary people in their everyday lives collude in this destruction as they secure their money incomes *first*, with the never-quite-achieved intention of getting around to thinking about the longer term implications of their impact on the social and ecological infrastructures – eventually.

The *chrematistics* economy became all-powerful in Western ‘civilization’ through the mortgaging of land and the creation of money debt secured by landed ‘property’. Thus land ceased to belong to the *community*, but was re-defined as a money-valued asset capable of being held in individual rather than communal ownership. Under the ‘modern’ economy which evolved at the end of the middle ages, *production*, became geared towards the securing of a *monetary* reward through trade and exchange so that *monetary* obligations could be met. There is no reason at all for these monetary obligations to relate to the social or ecological needs of the wider community, and on the whole they do not, in fact, do so. Hence the conventional history of the evolution of western civilisation presents the replacement of feudal ties and obligations with the freedoms of the universal money economy as an unmitigated ‘good’. In this scenario, the necessity to respect social and ecological obligations is viewed as objectionably oppressive of the freedom of the individual. The time has come to scrutinise these conventional value-judgements.

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The problem is, of course, that not only is economics bankrupt but it has always been nothing more than politics in disguise. Hazel Henderson

Economics is haunted by more fallacies than any other study known to man.
Henry Hazlitt

Minsky on financial capitalism

William Hummel

Hyman Minsky (1919-1996) was a leading authority on monetary theory and financial institutions. For much of Minsky's career, mainstream economics paid little attention to the role of the financial system in macroeconomic theory. But in recent years, there has been an outpouring of new research, both theoretical and empirical, much of which validates his remarkable insights.

Following is a digest of a paper* by Papadimitriou and Wray, briefly outlining Minsky's views on modern capitalist systems.

Capitalism's Many Stages

Capitalism is constantly evolving. We can identify several distinct stages in its evolution going back to the early 1600s. Today, capitalism is quite different from what it was just 30 years ago, and it may now be in the process of evolving into a new stage through globalization. The one constant throughout is the profit-seeking motive in money terms that leads to continual innovation, especially in finance. Firms spend money to earn more money.

Financial institutions play a critical but delicate role, since they are themselves profit-seeking enterprises. They not only supply the funds, but may have a direct stake in the potential profits of the enterprise. Banks increase the money supply whenever they share the belief of the borrower that positions in assets or financed activity will generate sufficient cash flows. Money is thus created as a result of normal economic processes.

The Key Role of Firms

A modern economy is ultimately dependent on the viability of its firms, all of which are owned by the household sector, and which provide the main source of household income as wages. *The focus should therefore be on firms, not households, and on investment and its finance, not on consumption and saving out of household income flows*. This is in sharp contrast to the exposition found in textbooks, which begins with households and their consumption vs saving decision, with thrift determining investment and therefore growth.

Two Price Model

Minsky's analysis involves two sets of prices. One set consists of the prices of *current output* -- consumption, investment, government, and export goods and services. The other set is the prices of *assets*-- capital assets used by firms in production and financial instruments that firms issue to gain control of fixed and working capital. The second set of prices is critical in determining how much investment will be undertaken. The two sets of prices reflect what happens in two different sets of markets, and will vary independently. This is in marked contrast to the single price system of the consumption versus investment model typically used in textbooks.

The spending on investment depends on the demand price of capital assets (what firms are willing to pay) relative to supply prices (what suppliers require to produce them). For capital assets to be produced and thus generate profits, demand prices must exceed supply prices by enough to cover the risks. The resulting investment will then validate previous investment. Investment today determines whether investment yesterday was a good idea, but also depends on expectations about the future regarding demand and supply prices of investment goods. Whether there will be aggregate profits to distribute depends on aggregate capitalist spending.

The Role of Profits

Capitalism involves the acquisition of expensive assets that usually require financing of positions in those assets. A firm must have sufficient market power to assure lenders that it will earn enough to service its financial liabilities. Thus a goal of every firm is to gain market power in order to control its markup. The ability to set price is critical in determining who gets credit.

At the micro level, each firm must be able to obtain a markup on labor costs. However at the macro level there won't be any profit unless there is spending in excess of aggregate wages in the consumption sector. Aggregate profit of firms equals the sum of investment plus consumption out of profits, plus government's deficit, plus the trade surplus, less saving out of wages.

In the simple case with no government deficit, no trade imbalance, and no saving out of wages, capitalist profit equals the sum of investment and capitalist consumption. As long as the price is set high enough that workers cannot buy all the output, capitalists can get the rest *so long as they spend*. The amount of surplus available at the aggregate level depends on the aggregate markup. It is aggregate spending on investment that generates the profit, and validates the accumulated capital. Neither thriftiness nor technology has anything to do with capital accumulation.

Financial Positions of a Firm

Minsky defines three financial positions of increasing fragility:

- Hedge finance: income flows are expected to meet financial obligations in every period.
- Speculative finance: the firm must roll over debt because income flows are expected to only cover interest costs.
- Ponzi finance: income flows won't even cover interest cost, so the firm must borrow more or sell off assets simply to service its debt.

Over a protracted period of good times, economies tend to move from a financial structure dominated by hedge financing to a structure with increasing speculative and Ponzi financing. The shift toward speculative positions occurs intentionally and more or less inevitably because of the way in which success in a boom enhances expectations. However the shift from speculative toward Ponzi finance is usually unintentional.

Business Cycles

Business cycles are endogenously generated, and are not due to shocks.

In large part they are due to the interplay between the two price systems and the way the financial system naturally evolves toward fragility. Any exogenous effects can precipitate a crisis, but only when the system has already evolved to a fragile position.

Conventional wisdom argues that an economy is naturally stable, with the invisible hand guiding the economy towards equilibrium. Rather than treating institutions as contributing to stability, orthodoxy views them as barriers to achieving equilibrium. Minsky argues that institutions and interventions thwart the inherent instability of financial capitalism by interrupting the endogenous process and restarting the economy under more favorable conditions.

System Instability

As Minsky observed, capitalism is inherently unstable. Even if each crisis is successfully contained, it encourages greater speculation and risk taking in borrowing and lending. Financial innovation makes it easier to finance various schemes. To a large extent, borrowers and lenders operate on the basis of trial and error. If a behavior is rewarded, it will be repeated. Thus stable periods naturally lead to optimism, to booms, and to increasing fragility.

A financial crisis can lead to asset price deflation and repudiation of debt. A debt deflation, once started, is very difficult to stop. It may not end until balance sheets are largely purged of bad debts, at great loss in financial wealth to the creditors as well as the economy at large.

Big Government and Big Bank

Before World War II, government spending was no more than 3% of GNP. Whenever the economy faltered, there was little countercyclical deficit spending to offset the loss in private spending. Thus the era was marked by a number of depressions. Since then, government spending has grown to a size exceeding 20% of GNP. This spending effectively sets both ceilings and floors on prices of current output, helping to constrain the natural tendency of aggregate demand toward boom and bust cycles. It is notable that there has been no depression in the Big Government era.

Government deficits may not be sufficient to prevent a debt deflation. If one occurs on a large enough scale, asset prices may become so depressed that revenue from sales of assets does not permit servicing of debt. Defaults can spread and bring down more creditors. Minsky argues that the prevention of such a financial crisis is the primary purpose of the central bank and not, as orthodoxy assumes, control of the money supply or inflation. To reduce the moral hazard effects, any lender of last resort activity must be accompanied by Big Bank supervision of balance sheets.

* Working Paper No. 275, Minsky's Analysis of Financial Capitalism, by Dimitri B. Papadimitriou & L. Randall Wray, of Jerome Levy Economics Institute, July 1999.

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Source: William Hummel's website on money - http://wfhummel.cnchost.com/minsky.html