

Economics

Dyrehaugen Web Notebook

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1

Economics



The ‘science’ of maximizing and minimizing stuff you can’t measure.

The cult of math modl-ing. Palley (2021) Life among the Econ - 50 years on (pdf)

1.1 Outdated Marginalism

With its fixation on equilibrium thinking and an exclusive focus on market factors that can be precisely measured, the neoclassical orthodoxy in economics is fundamentally unequipped to deal with today’s biggest problems. Change within the discipline is underway, but it cannot come fast enough.

Nowhere are the limitations of neoclassical economic thinking – the DNA of economics as it is currently taught and practiced – more apparent than in the face of the climate crisis. While there are fresh ideas and models emerging, the old orthodoxy remains deeply entrenched. Change cannot come fast enough.

The economics discipline has failed to understand the climate crisis – let alone provide effective policy solutions for it – because most economists tend to divide problems into small, manageable pieces. Rational people, they are wont to say, think at the margin. What matters is not the average or totality of one’s actions but rather the very next step, weighed against the immediate alternatives. Such thinking is indeed rational for small discrete problems. Compartmentalization is necessary for managing competing demands on one’s time and attention. But marginal thinking is inadequate for an all-consuming problem touching every aspect of society. Economists also tend to equate rationality with precision. The discipline’s power over public discourse and policymaking lies in its implicit claim that those who cannot compute precise benefits and costs are somehow irrational. This allows economists – and their models – to ignore pervasive climate risks and uncertainties, including the possibility of climatic tipping points and societal responses to them. And when one considers economists’ fixation with equilibrium models, the mismatch between the climate challenge and the discipline’s current tools becomes too glaring to ignore.

Brookes and Wagner (2021) Economics Needs a Climate Revolution

2

Scarcity

There is no Scarcity

When we look at the world in terms of real resources and energy (i.e., the stuff of provisioning), it becomes clear that there is no scarcity at all. The problem isn't that there's not enough, the problem, again, is that it is maldistributed. A huge chunk of global commodity production is totally irrelevant to human needs and well-being. Consider all the resources and energy that are mobilized for the sake of fast fashion, throwaway gadgets, single-use stadiums, SUVs, bottled water, cruise ships and the military-industrial complex. Consider the scale of needless consumption that is stimulated by manipulative advertising schemes, or enforced by planned obsolescence. Consider the quantity of private cars that people have been forced to buy because the fossil fuel industry and automobile manufacturers have lobbied so aggressively against public transportation. Consider that the beef industry alone uses nearly 60% of the world's agricultural land, to produce only 2% of global calories.

There is no scarcity. Rather, the world's resources and energy are appropriated (disproportionately from the global South) in order to service the interests of capital and affluent consumers (disproportionately in the global North). We can state it more clearly: our economic system is not designed to meet human needs; it is designed to facilitate capital accumulation. And in order to do so, it imposes brutal scarcity on the majority of people, and cheapens human and nonhuman life. It is irrational to believe that simply "growing" such an economy, in aggregate, will somehow magically achieve the social outcomes we want.

Hickel

3

Rationing

Climate Change Economics

Curbing consumption can be done either through rationing or draconian taxation. Both are feasible technically although their political acceptability may not be the same.

If one were to use rationing, one could introduce physical targets: there will be only x liters of gas per car annually and no family will be allowed to have more than two cars; or y kilograms of meat per person per month; or z kilowatts of electricity per household per month (or rolling blackouts). Clearly, there may be a black market for gas or meat, but the overall limits will be observed simply because they are given by the total availability of coupons. Some people might think that rationing is extraordinary, and I agree with them. But it has been done in a number of countries under wartime, and at times even during peacetime conditions, and it has worked. If indeed we face an emergency of such “terminal” proportions as the advocates of climate change claim, I do not see any reason why we should not resort to extreme measures.

Milanovic

4

Taxing

Climate Change Economics

But another approach (draconian taxation) is possible too. Instead of limiting physical quantities of goods and services that fulfill criteria (a) and (b) we would impose extremely heavy taxes on them. There is always a tax rate that would drive consumption of a good down to the level that we have in mind. It is here that I think we can use—again if we believe that the climate emergency is so dire—the lessons of covid.

Economic dislocations would be huge. It is not only the question of the entire upper middle class and the rich in advanced countries (and, as we have seen, elsewhere) losing significant parts of their real income as prices of most “staple” commodities (for them) increase by two, three or ten times; the dislocation will affect large sectors of the economy.

The effects will trickle down: unemployment will increase, incomes will plummet, the West will record the largest real income decline since the Great Depression.

However if such policies were steadfastly pursued for a decade or two, not only would emissions plummet too (as they have done in 2020), but our behavior and ultimately the economy would adjust. People will find jobs in different activities that will remain untaxed and thus relatively cheaper and whose demand will go up. Revenues collected from taxing “bad” activities may be used to subsidize “good” activities or retrain people who have lost their jobs.

This is not magical thinking. These are policies that, with intergovernmental cooperation, knowledge of economics, data on global inequality, and the experience of covid, could be implemented.

Milanovic

4.1 Tax Shifting

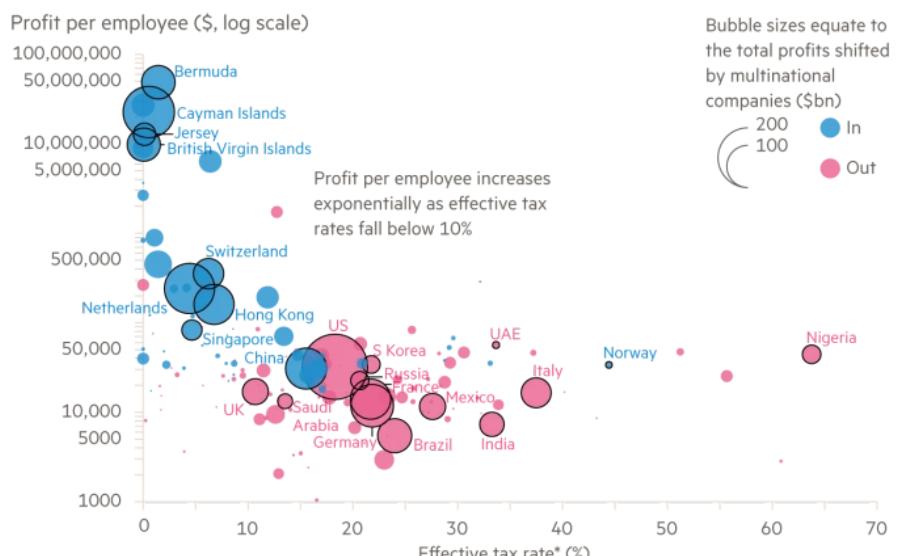
FT

US president Joe Biden's plan to reform global corporate taxation will do little to help the countries most in need of more tax revenues, say developing economies which are lobbying for greater power over multinationals.

Washington's ambitious proposal would tax 100 of the world's largest companies on profits made in countries where they have little or no physical presence but derive substantial revenues and would introduce a global minimum tax rate, in a bid to end what it dubbed a "race to the bottom" where businesses channel profits through low-tax jurisdictions.

But companies would pay most of their taxes in the country where they are headquartered, even if their profits — and in many cases the labour and raw materials used — are sourced from developing countries, senior diplomats and lobby groups told the Financial Times.

Higher profits booked in lower tax jurisdictions



US data refers to 2017; all other data is for 2016 *For profit-making multinational companies only

Graphic by: Chelsea Bruce-Lockhart based on work by Garcia-Bernardo, J. and Janský, P. (2021) Profit Shifting of Multinational Corporations Worldwide, ICTD Working Paper 119, Brighton, Institute of Development Studies

© FT

They are also concerned that many developing countries are not participating in the negotiations over the proposal at the OECD and fear the eventual agreement is unlikely to reflect their interests.

FT

5

Nudging

5.1 Randomness

Memo

There is strong evidence from the lab that people have misperceptions about what randomness looks like. When a person is asked to generate a series that approximates the flipping of a coin, they will alternate between heads and tails too often, and balance the frequencies of heads and tails over too short a sequence. When people are asked to judge which of two different sequences of coin flips are more likely, they tend to pick sequences with more alternation, despite their probability being the same.

What happens we look for a failure to perceive randomness in the outside world? Out of the lab?

When people watch basketball, they often see a hot hand. They will describe players as “hot” and “in form”. Their belief is that the person who has just hit a shot or a series of shots is more likely to hit their next one.

But is this belief in the “hot hand” a rational belief? Or is the hot hand an illusion, whereby, just like they do with coins, they are seeing streaks in what is actually randomness?

In a famous examination of this question, Thomas Gilovich, Robert Vallone and Amos Tversky took shot data from a variety of sources, including the Philadelphia 76ers and Boston Celtics, and examined it for evidence of a hot hand.

What did they find? The hot hand was an illusion. As Daniel Kahneman wrote in Thinking, Fast and Slow when describing this research:

The hot hand is entirely in the eye of the beholders, who are consistently too quick to perceive order and causality in randomness. The

hot hand is a massive and widespread cognitive illusion.

Possibly even more interesting was the reaction to the findings from those in the sporting world. Despite the analysis, many sports figures denied that it could be true. Red Auerbach, who coached the Boston Celtics to nine NBA championships, said “Who is this guy? So he makes a study. I couldn’t care less.”

This provides another insight, about which Gilovich wrote:

The story of our research on the hot hand is only partly about the misperception of random events. It is also about how tenaciously people cling to their beliefs even in the face of hostile evidence.

So, this isn’t just about the misperception of the hot hand, but also about the failure of people to see their error when presented with evidence about it.

Let’s delve into how Gilovich, Vallone and Tversky showed the absence of a hot hand.

Imagine a person who took ten shots in a basketball game. A ball is a hit, an X is a miss.

What would count as evidence of a hot hand? What we can do is look at shots following a previous hit. For instance, in this sequence of shots there are 6 occasions where we have a shot following a previous hit. Five of those shots, such as the seventh here, are followed by another hit.

We can then compare their normal shooting percentage with the proportion of shots they hit if the shot immediately before was a hit. If their hit rate after a hit is higher than their normal shot probability, then we might say they get a hot hand.

This is effectively how Gilovich, Vallone and Tversky examined the hot hand in coming to their conclusion that it doesn’t exist. They also looked at whether there was a hit or miss after longer streaks of hits or misses, but this captures the basic methodology. It seems sensible.

But let me take a detour that involves flipping a coin.

Suppose you flip a coin three times. Here are the eight possible sequences of heads and tails. Each sequence has an equal probability of occurring. What if I asked you: if you were to flip a coin three times, and there is a heads followed by another flip in that sequence, what is the expected probability that another heads will follow that heads?

Here is the proportion of heads following a previous flip of heads for each sequence. In the first row of the table, the first flip is a head. That first flip is followed by another head. After the second flip, a head, we also have a head. There is no flip after the third head. 100% of the heads in that sequence followed by another flip are followed by a head.

In the second row of the table, 50% of the heads are followed by a head. In the last two rows, there are no heads followed by another flip.

Now, back to our question: if you were to flip a coin three times, and there is a heads followed by another flip in that sequence, what is the expected probability that another heads will follow that heads? It turns out it is 42%, which I can get by averaging those proportions.

8 possible combinations of heads and tails across three flips

Flips	$p(H_{t+1} H_t)$
HHH	100%
HHT	50%
HTH	0%
HTT	0%
THH	100%
THT	0%
TTH	—
TTT	—
Exp.val	42%

That doesn't seem right. If we count across all the sequences, we see that there are 8 flips of heads that are followed by another flip. Of the subsequent flips, 4 are heads and 4 are tails, spot on the 50% you expect.

What is going on in that second column? By looking at these short sequences, we are introducing a bias. The cases of heads following heads tend to cluster together, such as in the first sequence which has two cases of a heads following a heads. Yet the sequence THT, which has only one shot occurring after a heads, is equally likely to occur. The reason a tails appears more likely to follow a heads is because of this bias whereby the streaks tend to cluster together. The expected value I get when taking a series of three flips is 42%, when in fact the actual probability of a heads following a heads is 50%. As the sequence of flips gets longer, the size of the bias is reduced, although it is increased if we examine longer streaks, such as the probability of a heads after three previous heads.

Why have I bothered with this counterintuitive story about coin flipping?

Because this bias is present in the methodology of the papers that purportedly demonstrated that there was no hot hand in basketball. Because of this bias, the proportion of hits following a hit or sequence of hits is biased downwards. Like our calculation using coins, the expected proportion of hits following a hit in a sequence is lower than the actual probability of hitting a shot.

Conversely the hot hand pushes the probability of hitting a shot after a previous hit up. Together, the downward bias and the hot hand roughly cancelled each other out, leading to the conclusion by researchers that each shot is independent of the last.

The result is, that when you correct for the bias, you can see that there actually is a hot hand in basketball.

When Miller and Sanjurjo crunched the numbers for one of the studies in the Gilovich and friends paper, they found that the probability of hitting a shot following a sequence of three previous hits is 13 percentage points higher than after a sequence of three misses. There truly is a hot hand. If Red Auerbach had coached as though there were no hot hand, what would his record have looked like?

I should say, this point does not debunk the earlier point about people misperceiving randomness. The lab evidence is strong. People tend to see the hot hand when people flip coins. It is possible that people overestimate the strength of the hot hand in the wild, although that is hard to show. But the hot hand exists.

Let's turn back to one of the quotes I showed earlier.

The story of our research on the hot hand is only partly about the misperception of random events. It is also about how tenaciously people cling to their beliefs even in the face of hostile evidence.

The researchers expanded the original hot hand research from a story about people misperceiving randomness, to one of them continuing to do so even when presented with evidence that they were making an error.

But, as we can now see, their belief in the hot hand was not an error. The punters in the stands were right. Their accumulated experience had given them the answer. The researchers were wrong. Rather than the researchers asking whether they themselves were making an error when people refused to believe their research, they double downed and identified a second failure of human reasoning. The blunt dismissal of people's beliefs led behavioural scientists to hold an untrue belief for over thirty years

This is a persistent characteristic of much applied behavioural science. It was an error I made many times when I first came to the discipline. We spend too little time questioning our understanding of the decisions or observations other people make. If we believe they are in error, we should first question whether the error is ours.

Jason Collins on Nudgestock 2020

6

Discounting

Ecological Fallacy

Solow (1974) like many other defenders of standard economics, resorts to an old paper of Harold Hotelling (1931) to convince us that neoclassical economists have not ignored the problem of intergenerational allocation. But he overlooks the important point that Hotelling's analysis referred to some known amount of resources owned by an individual who discount future royalties. Of course, Hotelling was completely correct about the last point. Any individual must certainly discount the future for the indisputable reason that, being mortal, he stands a chance of dying any day. But a nation, let alone the whole of mankind, cannot behave on the idea that it might die tomorrow. They behave as if they were immortal and, hence, value future welfare situations without discounting.

Georgescu-Roegen (1986) The Entropy Law and the Economic Process in Retrospect (pdf)

7

Risking

7.1 Uncertainty

Abstract

Uncertainty is critical to questions about climate change policy. Recently developed recursive integrated assessment models have become the primary tool for studying and quantifying the policy implications of uncertainty. The first wave of recursive models has made valuable, pioneering efforts at analyzing disparate sources of uncertainty. We decompose the channels through which uncertainty affects policy and quantify them in a recursive extension of a benchmark integrated assessment model. We argue that frontier numerical methods will enable the next generation of recursive models to better capture the information structure of climate change and to thereby ask new types of questions about climate change policy

Lemoine (2016) Uncertainty Recursive IAM

Cubic damage triple the risk premium

Traeger (ref.Gernot Wagner)

7.2 Pooling Risk

- A) We each put \$100 a month in our individual piggy banks to cover potential medical costs one day.
- B) We all chip in \$100 a month, for anyone who needs medical care this month.

Same costs for everyone, totally different risks, totally different societies.

Pooling risk reduces/eliminates volatility. Of course it also introduces adverse selection and moral hazard.

(Peters/Pienar (Twitter))

8

Cooperation

Handley Abstract

A fundamental puzzle of human evolution is how we evolved to cooperate with genetically unrelated strangers in transient interactions. Group-level selection on culturally differentiated populations is one proposed explanation. We evaluate a central untested prediction of Cultural Group Selection theory, by assessing whether readiness to cooperate between individuals from different groups corresponds to the degree of cultural similarity between those groups. We documented the normative beliefs and cooperative dispositions of 759 individuals spanning nine clans nested within four pastoral ethnic groups of Kenya—the Turkana, Samburu, Rendille and Borana. We find that cooperation between groups is predicted by how culturally similar they are, suggesting that norms of cooperation in these societies have evolved under the influence of group-level selection on cultural variation. Such selection acting over human evolutionary history may explain why we cooperate readily with unrelated and unfamiliar individuals, and why humans' unprecedented cooperative flexibility is nevertheless culturally parochial.

We conclude that group-level selection on cultural variation has likely left a mark on the human cooperative psychology and continues to influence which social norms and institutions prevail in human societies.

Handley (2020) Human large-scale cooperation as a product of competition between cultural groups (pdf)

9

Decoupling

Decoupling: *the end of the correlation between increased economic production and decreased environmental quality.*

The needed decoupling does not occur! Not GLOBAL, not FAST-ENOUGH, not LONG-ENOUGH

Vaden (abstract)

The idea of decoupling “environmental bads” from “economic goods” has been proposed as a path towards sustainability by organizations such as the OECD and UN. Scientific consensus reports on environmental impacts (e.g., greenhouse gas emissions) and resource use give an indication of the kind of decoupling needed for ecological sustainability: global, absolute, fast-enough and long-enough. This goal gives grounds for a categorisation of the different kinds of decoupling, with regard to their relevance. We conducted a survey of recent (1990–2019) research on decoupling on Web of Science and reviewed the results in the research according to the categorisation. The reviewed 179 articles contain evidence of absolute impact decoupling, especially between CO₂ (and SO_x) emissions and evidence on geographically limited (national level) cases of absolute decoupling of land and blue water use from GDP, but not of economy-wide resource decoupling, neither on national nor international scales. Evidence of the needed absolute global fast-enough decoupling is missing.

Vaden 2020 Decoupling for sustainability (pdf)

9.1 Rebound (Jevons Paradox)

Lange

Literature on the rebound phenomenon has grown significantly over the last decade. However, the field is characterized by diverse and ambiguous definitions and by substantial discrepancies in empirical estimates and policy proposals. As a result, cumulative knowledge production is difficult. To address these issues, this article develops a novel typology. Based on a critical review of existing classifications, the typology introduces an important differentiation between the rebound mechanisms, which generate changes in energy consumption, and the rebound effects, which describe the size of such changes. Both rebound mechanisms and rebound effects can be analytically related to four economic levels – micro, meso, macro and global – and two time frames – short run and long run. The typology is populated with eighteen rebound mechanisms from the literature. This contribution is the first that transparently describes its criteria and methodology for developing a rebound typology and that gives clear definitions of all terms involved. The resulting rebound typology aims to establish common conceptual ground for future research on the rebound phenomenon and for developing rebound mitigation policies.

Lange (2021) Jevons Unravelled (pdf)

10

Ergodicity

Almost everyone responded to my question about the rationality of expected utility by talking about rationality and utility. But it's the "expected" part that is the problem. Why would I only care about the mean? (Russel Roberts (Tweet))

10.1 Almost surely

Over the very long-term, an individual will tend to get around half heads and half tails. As the number of flips goes to infinite, the proportion of heads or tails "almost surely" converges to 0.5.

This means that each person will tend to get a 50% increase half the time (or 1.5 times the initial wealth), and a 40% decrease half the time (60% of the initial wealth). A bit of maths and the time average growth in wealth for an individual is $(1.5*0.6)0.5 \sim 0.95$, or approximately a 5% decline in wealth each period. Every individual's wealth will tend to decay at that rate.

To get an intuition for this, a long run of equal numbers of heads and tails is equivalent to flipping a head and a tail every two periods. Suppose that is exactly what you did – flipped a heads and then flipped a tail. Your wealth would increase to \$150 in the first round (\$100 1.5), and then decline to \$90 in the second (\$150 0.6). You get the same result if you change the order. Effectively, you are losing 10% (or getting only $1.5*0.6=0.9$) of your money every two periods.

A system where the time average converges to the ensemble average (our population mean) is known as an ergodic system. The system of gambles above is non-ergodic as the time average and the ensemble average diverge. And given we cannot individually experience the ensemble average, we should not be misled by it. The focus on ensemble averages, as is typically done in economics,

can be misleading if the system is non-ergodic.

While the population as an aggregate experiences outcomes reflecting the positive expected value of the bet, the typical person does not. The increase in wealth across the aggregate population is only due to the extreme wealth of a few lucky people.

10.2 Kelly Criterion

The only way for someone to maintain their wealth would be to bet a smaller portion of their wealth, or to diversify their wealth across multiple bets.

The Kelly criterion gives the bet size that would maximise the geometric growth rate in wealth.

$$f = \frac{bp - q}{b} = \frac{p(b + 1) - 1}{b}$$

f is the fraction of the current bankroll to wager

b is the net odds received on the wager (i.e. you receive \$b back on top of the \$1 wagered for the bet)

p is the probability of winning

q is the probability of losing (1-p)

The Kelly criterion is effectively maximising the expected log utility of the bet through setting the size of the bet. The Kelly criterion will result in someone wanting to take a share of any bet with positive expected value.

An alternative more general formula for the Kelly criterion that can be used for investment decisions is:

$$f = \frac{p}{a} - \frac{q}{b}$$

f is the fraction of the current bankroll to invest

b is the value by which your investment increases (i.e. you receive \$b back on top of each \$1 you invested)

a is the value by which your investment decreases if you lose (the first formula above assumes a=1)

p is the probability of winning

q is the probability of losing (1-p)

(More on Evolving Preferences)

A Primer (Jason Collins)

11

Behavioural Economics

Ole Peters

The symbol of behavioral economics is a fly etched into a urinal to reduce spillage.

Apparently, no scientific study of the effect exists.

It's becoming hard to avoid the impression that behavioral economics, broadly speaking, is a collection of made-up cocktail-party stories.



The behavioral economics concept on "nudging" people's behavior and actions is often illustrated with this urinal with a housefly image embossed in the enamel; the image "nudges" users into improving their aim, which lowers cleaning costs.

People are bad at making rational decisions.

One of the hottest topics in finance and economics for the past two decades has been Behavioral Economics, a field that originated in the research of Daniel Kahneman and Amos Tversky. Tversky died in 1996, and Kahneman was awarded The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel in 2002. The Nobel committee cited their joint work on “prospect theory as an alternative, that better accounts for observed behavior” of humans making decisions “when future consequences are uncertain” (aren’t they always?).

Classical financial modeling assumes that people make decisions in a cold-blooded utilitarian way that is therefore susceptible to mathematics and statistics. Kahneman and Tversky (K&T) cataloged a collection of irrational warm-blooded peculiarities in the way people choose between alternative bets on their own potential profits and losses when playing games of chance.

Not everyone agrees with K&T. Real life is not always a game of chance; while the probability of throwing heads and tails is known exactly, the probability of human behavior is not. Animate individuals are driven by motives that can defy statistics. Our legal system recognizes this, and finds defendants guilty or innocent not on the basis of statistical evidence but on the basis of judgement and believability.

Prospect Theory

K&T developed what they call prospect theory. In prospect theory, as opposed to classical economic theory, K&T replaced homo economicus’s rational notions of losses and gains and their probabilities by the empirically determined “irrational” values used by everyday fearful and greedy hot-blooded homo affectus.

Classical economic theory was elegant but flawed, and prospect theory was a beautiful idea/ideal that aimed to fix it by taking account of actual human preferences in determining economic value.

Unfortunately, that isn’t what happened. First, the ambitions of prospect theory as a science of human behavior foundered in a maelstrom of increasing mathematical complexity. Second, academics use the cover of behavioral economics to write papers on all sorts of irrelevant apparent irrationalities. Third, the part of behavioral economics that did flourish enormously is the notion that people are probabilistically challenged, and that it requires governments and agencies, helped by academics, to nudge people into doing what is “good” for them.

Consider Richard Thaler, a Chicago academic who has been an influential and early researcher in behavioral finance and is also the co-author of *Nudge*, a book he says is about “enlisting the science of choice to make life easier for people and by gently nudging them in directions that will make their lives better.”

It’s remarkable that behavioral economics has evolved from a field of study into a tool for manipulating people. This is not government of the people by the

people for the people. I think I'd rather be forced than nudged. At least then the battle lines are clearer.

Derman (2020) Misbehavioural (pdf)

12

Economic Growth

12.1 Growth without Economic Growth

Key messages

1. The ongoing ‘Great Acceleration’ [1] in loss of biodiversity, climate change, pollution and loss of natural capital is tightly coupled to economic activities and economic growth.
2. Full decoupling of economic growth and resource consumption may not be possible.
3. Doughnut economics, post-growth and degrowth are alternatives to mainstream conceptions of economic growth that offer valuable insights.
4. The European Green Deal and other political initiatives for a sustainable future require not only technological change but also changes in consumption and social practices.
5. Growth is culturally, politically and institutionally ingrained. Change requires us to address these barriers democratically. The various communities that live simply offer inspiration for social innovation.

EEA

12.2 Ditching Economic Growth

Russel

Growth may be central to mainstream economics but nature has paid the price through pollution, waste and climate change. Some economists say it’s time for a completely different approach.

It was only in the mid-20th century, in the wake of the shattering impact of World Wars and when capitalism and communism were competing for global

dominance, that we began to measure the success of an economy in terms of gross national product, or GDP.

The faster GDP was rising, the better an economy could be said to be performing. But something happens as all that economic activity expands. The amount of energy and resources we use also increase.

Ever since the industrial revolution, fossil fuels have set us on a course of furiously expanding production, which has also meant more waste and more pollution. Historically, greenhouse gas emissions have risen alongside GDP. As economies have grown richer, nature has paid the price.

And as the climate crisis has become ever-harder to ignore, more people are questioning whether infinite economic growth is possible on a planet of finite resources.

Zero-emissions with twice the GDP

“The Intergovernmental Panel on Climate Change in their Fifth Assessment, have 116 mitigation scenarios with a chance of staying below the 2 degree Celsius threshold. All of those scenarios assume 2-3% GDP growth rates,” says Jon Erickson, an ecological economist at the Gund Institute for Environment in Vermont, adding that this implies doubling the global economy by somewhere around 2050 .

These scenarios rely not just on switching to renewables, but also on the large-scale extraction of massive volumes of carbon from the atmosphere using as-yet unproven technology, which Erickson describes as “wildly unrealistic.”

“None of those models and the IPCC community even bother simulating a scenario where the global economy contracts, stabilizes and maybe even degrows,” Erickson says. “Yet that’s probably the one realistic scenario that would significantly affect greenhouse gas emissions.”

It is easy to see why the idea that we must keep growing is hard to give up. When economic activity declines and we go into recession, people lose their jobs and are plunged into poverty.

Yet those arguing for “degrowth” — a managed contraction of economic activity— say it doesn’t have to be this way.

ime for a different approach?

Federico Demaria, an economist at the Autonomous University of Barcelona, who has authored several books on degrowth, says that neoclassical economics — which has dominated economic discourse over recent decades, has “never looked at the question of how an economy could be managed without growth. It only looked at questions like, why do economies grow? If it’s not growing, how can we make it grow? Or, how can we make it grow even faster?”

These have become pertinent questions even — or especially — for wealthy, industrialized economies, where growth has slowed over recent decades. “What

the mainstream economists are doing is just trying to relaunch growth,” Demaria says.

A different approach, which aims to rein in growth without inflicting the pain that recession has traditionally entailed, comes from the field of ecological economics.

Embedding economics in ecology

Neoclassical economic models picture economies as closed systems, with no inputs of materials or energy and no outputs of pollution and waste. But ecological economists insist there is no real separation between economy and ecology. After all, if we destroy the planet that feeds us, economic activity will collapse pretty quickly too.

In an effort to fix this oversight, Demaria is among those devising new economic models that include factors like emissions and resources use. They are also working in things like social equality, debt, deficits and monetary systems, which have social impacts, and play into cycles of boom and bust.

Degrowthers argue that we do have to tighten our belts — and it doesn’t have to be painful. If we could reverse the central logic of economic systems that prioritize growth over human and ecological wellbeing, they don’t believe we would miss the furious activity that’s keeping a minority of the human population in must-have products and ever-more material wealth.

Russel (2020) Climate crisis: Is it time to ditch economic growth?

13

Institutional

13.1 Veblen

Like his fellow economists, Veblen was excited by the prospect that, after Darwin, the study of human society could be placed on a scientific footing. Unlike most of his colleagues, he did not think the economic system was working. In one way or another, they maintained that an economy metes out its own rewards in proportion to the productivity of those who constitute the economy. For Veblen, it was not the fittest—that is, the most productive—who were surviving and prospering. On the contrary, the winners were a “leisure class” of unproductive parasites devoted to what he called “conspicuous consumption.” In the process, they were damaging rather than serving the interests of society as a whole. This was, to speak in rational terms, inefficient and irrational.

Capitalism = Plunder

Veblen’s early translation of the Icelandic epic [*Laxdøla-saga*] did foretell the visionary economics that would carry him to fame. In the introduction, added thirty-five years later, he wrote that “the Viking age was an enterprise in piracy and slave-trade” and that the Vikings thus anticipated modern “business enterprise,” which is driven “by its quest for profits” and reliant on “getting something for nothing by force and fraud.” Behind the gently waggish satire of terms like “leisure class” and “conspicuous consumption” lies a proposition that is much sterner, and more scientific. In Veblen’s view, modern capitalism, which congratulates itself on its high level of civilization, is in essence a highly organized system of barbaric plunder.

He was also lucky to take classes from a young professor named John Bates Clark (1847–1938)—“one of the most important economic theorists America has ever produced,” in Camic’s opinion. Though Clark exposed Veblen to the classical economics descended from Adam Smith and embodied by John Stuart

Mill, he added his own “strong objections.” Like the so-called “historical” school of economics, which he had encountered during two years of study in Germany, Clark insisted that economic man was not a mere creature of self-interest, but rather a social being. Morality exerted an objectively measurable influence on economic life, and economics had to be cognizant of it. At that stage of his career, Clark identified as a “Christian socialist.” Veblen himself already had a reputation as an atheist.

Veblen’s doctorate in 1884, which he received after transferring to Yale, was one of the first dozen granted in philosophy at any American university. What followed, as noted above, was years of unemployment.

In all his many writings, Veblen distinguished between the industrial, which is about making useful things and providing useful services, and the pecuniary, which is about trying to get something for nothing. It is the pecuniary, he argued, that has become the dominant mode of the modern American economy and that recalls his predatory Viking ancestors.

But his scorn for pecuniary plunderers was also an inheritance. Where he grew up, the value of honest labor and the denunciation of “idleness, waste, extravagant display, and ill-gotten acquisitions” were drilled into the local children in church and in elementary school, and Camic explains why they would be. The family farm, “which both owns the means of production and provides the labor power to set them in motion,” if not exactly outside the capitalist system, was external enough to generate sharp critique of that system, especially as banks, railroads, and middlemen gradually extended their influence.

Robbins (2021) A Theory of Thorstein veblen

14

Marxist

Trigg Abstract

There is general agreement amongst scholars of Marx that his monetary theory is incomplete, especially in his most detailed writings on credit in the third volume of Capital. Moreover, in these unfinished notes Marx takes sides with the banking school approach, notable for its opacity compared to the clear axioms of its currency school counterpart. A reconstruction is proposed based on Marx's step-by-step method, commencing with a critique of Say's Law under simple commodity circulation, these foundations formalised here using the model of pure labour developed by Pasinetti (1993). Piecing together the fragments, and filling in some of the gaps in Marx's writings on money, the analysis builds from commodity money and private debt contracts, to the modelling of pure credit and pure banking systems. Adapting the Pasinetti model of a real economy, its endogenous money requirements provide an alternative to the exogenous money approach of the currency school: a streamlined analytical core to the banking school approach, as interpreted by Marx. In addition, the structure of payment crises — as an extension of Marx's possibility theory of crises — is examined with money as a means of payment required to settle debts between producers and the banking system.

Trigg (2021) Reconstructing Marx's Theory of Credit and Payment Crises under Simple Circulation (pdf)

15

Neo Classical Economics

Neoclassical economic theory has never resembled a scientific enterprise. It's simply an ideology presented through an avalanche of mathematics. The underlying assumptions of neoclassical theory all serve to justify the capitalist status quo. When we equate market value with utility, we implicitly assume that individuals' income indicates their contribution to society.

Fix GDP][\(https://economicsfromthetopdown.com/2019/12/15/why-we-should-abandon-real-gdp-as-a-measure-of-economic-activity/\)](https://economicsfromthetopdown.com/2019/12/15/why-we-should-abandon-real-gdp-as-a-measure-of-economic-activity/)

15.1 Free Market

Fix

According to neoclassical economics, the most efficient way to organize human activity is to use the free market. By stoking self interest, the theory claims, individuals can benefit society. This idea, however, conflicts with the evolutionary theory of multilevel selection, which proposes that rather than stoke self interest, successful groups must suppress it. Which theory better describes how human societies develop? I seek to answer this question by studying the opposite of the market: namely hierarchy. I find evidence that as human societies develop, they turn increasingly to hierarchical organization. Yet they do so, paradoxically, at the same time that the language of free markets becomes more common, and culture becomes more individualistic. This evidence, I argue, contradicts free-market theory, but only if we treat it as a scientific doctrine. If instead we treat free-market theory as an ideology, the pieces come together. Free-market thinking, I speculate, may stoke the formation of hierarchy by cloaking power in the language of 'freedom'.

In this evolutionary context, the theory of free markets is an outlier. It posits that, contrary to what we observe among other social organisms, humans need

not suppress self-interest to organize in large groups. And we need not use hierarchical organization. We can build complex societies, the theory claims, using decentralized competition.

Treating firms (not individuals) as the unit of competition legitimizes the firm as an autonomous unit, while leaving the firm's internal structure as a 'black box'. By championing firm autonomy, free-market theory may legitimize the firm's internal chain of command, thereby justifying the accumulation of power.

Neoclassical economics may be best treated as a belief system whose existence should be explained using the tools of cultural evolution.

Neoclassical theory — claims that outcomes from perfectly competitive markets are 'optimal', whereas outcomes from centralized control are 'inefficient'. It is much like if biologists deemed single-celled organisms to be 'optimal', but deemed multicellular organisms 'inefficient'.

Hierarchi - supressing lower-level selection

More complex structure is built from simpler components. Growth of complexity involve the centralization of control. Nested hierarchy occurs through a process of evolutionary problem solving. Structures evolve that solve specific problems. Newly created structure serves as the building block to solve new problems. Large, complex organisms are not composed of autonomous units. The growth of complexity involve gradual loss of autonomy among sub-units and the growth of centralized control. As societies become more populous, they add new layers of administrative hierarchy. Centralized control arise for two (related) reasons. First, assembling a larger system from many smaller components requires coordination. Second, there is the problem of the 'self-interest' of sub-units. The major evolutionary transitions happened by merging sub-units that were previously autonomous. According to the theory of multilevel selection, this merger is not possible unless the 'self-interest' of sub-units is suppressed.

The key insight of multilevel selection theory is that high-level organization requires high-level selection that suppresses selection at lower levels. Group-level selection suppresses individual-level selection.

Successful groups suppress lower levels of selection by turning to top-down 'management'. Large-scale organization is accomplished by integrating subunits into a hierarchical control structure.

Whether complex organization requires hierarchy is an open question. But it does seem that complexity and hierarchy go hand in hand.

Free Market - No Hierarki

According to the neoclassical theory of free markets, hierarchy is unnecessary for group organization. Instead, neoclassical theory argues that humans can organize effectively without any form of centralized control. All that is needed is a competitive market.

The ‘first fundamental theorem of welfare economics’ claims that under conditions of perfect competition (in which all firms are ‘price takers’), markets will allocate resources in a way that is ‘Pareto efficient’. With their welfare theorem in hand, neoclassical economists look at hierarchical organization and see an ‘inefficient’ system.

The growth of hierarchy with economic development

Fix (2021) Economic Development and the Death of the Free Market (pdf)

15.2 Human Capital Theory

The sentiment behind eugenics (that some people are far more productive than others) lingers on in mainstream academia. It survives – even thrives – in human capital theory.

In the 1950s, economists at the University of Chicago tackled the question of individual income. Why do some people earn more than others? The explanation that these economists settled on was that income resulted from productivity.

The claim that income stems from productivity was not new. It dated back to the 19th-century work of John Bates Clark (1899) and Philip Wicksteed (1894), founders of the neoclassical theory of marginal productivity. Clark and Wicksteed, though, were concerned only with the income of social classes. What the Chicago-school economists did was expand productivist theory to individuals.

Doing so required inventing a new form of capital. The idea was that individuals’ skills and abilities actually constituted a stock of capital – human capital. This stock made individuals more productive, and hence, earn more income.

The idea that skills constituted “human capital” was initially greeted with skepticism. For one thing, the term itself smacked of slavery. (Capital is property, so “human capital” implies human property.) For another, human capital theory overtly justified inequality. It implied that no matter how fat their incomes, the rich always earned what they produced. Any attempt (by the government) to redistribute income would therefore “distort” the natural order. During the 1950s and 1960s, there was little tolerance for such views. It was the era of welfare-state expansion, driven by Keynesian-style thinking. Yes, big government may have been “distorting” the free market – but society seemed all the better for it. Until the 1970s, human capital theory remained obscure.

In the 1990s, a second generation of economists took up the human-capital mantle. By then, neoliberal politics was in full swing. The fact that human capital theory explicitly justified inequality was no longer a liability. Today, the fortunes of human capital theory seem to have peaked.

We can see the scientific flaws by returning to William Muir’s chicken experiment. I have already told you about his psychopathic chickens, created by breeding the most productive hens. But I have not told you about his alternative trial. In it,

he bred the most productive *group* of chickens. The result was an astonishing increase in egg-laying productivity.

The reason this group selection worked is that chickens are social animals. That means productivity is influenced by the social environment. By selecting productive groups, Muir selected for egg-laying ability, but also for sociality. The resulting social hens flourished together.

Human capital theory supposes that income stems from productivity, and that this productivity is an isolated trait of the individual.

When we expose the realities of *power* (a social trait), we undermine the legitimacy of the social order.

Blair Fix: Human Capital Theory RWER95 (pdf)

16

Neo-liberal Economics

The neoliberal solution to climate change is to hope that somehow it will become profitable to save the planet. This will not work. (@ExistentialComics)

16.1 Washinton Consensus

John Williamson coined the term “Washington Consensus” to refer to a set of ten economic policies and reforms that received widespread support at the time. These policies included - maintaining fiscal discipline, - reordering public spending priorities (from subsidies to health and education expenditures), - reforming tax policy, - allowing the market to determine interest rates, - maintaining a competitive exchange rate, - liberalizing trade, - permitting inward foreign investment, - privatizing state enterprises, - deregulating barriers to entry and exit, and - securing property rights.

Williamson was writing in the context of Latin America as it was emerging from the debt crisis of the 1980s. His list of policies was not prescriptive but descriptive of what he thought various Washington-based institutions, such as the US Treasury, the International Monetary Fund, the World Bank, and various think tanks, agreed would stabilize and restore growth in the region.

Williamson’s original conception indicated the general direction in which policy should move, away from a heavily statist approach while retaining an important regulatory role for government.

Another version came to represent an extreme market-fundamentalist neoliberal approach that simplified economic policy to “stabilize, liberalize, and privatize” with minimal government, all of which was far from Williamson’s original intent.

Critics charged that the Washington Consensus ignored the problems associated with rising inequality and even encouraged the weakening of social safety nets.

A series of financial crises—the tequila crisis in 1994–95, the Asian crisis in 1997–98, and the Russian crisis of 1998—further damaged the reputation of Washington Consensus-type policies.

Of course, critics of the Washington Consensus usually did not argue that emerging markets should pursue policies of fiscal indiscipline, high inflation, financial repression, trade protectionism, overvalued exchange rates, more nationalization of business, and the like. Rather, they tended to argue that the original list of ten policies was incomplete and that additional policies were needed to improve economic performance. Williamson’s list was also very general, leaving ample room for debate as to how far to go in achieving those policy objectives.

But as we mark the thirtieth anniversary of John Williamson’s initial discussion of the Washington Consensus, it is important to recognize that a growing body of recent research suggests that the Consensus has produced tangible benefits while unorthodox populist policies have entailed significant economic costs. A key challenge for policymakers is to ensure that the benefits of economic reform are widely shared so that the divisions that lead to economic populism do not arise and erase those gains.

Peterson

Imagine writing ‘Washington Consensus really does work’ at the end of a year when central banks bought all bonds issued by fiscal authorities in high income countries, so said fiscal authorities can put safety nets under both capital and labour.

Including Nicaragua is problematic to start with: first Ortega regime had to contend with an internal war against paramilitaries (Contras) financed by US in the famous Iran-Contras affair. You’d think the paper would mention that.

Guys, the Sandinista Revolution was distracted from growth outcomes by Ronald Reagan bombing them for refusing to say ‘yes uncle, mi patria tu patio’

Ironically, Ortega’s rein since 2007 is far more consistent with the paper’s definition of ‘populism’, but it’s a Washington Consensus, pro-market populism, so of course, we go for the civil war period.

An entire subsection on infant mortality under Ortega vs ‘synthetic Nicaragua’ that does not mention the war! Of course, synthetic Nicaragua is one that the US empire doesn’t bomb.

Gabor (twitter comment)

Un thread à lire absolument pour voir le type d’analyse défendu par certains économistes américains universitaires réputés. Où inventer des pays “fictifs” entièrement à sa main est censé permettre de “prouver” le bénéfice de certaines lignes idéologiques. (@NBarreyre)

Alves

Decades of research have documented the devastating impacts of the Washington Consensus in the developing world. Yet revisionist accounts of this story have emerged in recent years. Remarkable amongst these, a recent blog post by the Peterson Institute for International Economics – “Washington Consensus stands the test of time better than populist policies” – draws on research that is jaw-droppingly ideological and flawed.

For decades, mainstream and heterodox economists broadly agreed that the Washington Consensus failed (Stewart 1995, Krueger 2004, Mkandawire 2005). Debt-crisis ridden developing countries that implemented the reforms associated with privatization, liberalisation and deregulation in the 1980s and 1990s tended to see an increase in poverty along with worsening health and educational outcomes. This led to the 1980s and 1990s being dubbed the ‘lost decades’ of development (Easterly 2001) and ultimately paved the way for the the post-Washington Consensus and pro-poor policies (Saad-Filho 2011).

But this is about to change. New methods that ‘produce credible counterfactuals in case studies’, turn the conventional wisdom of the Washington Consensus failure on its head (Marrazzo and Terzi 2017, Absher et al. 2020, Grier and Grier 2021). Essentially, the counterfactual approach involves first creating fictitious or synthetic countries, whose policy makers chose the opposite policy trajectory, and then testing whether the Washington Consensus package works better than the alternative. The results, the PIIE blog informs us, stack up for the Washington Consensus: countries adopting WC policies are shown to (eventually) be better off in GDP per capita terms. In contrast, left-wing populists – of the Latin American pedigree – hurt their economies by throwing the Washington Consensus policies out with the neoliberal bathwater.

If one unpacks its mechanics carefully, the counterfactual approach turns out to be a thinly-veiled ideological attempt to whitewash the Washington Consensus, to resurrect its key tenets: that minimising the footprint of the state is the right policy choice in health or education, that macroeconomic policy should mean inflation targeting by central banks not active fiscal policy by elected politicians, that state-owned companies are all white elephants in urgent need of privatization, that trade unions harm labour markets.

How does one empirically create a fictitious country? The synthetic control method predicts a ‘no Ortega’ growth/infant mortality path by creating a pool of ‘donor’ countries and calibrating their relative contribution to a synthetic Nicaragua such that the pre-Ortega growth or infant mortality path is close to actual Nicaragua. The Washington Counterfactual thus creates a synthetic Nicaragua composed of 23% Chile, 54% Honduras, 9% Mexico, 8% Norway, and 7% the US.

Or, to bring a historical touch to the method, synthetic Nicaragua, like a neoliberal Frankenstein, consist of 7% country bombing Nicaragua (US), 54% country used by the CIA/US to bomb Nicaragua (Honduras), 23% country where Washington Consensus was being implemented by Chicago Boys and a military

dictatorship (Chile), 8% country never analytically paired with the Washington Consensus (Norway), and Mexico. It is this synthetic Nicaragua where per capita GDP would have been 5.000 USD dollars higher, a Nicaragua that the US empire does not bomb.

Revisionist accounts of the Washington Consensus matter because the pandemic has revived the debate around the role that the state should play in the economy.

If anything, this is a powerful reminder that all economics is political, however much some hide it behind new or ‘sophisticated’ econometric techniques.

Alves on Peterson

17

Steady State Economics (SSE)

17.1 Herman Daly

Point Policy Summary From “A Steady-State Economy,” by Herman E. Daly
School of Public Policy, University of Maryland, College Park MD 20742 USA

1. Cap-auction-trade systems for basic resources. Cap limits to biophysical scale according to source or sink constraint, whichever is more stringent. Auction captures scarcity rents for equitable redistribution. Trade allows efficient allocation to highest uses.
2. Ecological tax reform—shift tax base from value added (labor and capital) and on to “that to which value is added”, namely the entropic throughput of resources extracted from nature (depletion), through the economy, and back to nature (pollution). Internalizes external costs as well as raises revenue more equitably. Prices the scarce but previously unpriced contribution of nature.
3. Limit the range of inequality in income distribution—a minimum income and a maximum income. Without aggregate growth poverty reduction requires redistribution. Complete equality is unfair; unlimited inequality is unfair. Seek fair limits to inequality.
4. Free up the length of the working day, week, and year—allow greater option for leisure or personal work. Full-time external employment for all is hard to provide without growth.
5. Re-regulate international commerce—move away from free trade, free capital mobility and globalization, adopt compensating tariffs to protect effi-

cient national policies of cost internalization from standards-lowering competition from other countries.

6. Downgrade the IMF-WB-WTO to something like Keynes' plan for a multi-lateral payments clearing union, charging penalty rates on surplus as well as deficit balances— seek balance on current account, avoid large capital transfers and foreign debts.
7. Move to 100% reserve requirements instead of fractional reserve banking. Put control of money supply and seigniorage in hands of the government rather than private banks.
8. Enclose the remaining commons of rival natural capital in public trusts, and price it, while freeing from private enclosure and prices the non rival commonwealth of knowledge and information. Stop treating the scarce as if it were non scarce, and the non scarce as if it were scarce.
9. Stabilize population. Work toward a balance in which births plus immigrants equals deaths plus out-migrants.
10. Reform national accounts—separate GDP into a cost account and a benefits account. Compare them at the margin, stop growing when marginal costs equal marginal benefits. Never add the two accounts.

Herman Daly (2008) Steady State Economy (Sustainable Development Commission) (pdf)

18

Spatial Economics

Agglomeration Economics

(Ongoing Research Programme)

HSCIF

18.1 Urban Economics

When and why did the expertise associated with economics as an academic discipline become so highly valued in the world of public policy?

The embedding of agglomerationism within the thinking of policy-makers and governmental institutions provides a fascinating example of a broader shift towards the growing impact of economic expertise, and indeed of individual economists, on policy-making.

This focus sits within a wider field of study which is interested in the complex roles that economists have at times played – as public intellectuals, policy experts and academic specialists. How different kinds of analytical tools and a particular style of economic reasoning made their way into the world of elite decision-making is a major theme of interest for many historians and social scientists. So too is the related question of how quantification (testable theoretical hypotheses, measurement technique and indicators, as well as decision-models) has over the last few decades gained ascendancy in policy circles.

History of Urban Policy Expertise

18.1.1 Expertise

Expertise under Pressure

What is the role of experts in understanding social change? Expert judgment today is both intensely sought out, across private and public spheres, and also intensely criticised and derided with well-publicised failures to predict various high profile social and natural phenomena. Does the problem lie with the very idea that objective expertise about complex processes is attainable? Or does it stem from the way that expert judgment is developed and communicated? Or, perhaps it reflects the diminished standing of experts and expert knowledge in democratic and pluralistic societies?

To explore these questions, we propose three case studies in which expert judgment is both consequential and controversial. They are the UK Government's emergency response, the use of agglomeration theory in city planning, and deep philosophical controversies about the possibility and objectivity of social science. These cases differ in scope and focus but they enable us to analyse four distinct features of legitimate expertise: sensitivity to temporal scale, translatability in space, ambivalence about precision, and moral responsibility. The overarching goal of the project is to establish a broad framework for understanding what makes expertise authoritative, when experts overreach, and what realistic demands communities should place on experts.

CRASSH Expertise under Pressure Programme

18.1.2 Trusting Science

Bennett

Trust is necessary for many kinds of policy, particularly where that policy requires citizens to comply with rules that come at significant cost, and coercion alone would be ineffective. What is distinctive about our pandemic policies is that they depend not just on public trust in policy, but public trust in the science that we are told informs that policy.

When public policy claims to follow the science, citizens are asked not just to believe what they are told by experts, but to follow expert recommendations.

While ministers defer to scientists, those same scientists have been eager to point out that their role is exclusively advisory.

We are still being asked by the government to trust in recommendations provided by experts, even if the government is not being led by evidence in the way it would have us believe. The communications strategy may not be honest.

Public trust in science is both a necessary and desirable feature of an effective public health response to the pandemic. But it is desirable only insofar as it is well placed trust. What makes trust in experts reasonable, when it is?

A perceived threat to knowledge about a range of basic facts that most of us don't have the resources to check for ourselves.

If an expert tells me that something is the case this is enough reason for me

to believe it too, provided that I have good reason to think that the expert in question has good reason to believe what they tell me.

Is it still reasonable to trust science when it doesn't just provide policy-relevant facts, but leads the policy itself?

Knowledge regarding the relevant facts might not reliably indicate ability to reason well about what to do in light of the facts.

Well-placed trust in the recommendation of an expert is more demanding than well-placed trust in their factual testimony.

A good reason for an expert to think I should do something is not necessarily a good reason for me to do it. This is because what I value and what the expert values can diverge without either of us being in any way mistaken about the facts of our situation.

One helpful measure to show the public that a policy does align with their interest is what is something called *expressive overdetermination*: investing policy with multiple meanings such that it can be accepted from diverse political perspectives. Reform to French abortion law is sometimes cited as an example of this. After decades of disagreement, France adopted a law that made abortion permissible provided the individual has been granted an unreviewable certification of personal emergency. This new policy was sufficiently polyvalent to be acceptable to the most important parties to the debate;

A second helpful measure, which complements expressive overdetermination, is to recruit spokespersons that are identifiable to diverse groups as similar to them in political outlook. This is sometimes called *identity vouching*. The strategy is to convince citizens that the relevant scientific advice, and the policy that follows that advice, is likely not to be a threat to their interests because that same consensus is accepted by those with similar values.

Expressive overdetermination and identity vouching are ways of showing the public that a policy is in their interests. Whether they really are successful at building public trust in policy, and more specifically in science-led policy, is a question that needs an empirical answer. What I have tried to show here is that we have good theoretical reasons to think that such additional measures are needed when we are asking the public not just to believe what scientists tell us is the case, but to comply with policy that is led by the best science.

Public trust in science comes in at least two very different forms: believing expert testimony, and following expert recommendations. Efforts to build trust in experts would do well to be sensitive to this difference.

[Bennett - Trusting the experts take more than belief(Blog Post)]<https://hsclf.org/trusting-the-experts-takes-more-than-belief/>

18.2 History of Urban Economics

Cherrier and Rebours

The field of ‘Urban Economics’ is an elusive object. That economic phenomena related to the city might need a distinctive form of analysis was something economists hardly thought about until the early 1960s. In the United States, it took a few simultaneous scholarly articles, a series of urban riots, and the attention of the largest American philanthropies to make this one of the hottest topics in economics. The hype about it was, however, short-lived enough so that, by the 1980s, urban economics was considered a small, ‘peripheral’ field. It was only through the absorption into a new framework to analyze the location of economic activities – the ‘New Economics Geography’ – in the 1990s that it regained prominence.

Understanding the development of urban economics as a field, or last least the variant which originated in the US and later became international, presents a tricky task. This is because the institutional markers of an academic field are difficult to grasp. A joint society with real estate economists was established in 1964, and a standalone one in 2006; a journal was founded in 1974, with an inaugural editorial which stated that: “Urban economics is a diffuse subject, with more ambiguous boundaries than most specialties. Situated within a master-discipline (economics) that is often described as exhibiting an articulated identity, clear boundaries with other sciences and strict hierarchies, urban economics is an outlier.”

There is, however, one stable and distinctive object that has been associated with the term ‘urban economics’ throughout the 1970s, the 1980s, the 2000s and the 2010s: the Alonso-Muth-Mills model (AMM). It represents a monocentric city where households make trade-offs between land, goods and services, and the commuting costs needed to access the workplace. The price of land decreases with distance from the city center. The model was articulated almost simultaneously in William Alonso’s dissertation, published in 1964, a 1967 article by Edwin B. Mills, and a book by John Muth published in 1969. This trilogy is often considered as a “founding act” of urban economics.

Agglomeration

In 1956, William Alonso moved from Harvard, where he had completed architecture and urban planning degrees at the University of Pennsylvania. He became Walter Isard’s first graduate student in the newly founded department of “regional science.” He applied a model of agricultural land use developed 150 years earlier by the German economist Johann Von Thünen to a city where all employment is located in a Central Business District. His goal was to understand how the residential land market worked and could be improved. His resulting PhD, Location and Land Use, was completed in 1960. Around that time, young Chicago housing economist Richard Muth spent a snowstorm lockdown thinking about how markets determine land values. The resulting model he developed

was expanded to study population density. And a book based on it was published a decade later: *Cities and Housing*. Drafts of Alonso and Muth's work reached inventory specialist Edwin Mills in 1966, while he was working at the RAND corporation, and trying to turn models describing growth paths over time into a model explaining distance from an urban center. His "Aggregative Model of Resource Allocation in a Metropolitan Area" was published the next year.

This new set of models immediately drew attention from a wide array of transportation economists, engineers and geographers concerned with explaining the size and transformation of cities, why citizens chose to live in centers or suburbs, and how to develop an efficient transportation system. The economists included Raymond Vernon and Edgar Hoover, whose study of New York became the *Anatomy of the Metropolis*; RAND analyst Ira Lowry, who developed a famous spatial interaction model; spatial and transportation econometrician Martin Beckman, based at Brown; and Harvard's John Kain, who was then working on his spatial mismatch hypothesis and a simulation approach to model polycentric workplaces. Through the early works of Brian Berry and David Harvey, quantitative urban geographers also engaged with these new urban land use models.

But the development of a new generation of models relying on optimization behavior to explain urban location was by no mean sufficient to engender a separate field of economics. Neither Alonso, who saw himself as contributing to an interdisciplinary regional science, nor Muth, involved in Chicago housing policy debates, cared much about its institutionalization. But both were influenced and funded by men who did. Muth acknowledged the influence of Lowdon Wingo, who had authored a land use model. Together with Harvey Perloff, a professor of social sciences at the University of Chicago, they convinced the Washington-based think-thank Resource for the Future to establish a "Committee for Urban Economics" with the help of a grant by the Ford Foundation. The decision was fueled by urbanization and dissatisfaction with the urban renewal programs implemented in the 1950s. Their goal was to "develop a common analytical framework" through the establishment of graduate programs in urban economics.

Their agenda was soon boosted by the publication of Jane Jacobs' *The Death and Life of Great American Cities*, and by growing policy interest in the problems of congestion, pollution, housing segregation and ghettoization, labor discrimination, slums, crime and local government bankruptcy, and by the stream of housing and transportation acts which were passed in response to these. The Watts riots, followed by the McCone and Kerner commissions, acted as an important catalyst. The Ford Foundation poured more than \$ 20 millions into urban chairs, programs and institutes through urban grants awarded to Columbia, Chicago, Harvard and MIT in 1967 and 1970. The first round of funds emphasized "the development of an analytical framework", and the second sought "a direction for effective action." As a consequence of this massive investment,

virtually every well-known US economist turned to urban topics.

At MIT, for instance, Ford's money was used to set up a two-year "urban policy seminar," which was attended by more than half of the department. The organizer was welfare theorist Jerome Rothenberg, who had just published a book on the evaluation of urban renewal policies. He was developing a large-scale econometric model of the Boston area with Robert Engle and John Harris, and putting together a reader with his radical colleague Matt Edel. Department chair Carry Brown and Peter Diamond were working on municipal finance. Robert Hall was studying public assistance while Paul Joskow examined urban fire and property insurance. Robert Solow developed a theoretical model of urban congestion, published in a 1972 special issue of the Swedish Journal of Economics, alongside a model by taxation theorist Jim Mirrlees investigating the effect of commuter and housing state tax on land use. Solow's former student Avinash Dixit published an article modeling a tradeoff between city center economies of scale and commuting congestion costs in another special issue on urban economics in the Bell Journal the next year. A survey of the field was also published in the Journal of Economic Literature, just before the foundation of the Journal of Urban Economics in 1974.

Segregation

But the publication of a dedicated journal, and growing awareness of the "New Urban Economics" was not the beginning of a breakthrough. It turned out to be the peak of this wave. On the demand side, the growing policy interest and financial support that had fueled this new body of work receded after the election of Richard Nixon and the reorientation of federal policies. On the supply side, the mix of questions, methods and conversations with neighboring scholars that had hitherto characterized urban economics was becoming an impediment. More generally, the 1970s was a period of consolidation for the economics profession. To be considered as bona fide parts of the discipline, applied fields needed to reshape themselves around a theoretical core, usually a few general equilibrium micro-founded workhorse models. Others resisted, but could rely on separate funding streams and policy networks (development and agricultural). Urban economics was stuck.

Policy and business interest was directed toward topics like housing, public choice and transportation. And, combined with the growing availability of new microdata, micro-econometrics advances, and the subsequent spread of the personal computer, this resulted in an outpouring of applied research. Computable transportation models and real estate forecasting models were especially fashionable.

On the other hand, a theoretical unification was not in sight. Workhorse models of the price of amenities, the demand for housing, or suburban transportation, were proposed by Sherwin Rosen, William Wheaton and Michelle White, among others. But explanations of the size, number, structure and growth of cities were now becoming contested. J. Vernon Henderson developed a general equilibrium

theory of urban systems based on the trade-off between external economies and diseconomies of city size, but in these agglomeration effects did not rely on individual behavior. Isard's former student Masahita Fujita proposed a unified theory of urban land use and city size that combined externalities and the monopolistic competition framework pioneered by Dixit and Joseph Stiglitz, but without making his framework dynamic or relaxing the monocentric hypothesis. At a point when there was growing interest in the phenomenon of business districts – or Edge cities as journalist Joël Garreau called them, this was considered a shortcoming by many economists. General equilibrium modelling was rejected by other contributors, including by figures like Harry Richardson, and a set of radical economists moving closer to urban geographers (such as David Harvey, Doreen Massey and Allen Scott) working with neo-Marxist ideas.

Renewal

In the 1990s, various trends aimed at explaining the number, size, evolution of cities matured and were confronted to one another. In work which he framed as contributing to the new field of “economic geography,” Krugman aimed to employ his core-periphery model to sustain a unified explanation for the agglomeration of economic activity in space. At Chicago, those economists who had spent most of the 1980s modeling how different types of externalities and increasing returns could help explain growth – among them Robert Lucas, José Scheinkman and his student Ed Glaeser – increasingly reflected on Jane Jacob's claim that cities exist because of the spillover of ideas across industries which they facilitate. Some of them found empirical support for her claim than for the kind within-industry knowledge spillovers Henderson was advocating.

Krugman soon worked with Fujita to build a model with labour mobility, trade-offs between economies of scale at the plant level and transportation costs to cities. Their new framework he was adamant to compare to Henderson's general equilibrium model of systems of cities. He claimed that their framework enabled the derivation of agglomeration from individual behavior and could explain not only city size and structure, but also location. In his review of Krugman and Fujita's 1999 book with Venables, Glaeser praised the unification of urban, regional and international economics around the microfoundations of agglomeration theory. He also contrasted Krugman's emphasis upon transportation costs – which were then declining – with other frameworks focusing on people's own movement, and began to sketch out the research program focused on idea exchanges that he would develop in the next decades. He also insisted on the importance of working out empirically testable hypotheses.

The “New Economic Geography” was carried by a newly-minted John Bates Clark medalist who had, from the outset, promised to lift regional, spatial and urban economics from their “peripheral” status through parsimonious, micro-founded, tractable and flexible models. It attracted a new generation of international scholars, for some of whom working on cities was a special case of contributing to spatial economics. In the process, however, older ties with geographers were severed, and questions that were closely associated with changing

cities, like the emergence of the digital age, congestion, inequalities in housing, segregation, the rise of crime and urban riots, became less central to the identity of this field. The field lost some sort of autonomy.

Most recently, Glaeser's insistence that urban models need to be judged by their empirical fit may be again transforming the identity of urban economics. The shift is already visible in the latest volume of the series of Handbooks in Urban and Regional Science. Its editors (Gilles Duranton, Henderson and William Strange) explain that, while its previous volume (2004) was heavily focused on agglomeration theory, this one is "a return to more traditional urban topics." And the field is now characterised not in terms of a unified, theoretical framework, but with reference to a shared empirical epistemology about how to develop causal inferences from spatial data.

Overall, the successive shifts in urban economists' identity and autonomy which we describe here, were sometimes prompted by external pressures (urban crises and policy responses) and sometimes from internal epistemological shifts about what counts as "good economic science." A key development in the 1970s was the unification around general equilibrium, micro-founded models. It is widely held that the profession is currently experiencing an "applied turn" or a "credibility revolution", centered on the establishment of causal inference (gold) standards. How this will affect urban economics remains unclear.

Cherrier and Rebours

18.2.1 Jane Jacobs

Considering her contribution to economic theory may seem counter-intuitive. In addition to lacking academic credentials, she took little interest in engaging the discipline of economics. Her models were neither formal nor developed in reference to existing models. And her view of economic theory in general was dismissive. In the opening chapter of *Cities and The Wealth of Nations*, "Fool's paradise," Jacobs lays out a history of economic thought and arrives at this sweeping conclusion: "Choosing among the existing schools of thought is bootless. We are on our own." The same dismissive stance extended to academic institutions, as she refused numerous honorary degrees from various Universities.

Jacobs Externalities

Some economists picked up on her insights. A type of economic externality has been derived from her detailed historical accounts of new economic activities arising from urban diversity. Chicago and Harvard urban economists Glaeser, Kallal, Scheinkman, and Shleifer credited Jacobs in 1992 for identifying cross-industry knowledge transfers, which they dubbed "Jacobs externalities." The concept was based on Jacobs' *The Economy of Cities* and posits that knowledge transfer occur between different industries, and that local competition supports economic growth.

This came four years after future Nobel prize recipient Robert Lucas pointed to Jacobs' work while investigating the external effects of human capital in his 1988 article *On the Mechanics of Economic Development*, although without formalizing his insight. Lucas' endorsement earned Jacobs increasing recognition among economists over the following decades. Paul Krugman described her as a "patron saint of the new growth theory" and her unusual status was summed up by Robert Dimand and Robert Koehn who saw her as "her own distinctive kind of political economist ... an exceptional instance of a woman without academic affiliation or university training achieving recognition among leading academic economists". And a considerable literature grew up after Glaeser et al.'s piece. Despite this interest in her work, extended reassessments of her contribution to economic thought have yet to appear.

The city economy model, first developed in *The Economy of Cities*, argues that the desirable diversification of local economic activities depends largely on the destination of goods and services entering the city's economy. The key claim is that imports are key to economic development: they embody knowledge and allow further diversifications in the local economy, as imports are gradually replaced by local supply, and make "room" for new imports – in a similar manner to import substitution. Jacobs uses this model to stress the long-term undesirability of overspecialization derived from a focus on maximizing exports, and the importance of a large and diverse local economy – ultimately delivering a critique of comparative advantages as an organizing principle of trade.

The more niches that are filled in a given natural ecology, other things being equal, the more efficiently it uses the energy it has at its disposal ... That is another way of saying that economies producing diversely and amply for their own people and producers, as well as for others, are better off than specialized economies ...

The most elaborate study of Jacobs' use of biological and ecological analogies is provided in mathematician and philosopher David Ellerman's paper *How Do We Grow? Jane Jacobs on Diversification and Specialization* (2005).

Depicting the city economy's boundaries as an open system governed by evolutionary dynamics: "development is a conceptualized form of social learning." Incoming goods, the products of foreign know-how, are vectors of developmental learning. And exports of commodities and services fund these imports. When imports feed into the somewhat enclaved export economy (i.e. overspecialized), they have a lesser effect than when they are dissipated in local consumption.

Following Geoffrey Hodgson's taxonomy in *Economics and Evolution* (1993), part of Jacobs' system could be characterized as phylogenetic and non-consummatory, that is, as exhibiting an open-ended process of evolutionary selection among a population of firms and individuals.

Jacobs targeted development schemes developed by the World Bank. She pointed to the inherent weaknesses of Robert McNamara's development strategies for addressing "basic human needs" (literacy, nutrition, reduction

in infant mortality, and health) of poor populations. She argued that because economic development is a process, it cannot be thought of as a “collection of things” which can be bought or provided. The “basic human needs approach” ignored the necessity for solvent markets to support increased agricultural yields and the populations that were being displaced. As they could no longer rely on agricultural work to sustain themselves, displaced workers failed to find jobs in nearby city economies, where labor markets had not evolved alongside the increased agricultural yields through a succession of appropriate feedback mechanisms triggering the needed corrections. And she made the same argument against technology transfers in the “Green Revolution” of the 1960s and 1970s.

The mechanism of feedback relationships is one example among others of Jacobs’ usage of systemic concepts to draw boundaries around the city economy as a system and elaborate on its behavior. Further examination of Jacobs’ use of these concepts within the paradigm she adopted may reveal a consistent link between her analysis of cities as economic units and the policies she is tended to critique. In short, future attempts at more comprehensive interpretations of Jacobs’ economic thought might benefit from stepping away from the urban focus of *The Death and Life of Great American Cities* while considering more carefully her later economic writings.

Divry on Jacobs

18.3 Regional Economics

Rebours

The history of regional science offers an interesting case study, as well as a one of the few examples, of the institutionalization of an entirely new scientific field in the years after 1945. Its foundation by Walter Isard and a group of social scientists in the 1950s represents the most institutionalized attempt to stimulate the relationship between economics and geography. The original project of Isard, who was trained as an economist at Harvard, was to promote the study of location and regional problems.

And at the outset, regional science was, in various ways, a success. It attracted many scholars from different disciplines, mostly economics, geography and urban/regional planning, and it quickly became institutionalized formally through the foundation of the Regional Science Association (RSA) in 1954 and establishment of a Regional Science Department at the University of Pennsylvania in 1958. At the same time, the creation of the Papers and Proceedings of The Regional Science Association in 1955 and of the Journal of Regional Science in 1958, offered new publication venues for scholars interested in location analysis, in particular quantitative geographers who found it difficult to publish in traditional geography journals. Within economics, regional science influenced analytical works in urban economics, as, for instance, William Alonso’s thesis,

widely recognized as one of the foundational works of urban economics, was written at Penn under the supervision of Isard in 1960.

However, the prevailing processes of knowledge production and evaluation which shaped the emergence of this new field were deeply influenced by economics. Geographers became dissatisfied with Isard's vision of the hierarchical division between geographers and economists, and the primacy given to economic theorizing and modelling as the core of the new regional science. Thus, the social organization of the field of regional science and its interactions with other disciplines mirrored the particularity of economics, a hierarchical discipline organized around a strong theoretical core and an insularity from the rest of social sciences.

In the late 1940s, Isard became increasingly concerned about the lack of interest among economists in the location of economic activities. His perception of the subject was not really different to his colleagues, but he wanted to improve the theory they used, which, following the British tradition of the late 19th century, suffered from a lack of spatial dimension. He did not seek to challenge the general equilibrium economic theory that was becoming dominant, but sought instead to integrate a spatial aspect within it.

In 1949 Isard was recruited to Harvard by Wassily Leontief to develop an input-output approach to regional development. During the war, input-output analysis received much attention because it enabled the American Air Force to identify the best targets for bombing. As a consequence, Leontief had received large research funds to develop his input-output framework.

Isard expressed a hierarchical division between economists, who provided the analytical foundations of regional science, and the geographers, who provided the empirical facts and testing.

While, the identity of economics was legitimated and reinforced by its success during the war, in geography, there was an increasing dissatisfaction with the regional geography approach that dominated the field in the 1950s. The Cold War context facilitated the promotion of a new generation of quantitative geographers looking for more scientific methods.

By the mid-1970s, regional science experienced a progressive decline when geographers started to distance themselves from the analytical methods that were promoted by Isard. But even after the Regional Science Department at Penn closed its doors in 1993, regional science journals remained a going concern and continued to promote studies of spatial issues notably from urban economics and, after 1991, New Economic Geography.

Rebours

19

Econophysics

Blair Fix

Econophysics is an attempt to understand economic phenomena (like the distribution of income) using the tools of statistical mechanics.

The particle model of physics demonstrates how a seemingly equal process (the random exchange of energy) can give rise to wide inequalities. If econophysicists are correct, this model tells us why human societies are mired by inequality. It's just basic thermodynamics.

The idea required a leap of faith: treat humans like gas particles. Econophysicists highlighted an interesting parallel. When humans exchange money, it is similar to when gas particles exchange energy. One party leaves with more money/energy, the other party leaves with less.

With the parallel between energy and money, ecophysicists arrived at a startling conclusion. Their models showed that when humans exchange money, inequality is inevitable.

When econophysicists use ‘random exchange’ to explain income, many people are horrified by the lack of causality. To understand the behavior of large groups of particles, Boltzmann was forced to use the mathematics of probability. The resulting uncertainty in cause and effect made him uneasy.

Quantum mechanics would later show that at the deepest level, nature is uncertain. But this quantum surprise does not mean that probability and determinism are always incompatible. In many cases, the use of probability is just a ‘hack’. It is a way to simplify a deterministic system that is otherwise too difficult to model. Like a coin toss, econophysicists think we can treat monetary exchange in probabilistic terms.

Econophysicists think we can model the exchange of money without understanding property transactions.

Blair Fix

20

Complexity Economics

The discovery that higher order phenomena cannot be directly extrapolated from lower order systems is a commonplace conclusion in genuine sciences today: it's known as the "emergence" issue in complex systems (Nicolis and Prigogine, 1971, Ramos-Martin, 2003). The dominant characteristics of a complex system come from the interactions between its entities, rather than from the properties of a single entity considered in isolation.

The fallacy in the belief that higher level phenomena (like macroeconomics) had to be, or even could be, derived from lower level phenomena (like microeconomics) was pointed out clearly in 1972—again, before Lucas wrote—by the Physics Nobel Laureate Philip Anderson:

The main fallacy in this kind of thinking is that the reductionist hypothesis does not by any means imply a "constructionist" one: The ability to reduce everything to simple fundamental laws does not imply the ability to start from those laws and reconstruct the universe. (Anderson, 1972, p. 393)

The impossibility of taking a "constructionist" approach to macroeconomics, as Anderson described it, means that if we are to derive a decent macroeconomics, we have to start at the level of the macroeconomy itself. This is the approach of complex systems theorists: to work from the structure of the system they are analysing, since this structure, properly laid out, will contain the interactions between the system's entities that give it its dominant characteristics.

Neoclassical macroeconomists have tried to derive macroeconomics from the wrong end—that of the individual rather than the economy—and have done so in a way that glossed over the aggregation problems that entails by pretending that an isolated individual can be scaled up to the aggregate level. It is certainly sounder—and may well be easier—to proceed in the reverse direction, by starting from aggregate statements that are true by definition, and then by

disaggregating those when more detail is required.

Using these definitions, it is possible to develop, from first principles that no macroeconomist can dispute, a model that does four things that no DSGE model can do: it generates endogenous cycles; it reproduces the tendency to crisis that Minsky argued was endemic to capitalism; it explains the growth of inequality over the last 50 years; and it implies that the crisis will be preceded, as it indeed was, by a “Great Moderation” in employment and inflation.

The three core definitions from which a rudimentary macro-founded macroeconomic model can be derived are the employment rate (the ratio of those with a job to total population, as an indicator of both the level of economic activity and the bargaining power of workers), the wages share of output (the ratio of wages to GDP, as an indicator of the distribution of income), and, as Minsky insisted, the private debt to GDP ratio.

A simple model can explain most of the behaviour of a complex system, because most of its complexity come from the fact that its components interact—and not from the well-specified behaviour of the individual components themselves

So the simplest possible relationships may still reveal the core properties of the dynamic system—which in this case is the economy itself.

Even at this simple level, its behaviour is far more complex than even the most advanced DSGE model, for at least three reasons. Firstly, the relationships between variables in this model aren’t constrained to be simply additive, as they are in the vast majority of DSGE models: changes in one variable can therefore compound changes in another, leading to changes in trends that a linear DSGE model cannot capture. Secondly, non-equilibrium behaviour isn’t ruled out by assumption, as in DSGE models: the entire range of outcomes that can happen is considered, and not just those that are either compatible with or lead towards equilibrium. Thirdly, the finance sector, which is ignored in DSGE models (or at best treated merely as a source of “frictions” that slow down the convergence to equilibrium), is included in a simple but fundamental way in this model, by the empirically confirmed assumption that investment in excess of profits is debt-financed

With a higher propensity to invest comes the debt-driven crisis that Minsky predicted, and which we experienced in 2008. However, something that Minsky did not predict, but which did happen in the real world, also occurs in this model: the crisis is preceded by a period of apparent economic tranquillity that superficially looks the same as the transition to equilibrium in the good outcome. Before the crisis begins, there is a period of diminishing volatility in unemployment.

The difference between the good and bad outcomes is the factor Minsky insisted was crucial to understanding capitalism, but which is absent from mainstream DSGE models: the level of private debt. It stabilizes at a low level in the good outcome, but reaches a high level and does not stabilize in the bad outcome.

The model produces another prediction which has also become an empirical given: rising inequality. Workers' share of GDP falls as the debt ratio rises, even though in this simple model, workers do no borrowing at all. If the debt ratio stabilises, then inequality stabilises too, as income shares reach positive equilibrium values. But if the debt ratio continues rising—as it does with a higher propensity to invest—then inequality keeps rising as well. Rising inequality is therefore not merely a “bad thing” in this model: it is also a prelude to a crisis.

The dynamics of rising inequality are more obvious in the next stage in the model's development, which introduces prices and variable nominal interest rates. As debt rises over a number of cycles, a rising share going to bankers is offset by a smaller share going to workers, so that the capitalists share fluctuates but remains relatively constant over time. However, as wages and inflation are driven down, the compounding of debt ultimately overwhelms falling wages, and profit share collapses.

Steve Keen

21

Functional Finance

Functional finance is a heterodox macroeconomic theory developed by Abba Lerner during World War II that seeks to eliminate economic insecurity (i.e., the business cycle) through government intervention in the economy. Functional finance emphasizes the result of interventionist policies on the economy. It actively promotes government deficit spending as an effective way of reducing unemployment.

Functional finance is based on three major beliefs:

1. It is the role of government to stave off inflation and unemployment by controlling consumer spending through the raising and lowering of taxes.
2. The purpose of government borrowing and lending is to control interest rates, investment levels, and inflation.
3. The government should print, hoard or destroy money as it sees fit to achieve these goals.

Functional finance also says that the sole purpose of taxation is to control consumer spending because the government can pay its expenses and debts by printing money. Furthermore, Lerner's theory does not believe it is necessary for governments to balance their budgets.

Lerner was a follower of the extremely influential economist John Maynard Keynes and helped to develop and popularize some of his ideas. Keynesian economics embraced the concept that optimal economic performance could be achieved by using economic intervention policies by the government to influence

Investopedia

Levy Publications

Tankus on Krugman vs MMT

22

Macro-Finance

The ultimate driver of government financing costs is the central bank.

22.1 Institutional Supercycles

Dafermos

Supercycle

We build upon the Minskyan concepts of ‘thwarting mechanisms’ and ‘super-cycles’ to develop a framework for the analysis of the dynamic evolutionary interactions between macrofinancial, institutional and political processes.

Thwarting mechanisms are institutional structures that aim to stabilise the macrofinancial system. The effectiveness of such structures changes over time, creating a secular cyclical pattern in capitalism: the supercycle.

We develop a macrofinancial stability index and identify two supercycles in the post-war period, which we label the industrial and financial globalisation supercycle respectively.

For each, we apply a four-phase classification system, based on the effectiveness of institutions, customs and political structures for stabilising the macrofinancial system.

The supercycles framework can be used to explain and anticipate macroeconomic, financial and thus political developments, and moves beyond conventional approaches in which such developments are treated as exogenous shocks.

Framework

Despite the bidirectional and dynamic nature of the interactions between institutions and macrofinancial processes, analysis is often partial and static. In the political economy literature, institutional change is linked with exogenous

macroeconomic or financial shocks, such as shifts in inflation or the policy interest rate (Iversen and Soskice, 2012; Gabor and Ban, 2013). Conversely, macro-financial developments are explained as arising from exogenous institutional change, such as alterations to financial regulation or labour market legislation. A framework in which institutional change and macrofinancial processes are dynamically interlinked is still missing.

In this paper, we develop an evolutionary framework that connects macrofinancial processes and institutional change. The foundations of this framework lie with two largely overlooked concepts in Minsky's analysis of financial capitalism (Palley, 2011). The first is that of 'thwarting mechanisms.' This concept draws on Minsky's insight that, although capitalism is inherently unstable, this instability rarely becomes explosive because of the existence of 'customs, institutions or policy interventions' that tame destabilising forces (Ferri and Minsky, 1992, p. 84). Thwarting mechanisms counteract the inherent instability of capitalism, allowing for long periods of high economic activity and social and financial stability. However, the effectiveness of thwarting mechanisms varies over time, eventually diminishing as a result of the profit-seeking actions of economic agents and the generation of new sources of long-run instability. This endogenous erosion gives rise to crises, which, in turn, lead to the development of new thwarting mechanisms. The rise and fall of thwarting mechanisms generates secular cycles in macrofinancial stability. This 'supercycle' is the second concept we borrow from Minsky and Palley.

Thwarting Mechanisms

Minsky's concept of thwarting mechanisms: 'customs, institutions or policy interventions that make observed values of macroeconomic variables different from what they would have been if each economic agent pursued "only his own gain"'.

Thwarting mechanisms reduce the amplitude of basic cycles, constraining instability by *imposing ceilings and floors* on the dynamic path of the economic system.

Floor mechanisms aim to ensure a minimum level of aggregate demand, thereby placing a floor under the level of economic activity. These mechanisms may be the result of deliberate policy interventions, (e.g. activist fiscal policy), or a side effect of other developments (e.g. expansion of household debt to maintain consumption spending).

Ceiling mechanisms aim to impose upper limits on the economic expansion by restricting activities that may enhance growth but also generate instability. Examples of ceiling mechanisms include inflation targeting, financial regulation aimed at reducing procyclicality and leverage, and capital controls to restrict speculative financial inflows.

The supercycle is a long-run institutional and political cycle over which the effectiveness of a particular configuration of thwarting mechanisms first increases

and then declines. The configuration of thwarting mechanisms shapes the supercycle, hardwiring powerful macroeconomic ideas into policy regimes.

Macrofinancial stability is primarily driven by the effectiveness of thwarting mechanisms.

Four Phases

Four phases of the supercycle: expansion, maturity, crisis and genesis.

During the *expansion* phase, newly introduced thwarting mechanisms are effective, leading to economic expansion and broad social and financial stability: economic and financial activity is disrupted by the recessions of the basic cycles, but thwarting mechanisms prevent a systemic crisis. Economic agents learn how to adapt to the new institutional environment, however, innovating to preserve or increase their profits and thereby reducing the effectiveness of thwarting mechanisms. Further, mechanisms introduced to reduce one source of instability may over time create others, potentially as a result of interaction with other thwarting mechanisms.

Once the effectiveness of thwarting mechanisms starts to decline, the cycle enters the *maturity* phase, during which economic expansion continues but the macrofinancial stability of the system is diminishing.

The declining effectiveness of thwarting mechanisms ultimately leads to *crisis*, because the institutional framework is no longer sufficient to constrain the dynamics of the basic cycle. At this point, a basic-cycle recession leads to deep economic, political and social instability, and institutional restructuring. While government intervention may stabilise the economy, broad-based recovery is impossible because existing thwarting mechanisms are ineffective: the institutional structure is can no longer ensure macrofinancial stability.

The ensuing *genesis* phase sees attempts to establish a new configuration of thwarting mechanisms, attempts shaped by political struggles. When – or if – effective new mechanisms are introduced, the next supercycle begins. In the case that – for political, social or technological reasons – such mechanisms cannot be introduced, the crisis phase will be prolonged, likely accompanied by political and social turmoil.

Institutional Change

Institutions, understood as ‘rules of the game’ provide mechanisms to facilitate market exchange in the presence of transactions costs that prevent an optimal frictionless equilibrium.

Causation is largely unidirectional: given the presence of transactions costs, exogenously imposed ‘good’ institutions – usually understood as the rule of law, secure property rights, well-developed financial markets etc. – produce good economic outcomes. Changes in institutional structure, understood as formal ‘rules of the game’ result from ongoing optimisation by market participants over

the costs of reconfiguration relative to the benefits, given incomplete information sets, technology, and firm-specific knowledge.

Recent work goes beyond this micro-based analysis to examine the possibility of emergent properties in *complex evolutionary systems*, using agent-based modelling techniques. Thwarting mechanisms can be viewed as constraining the macrofinancial instability that arises from the emergent properties of such complex systems.

Institutional structure itself, understood as the configuration of thwarting mechanisms, emerges and evolves as a result of the profit-seeking behaviour of agents. The agent-driven erosion of thwarting mechanisms can give rise to macrofinancial instability.

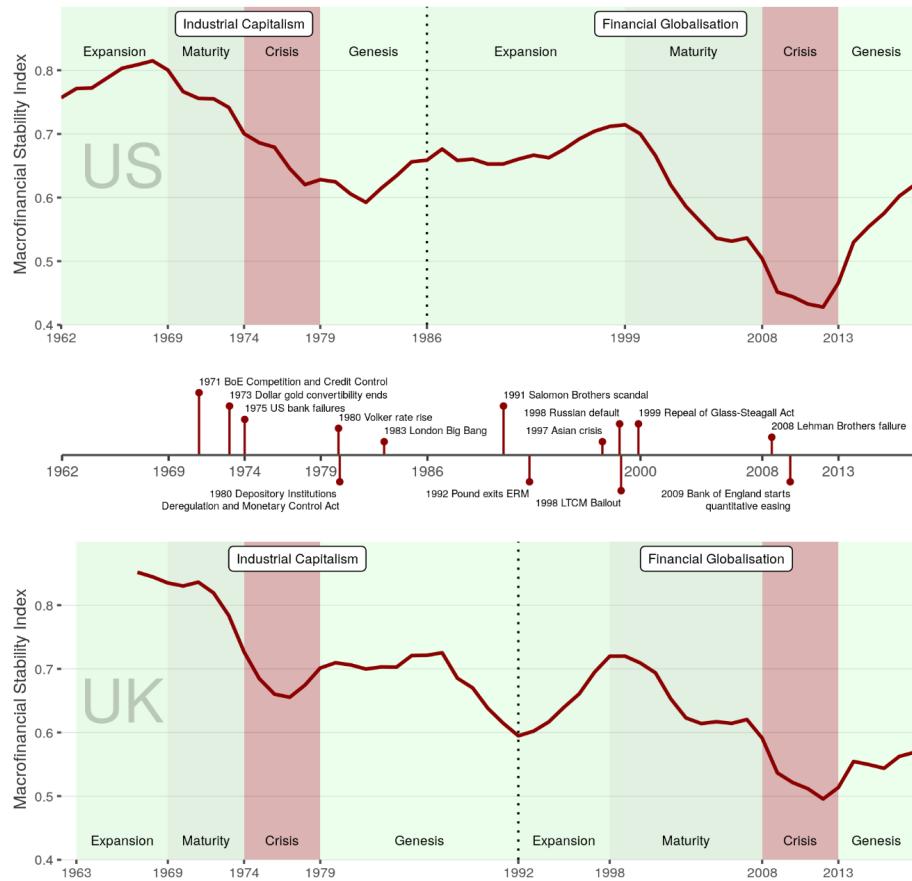
The distribution of power influences the design of thwarting mechanisms; it does not merely affect macroeconomic targets and the associated policy design. Policy makers need to establish mechanisms that keep a range of key macroeconomic variables within certain bounds, irrespective of the primary macroeconomic target; otherwise, macroeconomic instability would undermine political stability.

The way that thwarting mechanisms are eroded is specific to each supercycle: the strength of labour in the 1970s undermined the wage-price consensus, giving rise to inflationary pressure, while the strength of finance in the 2000s placed limits on the effectiveness of mechanisms to constrain financial instability.

Macrofinancial Stability Index (MSI)

The MSI is constructed using a number of ‘floor’, ‘ceiling’ and ‘corridor’ macroeconomic and financial variables.

The MSI is calculated as one minus an average of the normalised distances of floor, ceiling and corridor variables from their maximum, minimum and average values respectively (over the period under investigation). The MSI thus takes values between 0 (minimum stability) and 1 (maximum stability).



High-income countries experienced common secular cyclical movements in their macrofinancial stability in the post-World War II period.

The ideological shift on macroeconomic management at the end of the 1970s brought independent central banks oriented to inflation targeting and fiscal deficits financed on sovereign debt markets. Mass privatisation reduced the state's economic footprint, while previous gains on employment protection and unemployment benefits were substantially rolled back. Growth increasingly relied on rapid expansion of leverage and increasing financial activity. The financial sector, in turn, found that new institutional structures were required to enable leverage to expand beyond traditional constraints. During the expansionary phase of the FG supercycle, shadow banking expanded significantly, absorbing the flow of assets resulting from the continued expansion of credit. Securitisation and the originate-to-distribute model allowed banks to transform illiquid assets, mortgage loans in particular, into marketable securities. These securities were financed with short-term liabilities such as repos and asset-backed commercial paper (ABCP). Growth became increasingly reliant on collateral-

based financial activity.

Collateral plays a central role in funding neorentier balance sheets. Neorentiers issue short-term (often overnight) repo deposits secured by tradable collateral. For lenders such as institutional cash pools or money market funds, collateral makes repos a better liquidity management vehicle than unsecured bank deposits. Repo borrowing allows a wide range of institutions to access money market funding, while rising asset prices lead to increasing leverage capacity because repo collateral is marked to market. The use of collateral functionally, and imperfectly, replaces direct sovereign guarantees on short-term liquid assets.

The rise of collateral-based finance fundamentally changed the relationships between central banks and governments. In the 1990s, central banks in high-income countries collectively sanctioned neorentiers' turn to shadow deposits by liberalising repo markets, often to enable Ministries of Finance to develop liquid government bond markets. States turned to neorentiers in the age of independent central banks and capital market financing of budget deficits, introducing reforms in sovereign bond markets designed according to neorentier preferences: regular auctions facilitated by primary dealers and deregulated repo markets

The promise of liquidity for sovereign bonds entrenches the ‘infrastructural power’ of finance: neorentiers promise liquidity to Ministries of Finance, and well-functioning monetary transmission mechanisms to central banks, improving their ability to oppose policy innovations or tighter regulatory measures. The rising power of neorentiers thus serves to discipline states, curbing fiscal and regulatory thwarting mechanisms: market financing of fiscal deficits privileges neorentiers as mediators between the monetary and the fiscal arms of the state, and creates conflicting objectives for the central bank and the Treasury.

Easy credit conditions allowed sustained expansion of private debt, enabling aggregate demand to keep up with productive capacity in the face of weak income growth and government retrenchment. Credit-financed consumption took over from capital investment as the driver of growth.

While crisis-era innovations succeeded in preventing financial system collapse and depression, growth has not returned. In our framework, this less due to ‘secular stagnation’ than to the institutional architecture of the FG supercycle – weak and ‘flexible’ labour, high inequality and government retrenchment. Without a change in this architecture – without a new set of thwarting mechanisms – it is difficult to identify a likely source of sustained demand growth other than a return to credit expansion.

Overall, while institutional changes improved the effectiveness of stabilising mechanisms in the period prior to the coronavirus pandemic, the continuous push for asset-based welfare reinforced the structural drivers of neorentier capitalism without delivering a new engine of growth. When the coronavirus crisis struck, a new configuration of thwarting mechanisms that could foster economic expansion alongside financial stability had not yet emerged. The thwarting mechanisms of the next supercycle will be, at least in part, the result of the

rapid institutional change that has taken place as a result of this crisis, and of greater awareness of the potential for future pandemics. Inevitably, the next supercycle will also be conditioned by the even greater crisis of climate change.

Green Supercycle

What is most urgently required, in light of the COVID-19 and climate crises, is a detailed understanding of the current genesis phase and the prospects for the emergence of a new set of thwarting mechanisms that would underpin a green supercycle.

Dafermos Gabor (2020) Institutional Supercycles (pdf)

22.2 Central Banking

Braun

The impact of international economic integration on social protection is conditional on the monetary regime.

The role of the European Central Bank (ECB) as the supranational enforcer of the economic logic of integration since monetary union.

While Polanyi conceptualized central banking as an institution of non-market coordination that evolved to protect the domestic economy from gold standard pressures, the ECB has acted as an enforcer of disembedding “euro standard” pressures vis-à-vis national labor market and welfare state institutions.

Despite lacking the mandate or the authority to override national legislation, the ECB, strategically pursuing its organizational and systemic interests, pushed for structural reforms via discursive advocacy and conditionality. Our results show that Europe’s prospects for Polanyian non-market coordination are determined by Frankfurt as much as by Luxembourg and Brussels.

The death of ‘Social Europe’

The European Commission’s slogan of “a Europe that protects”, introduced in 2019, subtly diverges from the Treaty of Rome’s commitment to “proper social protection.” This is no accident. The euro area debt crisis accelerated labor market deregulation and welfare state retrenchment, and the idea of a “Social Europe” has been declared “dead.” At the same time, and particularly among those most affected by these developments, protectionist and nationalist sentiments have been on the rise. Brussels watchers have read “a Europe that protects” as a bellwether of a new, non-liberal politics of protection.

The European Union (EU) as a unique case combining high levels of protection with full “globalization in the strict sense of the word”, namely unrestricted competition for capital, goods and services.

The strictures of the euro considerably amplified the economic logic of integration relative to the legal and political logics expressed through the ECJ and the Commission, respectively. With the introduction of the euro in 1999, this economic logic of integration found its institutional expression in the European Central Bank (ECB). Since then, the relationship between economic integration and social protection has been shaped in Frankfurt as much as in Brussels and Luxembourg.

Structural Reforms

The ECB defined structural reforms, in strikingly Polanyian terms, as policies that “change the fabric of an economy, the institutional and regulatory framework in which businesses and people operate.”

This advocacy constitutes a puzzle: The ECB lacks both a mandate and the legal means to shape labor market and social policies at the member-state level. Pushing to “change the fabric” of societies therefore entails significant reputational risks. Why, then, did the ECB chose to push for structural reforms? Our explanatory framework places the emphasis on the ECB’s organizational (credibility and legitimacy) and systemic (survival of the euro) interests. In pursuing those interests, the ECB strategically adjusted the method and content of its structural reform advocacy to fit the economic and political context. In the wake of the euro area debt crisis, the ECB acquired the power—shared with the Commission and the International Monetary Fund (IMF)—to impose and enforce policy conditionality.

Polanyi

Our analysis, while drawing on Polanyi, fills an important gap in Polanyian thinking on the political economy of central banking. According to Polanyi, national central banking evolved as an expression of the countermovement to the commodification of money under the international gold standard. Whereas Polanyi said little about potential conflicts between non-market coordination in the domain of money (central banks) and social protection in the domain of labor (social policies and trade unions), this conflict subsequently moved to the very center of macroeconomic governance. A large literature has since studied the interaction between national central banks and national labor market policies and wage-setting actors.

The institutional setting of this interaction changed dramatically with EMU, which established a supranational monetary regime with its own supranational central bank. From the beginning, heterogeneous labor market institutions and social policies threatened divergent national inflation developments, which clashed with the ECB’s one-size-fits-all monetary policy.

Whereas Polanyi would have expected a central bank to protect national economies from the disembedding pressures of the monetary regime, the ECB has instead embodied these very pressures, acting as a—if not the—key planner of laissez-faire in national labor markets.

Looking beyond Europe, our analysis contributes to the literature on policy diffusion in the context of economic globalization. Here, national policymakers routinely encounter the problems of translating and enforcing perceived functional pressures emanating from the international level.

The IMF, guided by the “Washington Consensus,” made its emergency lending conditional on governments’ implementing specific structural reforms, playing the role of both translator and enforcer.

Central banks, as the ultimate repositories of “epistemic authority” on economic matters, are uniquely positioned to play a similar role at the domestic level. In the euro area, the role of translator and—to a lesser but significant extent—enforcer of perceived functional pressures was assumed by the ECB identified—and sought to counter via structural reforms and public-sector wage restraint—the diverging trend in unit labor costs as early as 2005, years before the European Commission.

The ECB has been a highly articulate proponent of specific structural reforms in national labor markets and social policy regimes. When unit labor cost divergence, first recognized and prioritized by Trichet, threatened the very effectiveness of supranational monetary policy, the ECB began to promote structural reforms as means of macroeconomic adjustment, both in public speeches and behind the scenes with national policymakers. Executive Board members urged governments to seek downward wage adjustments, both via structural labor market reforms and by imposing wage restraint on the public sector. When the euro-area debt crisis hit, the ground for its interpretation as a crisis of competitiveness divergence had already been prepared by the ECB. When circumstances added formal and informal conditionality to the ECB’s toolkit, it wielded those instruments to help *enforce* labor market liberalization, internal devaluation, and public sector wage cuts. It was only when deflationary pressures and criticism in the European Parliament and elsewhere threatened its legitimacy that the ECB abandoned its advocacy of structural reforms.

Despite lacking both a mandate and the legal means to directly override national regulations, the ECB has been a keen supranational advocate of market-enhancing integration in the field of labor market and social policy.

This analysis also sheds new light on the broader political economy of central banking. Polanyi and others have shown that national central banking evolved under the international gold standard to buffer the disruptive adjustment pressures on national economies. The supranational ECB provided such protection for the financial system, but not for labor. Instead, emulating the role the IMF in other parts of the world, the ECB translated—and subsequently helped to enforce—the perceived functional pressures of international monetary and financial integration. Whether the ECB is constitutionally wedded to the role of “prime mover in the move to a market society” remains to be seen.¹³⁵ Its recent shift from structural reform advocacy to calls for wage increases has been echoed in the US, where the Federal Reserve has signaled that it will priori-

tize employment and wage growth over consumer and asset price stabilization. Central banks may yet again become “active agents of the countermovement.”

Braun (2021) Planning Laissez-faire: Supranational Central Banking (pdf)

23

Externalities

Resource extraction and pollution of the commons power the beating heart of global economic prosperity.

23.1 History of Economics' 'Externalities'

Duncan Austin

Incomplete Markets

Externalities were generally ignored through most of the 20 Century. After Pigou had identified the problem in the 1920s, there followed a long barren period for “welfare economics”, the natural home for this type of thinking. This lasted until the early 1970s when there were the first stirrings of renewed interest by serious economists.

Framed as “externalities”, market failures could be more easily dismissed. The term encourages a perception of unpriced damages as being mere residuals to the centrepiece of a priced economy. Since Pigou, some have sought to “beef up” the terminology. K. William Kapp, for example, bluntly described the market mechanism, *in toto*, as a “cost-shifting” institution. In this framing, externalities are not a bug, but a feature.

The mathematization of economics – another marker of the discipline’s scientific aspiration – exacerbated the situation. The desire for manageable equations and functioning models further pushed troublesome market imperfections away. Possibly, there was the sense that positive and negative externalities might roughly cancel each other out, leaving GDP incomplete but still reliable enough as a directional indicator. That rests on the assumption that positive and negative externalities are symmetrical in nature.

However, there is an important asymmetry. Positive externalities take the form

of “free goodies”, whereas certain negative externalities constitute systemic risks that may be catastrophic to “trip” or breach. While you generally cannot have too much of a positive externality – a “free good thing” – too much of certain unwanted harms may induce systemic failure.

Externalities exist because markets have an incomplete grasp of what humans value. Markets work off prices and not everything has – or can have – a price. As such, marketed values – or prices – exist amidst a broader “value field” of things that humans care about and which have an influence on our wellbeing.

Pigou’s proposition was an inconvenient truth for economics. It suggested that there are real limits to what conventional economics might say about matters of human value and, hence, to how far markets might serve human wellbeing. The inconvenience of his idea may be why Pigou is not better known – seemingly more tolerated, than celebrated

Complete markets...?

As a discipline, economics did the very human thing of trying to ignore a difficult proposition. By not confronting Pigou’s awkward challenge, the door was opened for a line of theorizing that led in exactly the opposite direction. Economists for most of the 20 Century sought to establish economics as a comprehensive corpus of thought with universal application.

Hence, by the 1950s, a very appealing theory of complete markets had been developed. No externalities in this theory, none at all.

Complete market theory is the laying down of a conceptual blanket over all our preferences that leaves no space for externalities.

The formulation of complete markets theory was deemed a major milestone for economics. Its authors were Kenneth Arrow and Gérard Debreu. It provided the cornerstone for the discipline’s claim for the superiority of markets as a mechanism for social coordination.

Rather, the key mistake made by 20 Century economics was not in misunderstanding externalities, but in grossly underestimating their magnitude and so foreclosing a debate on the innate limits of economic thinking. The discipline considered that markets were “complete enough” to safely proceed as if they were actually complete! We are now waking up to the consequences of that misjudgement.

... Or very incomplete markets?

Consider, for example, a recent study by Robert Costanza and colleagues. They estimated the monetary value of the “services” provided free by the Earth’s ecosystem at \$125 trillion in 2011, nearly twice the value of global GDP (gross domestic product) at the time. The authors believe this to be a conservative estimate because it grasps only about half of the “services” we know ecosystems provide.

Other studies have contemplated the value of unmonetized social systems, including one estimate that unpaid housework in the UK in 2016 was about 65 percent of GDP – another 3 huge block of value not captured by the market. Just combining this figure with the Costanza et al. figure suggests that measured GDP captures about a third of some larger conception of value.

From its very inception, GDP has been derided as an incomplete measure of well-being. However, in elevating GDP to its current perch of influence, the working assumption has been that GDP, and the market system it reflects, captures the lion's share of what matters. What the latest estimates of "externalities" and non-market values suggest – and what our sustainability crisis seems to underscore – is that our perception of GDP's reach may be horribly off. Such an estimate suggests that it is not that the market does not capture *all* things of value, it does not even capture *most* things of value. **Far from externalities being peripheral, they may be the main event!**

The failure of economics to fully incorporate externalities in its 20th-century theorizing now appears to be the dropped stitch that defines the whole discipline. For a long time, this was a tolerable neglect as markets were more robustly counterbalanced by pre-market institutions that upheld unpriced values, and as the environment was able to absorb the fewer demands of a smaller, less consumptive population. But, with the onset of climate and biodiversity emergencies, the context has changed considerably. It matters more and more that we might not have *slightly incomplete markets*, but *very incomplete markets*.

It has left us at the start of the 21 Century transforming the matter and energy of the world using economic and financial tools that have only a very limited grasp of the reality they fashion.

In a world of very incomplete markets, things of human value lie in two separate realms – the marketed domain and the non-marketed domain. Some of the growth of the marketed economy genuinely arises from human ingenuity and creativity unlocking better ideas and products from new combinations of inputs. This is "good" growth, which ought to be celebrated and encouraged. However, other parts of monetized "growth" arise from simply running down the stocks of what is valuable but in the non-marketed realm. This is the illusion of wealth creation based on registering the increase in marketed value, but not recording the decrease in unmarketed values. In contrast to growth from genuine ingenuity, this is robbing Peter to pay Paul.

Measured economic "growth" overall combines in unknown proportions a "creative growth", which we want to encourage, and a "parasitic growth", which we do not. At an aggregate level, it is almost impossible to trace the origins – creative or parasitic – of GDP growth, and very few official metrics make any attempt to do so.

Our working assumption is that all economic growth is good – as it indeed would be if we had complete markets eliminating the possibility of parasitic growth. However, in not knowing the real-world mix between creative and

parasitic growth, do we want more GDP growth, or less? It is not clear. And, given that companies work to the same price register as GDP, do we want companies to beat profit expectations or would it be better if they missed them? Who really knows? The conventional argument – captured by the notion of an Environmental Kuznets Curve – is that it is only by increasing monetary wealth that we can develop better technology to protect the environment. However, it is not clear in the aggregate whether the deployment of such new capabilities ever makes good the damage done by the initial enabling wealth creation. While anecdotes can be summoned to support the idea – electric cars, wind turbines, LEDs etc – thus far, at the global level that matters, data shows we remain in net ecological destruction mode.

Markets within Cultures

Paradoxically, then, to use markets more than we are, to introduce more externality pricing, would require a new cultural level reassertion that markets are a tool within culture. We need not a sustainable economy, but a sustainable culture that has an economy. Such a culture would establish room for governments to introduce new markets which powerful market incumbents may not like, but which improve human wellbeing. In turn, such a culture would also invigorate non-market means to protect our environment, for we must remember that not everything of human value can be priced and “internalized”. The interesting question, worth a moment’s reflection, is: why is that?

Commodifiable Externalities

Though Pigou identified commodifiable externalities, there are many things of human value that cannot withstand the disembedding from their context necessary for them to be commodified and, hence, be transactable via market exchange. Such values are non-transactable because they are irrevocably embedded either in specific things – they are unique – or in specific relations – they exist “between” certain things. Some examples: friendship, reputation, loyalty, integrity, trust, community, mental health, etc. If you believe you have purchased any of these items, you might want to check the label.

What is tricky is that most things in the world bear both separable transactable values and intrinsic non-transactable values. A tree has both separable value as a feedstock for furniture and paper and intrinsic value as part of the ecosystem in which it is relationally embedded.

We tend to value trees in managed plantations for their separable values, but we value General Sherman, the 26-story-tall giant sequoia that is the largest known tree on Earth, for its non-separable attribute of being uniquely the tree we call General Sherman. With General Sherman, we have chosen to perceive and value its uniqueness over its instrumental value. Indeed, we might say that General Sherman is price-less. The “economist” denies the validity of this perspective by arguing that everything has a price. To say that something is priceless is merely to say that nobody has yet offered a high enough price. In turn, the “ecologist” denies the “economist’s” perspective, arguing that while

you can apply such economic thinking to General Sherman, it is the wrong sort of thinking to apply.

Both the “economic” transactional perspective and the “ecological” intrinsic perspective are beneficial and valid, but they are incompatible.

The decision to apply an economic perspective to the external world is always a value judgment that necessarily transcends economics. More, it is a value judgment that can never be justified or refuted on economic grounds precisely because it is an argument about the validity of applying an economic perspective.

All this is a discussion that the field of economics may well have taken more seriously 100 years ago, had it been more open to the significance and implications of Pigou's formulation of externalities. Alas, we are now having to unknit to pick up this dropped stitch in a world now confronting large-scale problems of missed externalities.

Incompleteness Theorem of Economics

Economics might be well served by formalizing an incompleteness theorem that would act as a proverbial knot-in-a-handkerchief reminder about the limits of claims that economics can make. It is an oddity of human intellectual thought that the most logical of our sciences, mathematics, had a formal Incompleteness Theorem as early as 1930, while economics formalized a complete market theory in the 1950s and seemingly still has no definitive statement of incompleteness.

Ringfencing Economics

One of the ways, then, that we could better protect ecological values is for economics to recognize – re-cognize – the wisdom of culturally ring-fencing where economic thinking is preferred. In other words, to recognize the non-monetizable value of non-economic thinking.

Designating areas as protected are to explicitly restrain the ever-eager economic perspective. Such boundaries need to be upheld at the social or cultural level to count for anything. If not individuals can always free ride and extract the monetary instrumental value that others have agreed not to pursue.

While economics is undoubtedly *a* valuable form of knowledge, it is a way of seeing things, not *the* way.

A full century after Pigou formalized the idea of externalities, we might mark the anniversary by taking more seriously the effort to clarify the appropriate reach of economics and markets within the broader social and cultural context.

Economics is about solved Political Problems

Arguably, one of the most important questions in economics is not even an economic question. The field effectively punts the matter of its own ontology – the things that economics can talk about – to a different discipline. In Abba Lerner's words:

“An economic transaction is a solved political problem. Economics has gained the title of Queen of the Social Sciences by choosing solved political problems as its domain.”

Economics has been strangely content to focus its efforts on pattern-seeking within a domain it leaves other disciplines to define, but in the absence of contemplating its boundaries more explicitly, it has hubristically come to believe it has greater reach than it really has.

In turn, this leaves most economists – and the great many people who think and act economically in conducting their professional duties – dangerously unaware of where economic thinking is beneficial and valid and where it ultimately hits limits.

Duncan Austin: Pigou and the dropped stitch of economics RWER95 (pdf)

23.2 Ecosystem Services

Constanza

- Global loss of ecosystem services due to land use change is \$US 4.3–20.2 trillion/yr.
- Ecoservices contribute more than twice as much to human well-being as global GDP.
- Estimates in monetary units are useful to show the relative magnitude of ecoservices.
- Valuation of ecosystem services is not the same as commodification or privatization.
- Ecosystem services are best considered public goods requiring new institutions.

In 1997, the global value of ecosystem services was estimated to average \$33 trillion/yr in 1995 \$US (\$46 trillion/yr in 2007 \$US). In this paper, we provide an updated estimate based on updated unit ecosystem service values and land use change estimates between 1997 and 2011. We also address some of the critiques of the 1997 paper. Using the same methods as in the 1997 paper but with updated data, the estimate for the total global ecosystem services in 2011 is \$125 trillion/yr (assuming updated unit values and changes to biome areas) and \$145 trillion/yr (assuming only unit values changed), both in 2007 \$US. From this we estimated the loss of eco-services from 1997 to 2011 due to land use change at \$4.3–20.2 trillion/yr, depending on which unit values are used. Global estimates expressed in monetary accounting units, such as this, are useful to highlight the magnitude of eco-services, but have no specific decision-making context. However, the underlying data and models can be applied at multiple scales to assess changes resulting from various scenarios and policies. We emphasize that valuation of eco-services (in whatever units) is not the same as commodification or privatization. Many eco-services are best considered public goods or common pool resources, so conventional markets are often not the best institutional frameworks to manage them. However, these services must be (and are being) valued, and we need new, common asset institutions to better take these values into account.

Constanza (2014) Global value of ecosystem services (Paywall) (pdf)

Constanza (2019) Natural Capital and ERcosystem Services

“The fossil fuel industry has been granted the greatest market subsidy ever: the privilege to dump its waste products into the atmosphere at no charge.”
(Michael Mann)

23.3 Environmental Degradation

23.3.1 Kuznets and Engel Curves

Environmental Kuznets and Engel's Curve

I think degrowth is wrong on the merits (environmental kuznets curves and environmental engel curves are both concave), but it's also an obvious nonstarter even if it was founded on solid footing, To spell this out: if EKC and EECs are concave, redistribution within or between countries doesn't necessarily reduce environmental damages. (John Voorheis (twitter))

Abstract Maneejuk:

This study aims to examine the relationship between economic development and environmental degradation based on the Environmental Kuznets Curve (EKC) hypothesis. The level of CO 2 emissions is used as the indicator of environmental damage to determine whether or not greater economic growth can lower environmental degradation under the EKC hypothesis. The investigation was performed on eight major international economic communities covering 44 countries across the world. The relationship between economic growth and environmental condition was estimated using the kink regression model, which identifies the turning point of the change in the relationship. The findings indicate that the EKC hypothesis is valid in only three out of the eight international economic communities, namely the European Union (EU), Organization for Economic Co-operation and Development (OECD), and Group of Seven (G7). In addition, interesting results were obtained from the inclusion of four other control variables into the estimation model for groups of countries to explain the impact on environmental quality. Financial development (FIN), the industrial sector (IND), and urbanization (URB) were found to lead to increasing CO 2 emissions, while renewable energies (RNE) appeared to reduce the environmental degradation. In addition, when we further investigated the existence of the EKC hypothesis in an individual country, the results showed that the EKC hypothesis is valid in only 9 out of the 44 individual countries.

Maneejuk (2020) Does the Environmental Kuznets Curve Exist? (pdf)

The Kuznets curve expresses a hypothesis advanced by economist Simon Kuznets in the 1950s and 1960s. **As an economy develops, market forces first increase and then decrease economic inequality.**

Since 1991 the environmental Kuznets curve (EKC) has become a standard feature in the technical literature of environmental policy, though its application there has been strongly contested.

The environmental Kuznets curve (EKC) is a hypothesized relationship between environmental quality and GDP growth: according to its argument, which is spurious, various indicators of environmental degradation tend to get worse as modern economic growth occurs until average income reaches a certain point over the course of development, at which point some studies have argued, they improve.

It first became popular as introduced by Gene Grossman and Paul Krueger in their working paper: “Environmental Impacts of a North American Free Trade Agreement.” This paper simply showed that the non-direct Greenhouse gas, Sodium Dioxide, Dark Matter, and Suspended particles followed an inverted-U shaped pattern. This was almost immediately misinterpreted by the World Bank and Beckerman and adopted into policy as an argument that all negative environmental effects would follow an EKC pattern. Copious research has concluded that beyond these pollutants, and issues like water quality, that immediately threaten human health, GDP growth essentially harms, and does not help the environment with no lasting “turning point.” The EKC has led to poor policy choices reaping untold environmental damage.

Wikipedia

23.4 Energy and Transport

The “hidden cost” of our largely fossil fuel-based energy and transport systems could add up to around \$25 trillion (£18 trillion) – the equivalent of more than a quarter of the world’s entire economic output.

That’s according to new research, which estimates the hidden environmental, social and health costs associated with different forms of transport and electricity generation.

Sovacol (2021) [(pdf)[(pdf/Sovacol_2021_Energy_and_Transport_Externalities.pdf)

Independent

24

Capital

24.1 Produced Capital

24.1.1 Cambridge Controversy

Spash

Produced capital.

What is it?

Produced capital is defined as ‘capital goods embodied in human-made goods or structures, such as roads, buildings, machines, and equipment’ (Dasgupta, 2021, p. 507). These are physical assets, generated by human transformation of natural capital, that are used to provide a flow of goods or services, e.g. a sewing machine, factory or computer. A private house counts as produced capital because it provides services (e.g. shelter) repeatedly over time. Intangible assets, such as company patents, are also included. Produced capital is then a diverse stock measured as a value in national wealth accounts, and an increase of which contributes to economic growth (GDP). Thus, ‘inclusive wealth increases if and only if aggregate consumption is less than net domestic product (NDP), that is, GDP less the depreciation of all capital assets’ (Dasgupta, 2021, p. 138, emphasis original). Measuring the value of capital is then essential to the whole approach.

How is it valued?

Different forms of capital cannot be aggregated physically (i.e. hammers and tractors do not add together). So what is the aggregate or total amount of capital? The stock can be measured either as: (i) the monetary cost of production or (ii) the monetary returns attributed to specific capital on future output produced (i.e. future profits). The former, (i) involves capital itself in the pro-

duction of capital and so ends in circularity with the value of capital determining the value of capital, ad infinitum. One work around is to adopt a labour theory of value, so that all produced capital is valued by the labour required for its production. Today this classical economic theory is generally rejected outside of classical Marxist economics. As a neoclassical economist, Dasgupta opts for (ii), claiming that: '[a]ssets acquire their value from the services they provide over their remaining life' (Dasgupta, 2021, p. 138). This leads to an asset management approach whereby different types of assets, or forms of capital, are required to produce the same rate of return in order to achieve an optimally managed investment portfolio (i.e. that maximizes returns by equating returns on every investment at the margin). More simply, this means whether investing in produced capital, education or blue whales the economic agent ('citizen investor') seeks the same return. What is ignored by Dasgupta is a long history, that involved his own University and Economics Department, concerning problems with measuring capital.

What is problematic about it?

The failings of both approaches, (i) and (ii) above, were the subject of the 'Cambridge Capital Controversy', involving combat between economists in Cambridge England and USA. Starting in the 1950s this continued for two decades, or more, and was never resolved (see Cohen & Harcourt, 2003). In case (i) there is the need to take into account a flow of costs over time (period of production) which, in economics, requires knowing the rate of interest as a basis for equating values in different time periods. In case (ii) knowing the value of (profit from) a stream of future output (over a period of production) means calculating the net present value and so discounting it at a rate of interest. Knowing the rate of interest is required in both cases. However, the rate of interest is the return on capital investment, which requires knowing the quantity of capital. So, the value of capital cannot be determined without knowing the stock of capital, that, for multiple forms of capital, becomes a value which cannot be known without the rate of interest, which is defined by already knowing the stock of capital, and so on ...

Neoclassical economists (aka Cambridge USA) then opted for naïve empiricism and claimed they could collect data and observe the rates of return in actual markets without explanation as to how, or from where, it is produced. Thus, in this tradition Dasgupta claims that: '[t]he yield on investment in produced capital is its marginal product'. Solow, whom Dasgupta cites as a major influence on his economics, has sought to justify this approach. Yet, the basic problem remains, the value of capital and, indeed, its definition, are left indeterminate and the empirical approach lacks validity. The alternative is to admit that neoclassical theory bears no relationship to reality, and capital investment is not about simplistic production functions specifying the rate of return to different factors (i.e. land, labour, capital) measured by disaggregated marginal products, but, rather, concerns institutional arrangements to capture surplus. Indeed, outside of economic textbooks, the contributions of the separate factors

to output cannot be determined, let alone a marginal product attributed to each (i.e. what is due to labour vs. capital, say the farmer versus the tractor, let alone the land!). Rather than marginal productivity theory we might instead consider that profit is derived from the social power of those able to appropriate the technological achievements of society as a whole. They may be capitalists in market dominated economies or functionaries of the State in centrally planned economies. Under capitalism the key to power lies in gaining private property rights over resources, and this then lies at the heart of the debate over biodiversity. What is at stake is the legal right and economic authority to capture the surplus created by the production process. This is why classical political economy (as opposed to neoclassical economics) connected individuals' dependence on the market for their livelihoods with social class, as the fundamental unit of analysis.

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24.2 Natural Capital

(se renv on Spash/Dasgupta) Spash (2021) The Dasgupta Review deconstructed: an exposé of biodiversity economics (pdf)

24.3 Human Capital

Spash

The concept of human capital is heavily related to productivity in a wage labour economy.

People who can be more productive have more value and those who live longer (i.e. the young) can be productive for longer, and so have more value, than others. The two main elements, health and education, must be converted into monetary values to operationalize the human capital approach.

Dasgupta (2021, p. 256) notes that: 'The value of a statistical life (VSL), [is] a concept central to the meaning and measurement of human capital'. The idea is that monetary values can be placed on human life without specifying the people who will actually lose their lives as a result of a public policy decision. There are

two main methods for assessing the risk of death or VSL. First, an individual may be directly asked their willingness-to-pay to avoid a risk or their willingness-to-accept compensation for incurring a risk. CVM surveys have been commonly applied but also been severely criticized.

The other main alternative is to use measures related to earnings, a revealed preference method, technically termed a hedonic wage approach. This might, for example, use actual wage differentials in jobs with a range of risks.

The definition of human capital as productive wealth could be understood as framing a government's relations with its citizens primarily through the lens of their economic contribution, as if a human resources department, ensuring good health and education to the extent that it contributes to productivity. This implies allocating resources according to the expected payback, e.g. prioritizing young healthy adults. This productivist logic led some economists to justify eugenics. There are also long standing racist associations with references to lazy indigenous peoples by colonizing Europeans, and classist associations as in the history of removing common rights to force the poor into wage labour relations so they could become productive.

The apparently simple case of investment in education also quickly runs into trouble. Financial returns neither require being educated nor does education bring financial returns *per se*. Under capitalism it is business, banking and finance that 'makes money' not just being educated.

Health (mortality/morbidity) as a capital investment is even worse. Producing money numbers here requires the conjuring trick of talking about abstracted non-real people who are represented as 'statistical lives', under the VSL. For example, the results are used in transportation assessment to decide upon road building programmes and the installation of safety equipment. However, the public rejection of this approach is exposed when there is a train crash, people are killed and the public discover the lack of safety equipment is due to the calculation that it cost more than the expected fatalities times the VSL. Politicians rarely defend the numbers in such circumstances, although their transport departments may continue to use them on a daily basis.

Spash (2021) The Dasgupta Review deconstructed: an exposé of biodiversity economics (pdf)

24.4 Social Capital

Spash

Social capital is defined as mutual trust and associated norms of reciprocity that enable people to engage with one another.

Taken together, trust in others, confidence in government to deliver and in markets to function well, and the institutional arrangements

that enable people to engage with one another for mutual benefit, is called *social capital* – a concept central to the economics of biodiversity.

While mainstream economics commonly views society as comprising three classes of institutions (households, firms, government), ‘the idea of social capital illuminates a fourth class, comprising communities and civil society’ Dasgupta’s understanding here, and his capitalist reductionism, appear quite limiting.

Social capital must be optimized for several reasons. First, he believes trust and economic growth are positively related so that more cooperation improves efficient allocation of resources and so increases wealth. Second, civic engagement and membership in associations discipline governments and improve governance. Third, communities and civil society are regarded as essential for controlling Nature conservation and restoration programmes initiated by government or national/international NGOs.

Bringing together a range of actors – governments, NGOs and ‘increasingly’ private firms – is advocated to build local institutions to engage people in collective action and set rules. This is necessary because ‘beliefs do not appear out of nowhere’. Accordingly, this will be an institutional process: ‘That helps to align beliefs’

The danger of blanket calls to ‘align beliefs’,

Diversity of opinions, different stakeholders perspective, ‘misaligned beliefs’ and public debates are what democracy is about. Aligning beliefs is more inline with totalitarianism. Absolute trust in government by all is also neither likely nor something to be ‘optimised’ via investment. Promoting such ‘social capital’ might easily be instrumentalised to silence critical voices, blame civil society for being uncooperative, depoliticize issues and dismiss genuine concerns – class struggle, power relations, value conflicts. Civil society is also divided. The concept and promotion of social capital by The Review appears fuzzy, double-edged and dangerous for democracy.

Spash (2021) The Dasgupta Review deconstructed: an exposé of biodiversity economics (pdf)

25

Money

25.1 Money Creation

McLeay (2014) Money Creation in the Modern Economy (pdf)

The value of money depends on not creating too much of them relative to future value creation. (Pengenes verdi henger på at det ikke lages for mye av dem i forhold til fremtidig verdiskaping.)

Bankplassen: Hvordan skapes penger ('How money is created' in Norwegian)

25.2 Inflation

Monetarist theory, which came to dominate economic thinking in the 1980s and the decades that followed, holds that rapid money supply growth is the cause of inflation. The theory, however, fails an actual test of the available evidence. In our review of 47 countries, generally from 1960 forward, we found that more often than not high inflation does not follow rapid money supply growth, and in contrast to this, high inflation has occurred frequently when it has not been preceded by rapid money supply growth.

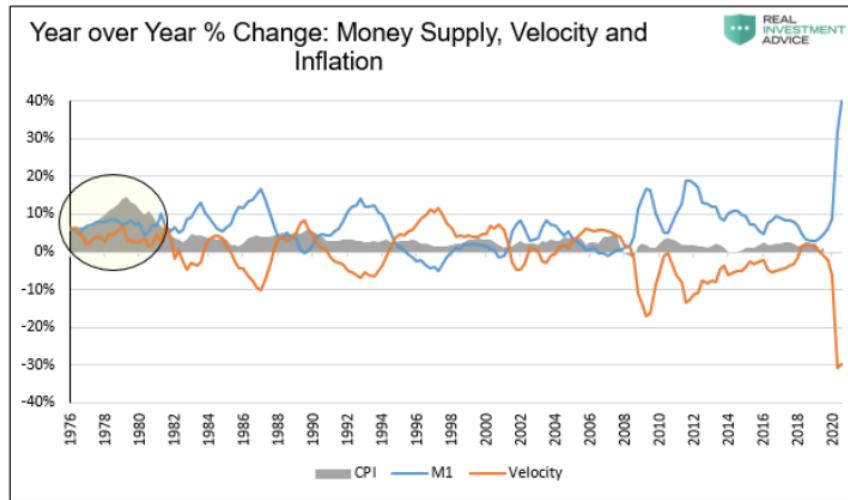
There are several implications. The most relevant of these seems to be that the current efforts of central banks to engender inflation are unlikely to be successful.

Based on our examination of countries that together constitute 91 percent of world GDP, we suggest that high inflation has infrequently followed rapid money supply growth, and in contrast to this, high inflation has occurred often when it has not been preceded by rapid money supply growth. The U.S. economy may well experience some increase in inflation in the coming year, but if it does, it is likely it will be due to factors other than monetary policy.

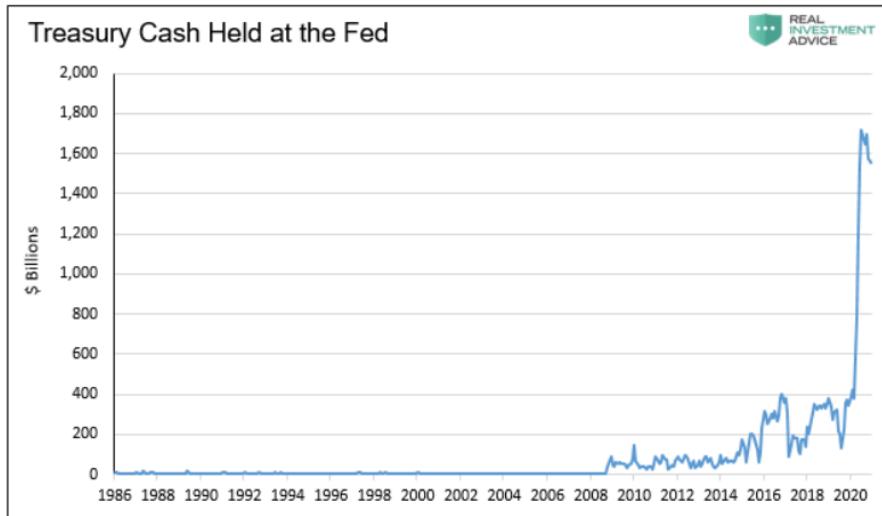
Money Growth Inflation

25.2.1 FED Policy and Inflation

When you view money supply and velocity together, one notices they tend to offset each other. However, we highlight the late 1970s, the last highly inflationary period, to show a period they did not counteract each other.



The Fed and Treasury are playing a dangerous game. The numbers we discuss above are massive and dwarf anything seen in American history. If consumers start spending their savings, and the government keeps borrowing and spending unprecedented amounts, velocity can pick up rapidly. We leave you with a vital question to better understand the prospects for inflation.



Lebowitz

Lebowitz and Freeze

25.3 Modern Monetary Theory (MMT)

Culbreath

The common conservative objection to government spending is not only based on a faulty economic model, but it also serves as a mental obstacle to using government capacity for purposes conservatives are supposed to care about.

Conservatives should re-examine the economics that underlie the tendency on the right to condemn any instance of large-scale government spending. The policy conversation could then shift away from whether government spending is economically justifiable and towards what kinds of spending are productive and worthwhile.

According to MMT, no sovereign state that issues its own currency can ever run out of money. This is because it simply “prints” its money in order to pay for whatever operations it deems necessary. The government doesn’t need to go out and find the money it needs for such spending; it needs no fundraisers, no sales, and not even taxes, to fund its operations. It simply spends into existence the money that it needs for its operations.

unlike any private entity, such as a household or a corporation, the government does not need to worry about its own solvency, since it can never go insolvent—it can never run out of money. Thus, the government does not need to take any of the measures that private entities take to accumulate savings or make a profit. It will always be able to “spend into existence” whatever money it needs to pay for its operations. The difference between the federal government and a household is thus not merely a difference in degree (one is bigger than the other). It is a difference in kind.

It follows that taxes do not amount to the accumulation of wealth for the government. Rather, they amount to no more than the extinction of money from the economy. Like God, the government giveth, and the government taketh away; the government spends money into the economy by printing it and removes money from the economy by taxing it.

In terms of the pure quantity of government spending, there is no limit except inflation to what the government may spend. Inflation only occurs, at least in any damaging degree, under certain conditions. Foremost among those conditions is full employment. When the economy is at full employment, which it rarely is, then the overall purchasing power within the economy may be considered to be at full capacity. At this point, an injection of more money into the economy might result in inflation, since it would likely push demand to outstrip supply, thereby causing prices to soar higher and purchasing power to decline

at a dangerous rate.

However, even this danger could be averted to a significant degree if the government aimed its spending not only at stimulating demand but also at stimulating the production of consumer goods. In fact, the U.S. government has a long history of doing exactly this, as the extensive research of economists like Mariana Mazzucato demonstrates quite compellingly. If there is a risk of inflation from government spending, it would not be because government spending automatically produces inflation. Rather, it might be due to the fact that the U.S. government has ever since the Reagan era failed to make a priority of stimulating both demand and production through the implementation of a deliberate industrial policy. This only highlights further the importance of well-planned spending by the government.

Furthermore, the government has many other tools at its disposal for controlling inflation. Not only does the Federal Reserve play a central role here, but even taxes can be levied by the government as a way of controlling inflation. When demand begins to outstrip supply, the government may very well consider imposing taxes where this might effectively limit inflation. Of course, not just any taxation would do this; the government needs to ensure that its taxes target entities or classes who spend enough money to affect consumer prices. Taxing the extremely wealthy, for example, may not be the best way to control inflation, since wealthy people tend to save more than they spend.

while there are many good reasons for the government to impose taxes, especially to control inflation, funding government expenditure is not one of those reasons. Indeed, the idea that taxes should fund the government's expenditure by "plugging its deficits" could prove to have damaging effects on the economy as a whole, if actually put into practice. As MMT theorists are fond of pointing out, what we call the government's deficit actually amounts to nothing other than the people's surplus.

As long as the government (public sector) spends more into the economy (private sector) than it taxes out (the definition of deficit spending), the economy itself will enjoy a money supply large enough to stimulate productivity and growth. By contrast, if the government were to tax more out of the economy than it spent into it, the economy would suffer from its own deficit, a risk of deflation, and a potential crisis of underconsumption. In other words, the deficit by itself is not a bad thing, and it is here to stay.

Culbreath (2021) MMT for Conservatives

26

Markets

26.1 Markets as Entropy Maximisers

Markets are randomising machines, they maximise entropy, and this fact alone is sufficient to explain some of the inequality we observe.

Market transactions involve a transfer of monetary value. After any transaction one party may have more or less money than before.

It's quite easy to write a short simulation program that takes a large collection of individuals that start with equal amounts of money. We then pick two individuals at random. One is the buyer. We randomly choose a proportion of their money to spend. The seller gets that money. We then repeat, and pick another two individuals at random. And we keep doing this forever.

After a short period, we can then measure the distribution of money across individuals. And we find, once again, the exponential distribution. Most individuals have very little money, and a small number have a great deal.

So the activity of market exchange is acting just like the cocktail shaker: its mixing everything up, randomising things, and maximising the entropy of the system.

You might think that this model of money exchange is far too simple to tell us anything about real markets. But you'd be wrong.

Remarkably, we observe the exponential distribution in actual economies. The exponential is a great fit to the bottom 80% of the wealth distribution, which is the vast majority of the population. And this holds true for whichever capitalist country we look at.

The fact that 80% of the wealth distribution of actual economies follows an exponential law is a very astonishing regularity.

We might think that differences in wealth must arise from accidents of birth or personal virtue. But the principle of entropy maximisation tells us there's a much more important causal factor at work. We quickly get extreme income inequality even in an economy with identical individuals with identical initial endowments of money.

The point is that markets are randomising machines, they maximise entropy, and this fact alone is sufficient to explain some of the inequality we observe.

So the anarchy of the market is the primary and essential cause of economic inequality.

But why doesn't the exponential law fit the entire wealth distribution? What about the remaining 20% of rich people?

26.1.1 The social relations of production as constraints

Ian Wright

26.2 Competition Bargaining

Tankus

The central question this paper tackles are: what institutional mechanisms coordinate between different market actors to produce market prices and how does law, particularly competition law, shape these institutional mechanisms?

This issue is surprisingly neglected because of the intuition built up by textbook microeconomics that market actors will coordinate markets without explicit governance institutions. Supposedly, they're to do this automatically: simply acting in their own narrow self-interest.

We tackle this myth head on by tackling the markets which are often claimed as "real world approximations" of textbook "perfect competition" markets: chartered exchange markets.

While these markets have many buyers and sellers, in most other ways they diverge wildly from textbook market behavior. The vast majority of those buyers and sellers are not producers or consumers of the product — if there is a currently produced product at all — but market specialists (e.g. brokers and dealers) who's explicit purpose is to smooth out market volatility.

Recognizing these markets as jointly governed by chartered exchanges and financial firms helps us realise that *governance architecture* reliably manages all types of markets. The main type of price market focused on our paper are prices which are administered by business enterprises i.e. *administered prices*.

Activities that happen "within" businesses are often illegal when conducted outside of businesses. It may seem obvious that a firm can set the price on the product it sells. But don't forget the same conduct, conducted by the same

individuals, using the same tools would be *illegal if shared*. This is known in competition law as the “per se rule” against “price fixing”. This differential treatment between firms and non-firms — or larger firms and smaller firms — is *the firm exemption*.

This differential treatment is worsened by the fact that current competition law gives a relatively free hand to large businesses dictating terms to their suppliers or customers. These are known as *vertical restraints*. As an aside, in “industrial organization”, businesses which you interact with but don’t undertake the same activities are referred to as “vertical” because they are either “behind” you, or in “front” of you. Meanwhile your direct competitors are “horizontal” to you — because you are in the same business. Ergo coordinating with your direct competitors is referred to as *horizontal coordination*.

Not all markets are vertically governed. Meanwhile the vast, vast majority of markets are not completely owned by one firm. Thus, *vertical restraints and the firm exemption cannot explain all market governance in contemporary markets*. And if it can’t, we are still left with a missing explanation for how markets are governed horizontally when explicit horizontal coordination is illegal. Posed in these terms, the answer is obvious. **Horizontal implicit coordination between direct competitors is legal.**

This type of market governance, known popularly as *price leadership*, requires sufficiently concentrated firms to make coordinating implicitly viable. Or at least make the appearance of implicit coordination plausible. Because only firms can be price leaders, and a number of relatively concentrated price followers are likely required to maintain market order, this form of market governance is an extension of the firm exemption — and built on top of it. Most obviously, a cartel of the same size and market share *could not be a price leader in the world of the firm exemption*.

Price leadership exemption.

This is a really important point to emphasize. Price leadership by concentrated, hierarchical business enterprises is the *most common form of market governance*. That’s because competition law is designed in such a way that no other form of market governance can be conducted legally. At the same time, the price leadership exemption facilitates explicit price coordination among large concentrated firms, since they are presumed to be engaging in price leadership.

Monetary policy, and to a certain extent fiscal policy, is obsessed with price stability. But only the type of price stability that appears in aggregate price indices. Our competition laws don’t value price stability.

Some might respond to this paper by arguing that cracking down on price leadership will finally produce “competitive prices” and “true competition”. I don’t think that is the case. I think that is simply a recipe for more price instability and uncertainty, without very many benefits.

27

Demand

27.1 Human Needs

I remember being fascinated when I discovered Manfred Max-Neef's matrix of human needs. It's such a rich description of the human animal that defies reduction to a single dimension. It puts homo economicus to shame. (Blair Fix)

Manfred Max-Neef (2007) Development and Human Needs (pdf)

27.2 Aggregate Demand Function

Since 1976, Robert Lucas—he of the confidence that the “problem of depression prevention has been solved”—has dominated the development of mainstream macroeconomics with the proposition that good macroeconomic theory could only be developed from microeconomic foundations. Arguing that “the structure of an econometric model consists of optimal decision rules of economic agents” (Lucas, 1976, p. 13), Lucas insisted that to be valid, a macroeconomic model had to be derived from the microeconomic theory of the behaviour of utility-maximizing consumers and profit-maximizing firms.

In fact, Lucas's methodological precept—that macro level phenomena can and in fact must be derived from micro-level foundations—had been invalidated before he stated it. As long ago as 1953 (Gorman, 1953), mathematical economists posed the question of whether what microeconomic theory predicted about the behaviour of an isolated consumer applied at the level of the market. They concluded, reluctantly, that it did not:

Market demand functions need not satisfy in any way the classical restrictions which characterize consumer demand functions... The importance of the above results is clear: strong restrictions are needed

in order to justify the hypothesis that a market demand function has the characteristics of a consumer demand function. Only in special cases can an economy be expected to act as an ‘idealized consumer’. The utility hypothesis tells us nothing about market demand unless it is augmented by additional requirements.’ (Shafer and Sonnenschein, 1993, p. 671-72)

What they showed was that if you took two or more consumers with different tastes and different income sources, consuming two or more goods whose relative consumption levels changed as incomes rose (because some goods are luxuries and others are necessities), then the resulting market demand curves could have almost any shape at all. They didn’t have to slope downwards, as economics textbooks asserted they did.

This doesn’t mean that demand for an actual commodity in an actual economy will fall if its price falls, rather than rise. It means instead that this empirical regularity must be due to features that the model of a single consumer’s behaviour omits. The obvious candidate for the key missing feature is the distribution of income between consumers, which will change when prices change.

The individual demand curve is derived by assuming that relative prices can change without affecting the consumer’s income. This assumption can’t be made when you consider all of society—which you must do when aggregating individual demand to derive a market demand curve—because changing relative prices will change relative incomes as well.

Since changes in relative prices change the distribution of income, and therefore the distribution of demand between different markets, demand for a good may fall when its price falls, because the price fall reduces the income of its customers more than the lower relative price boosts demand.

The sensible reaction to this discovery is that individual demand functions can be grouped only if changing relative prices won’t substantially change income distribution within the group.

Alan Kirman proposed such a response almost 3 decades ago:

If we are to progress further we may well be forced to theories in terms of groups who

Unfortunately, the reaction of the mainstream was less enlightened: rather than accepting this discovery, they looked for conditions under which it could be ignored. These conditions are absurd—they amount to assuming that all individuals and all commodities are identical. But the desire to maintain the mainstream methodology of constructing macro-level models by simply extrapolating from individual level models won out over realism.

Macroeconomics cannot be derived from microeconomics.

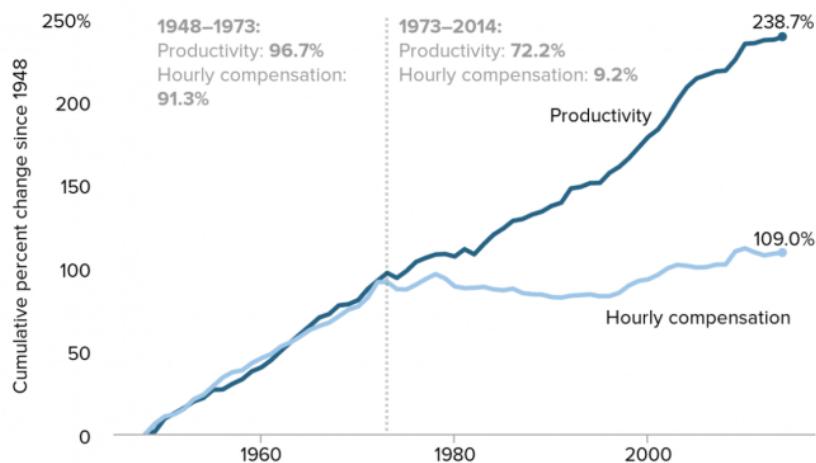
Steve Keen

28

Productivity

28.1 Productivity-Pay Gap

Using prices to aggregate ‘output’ leads to bizarre problems. On the one hand, it causes ‘productivity’ to be equivalent to average hourly income. This means that any connection between ‘productivity’ and wages is circular. On the other hand, the same decision causes ‘productivity’ to be ambiguous. Our measure of ‘productivity’ depends on arbitrary choices about how to adjust for price change. As a result, productivity trends (like the one in Figure 1) are riddled with uncertainty.



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

'Productivity' is used by both major schools of economic thought. Neoclassical economists use productivity to claim that the distribution of income is just. They argue that in a competitive economy, workers get what they produce. Marxists, in contrast, use productivity to claim that the distribution of income is unjust. They argue that in a capitalist economy, workers receive less than they produce (because capitalists extract a surplus).

What's interesting is that these two opposing theories commit the same sin. They define productivity in terms of income. Neoclassical economists do so explicitly, as I've described in this post. Marxists do so implicitly because they haven't developed their own system of national accounts. Instead, Marxists who do empirical work use neoclassical measures of productivity.

The result of this circular definition is that the analysis of productivity is a sleight of hand. 'Productivity' is just income relabelled.

The 'productivity-pay gap' is a textbook example of this relabelling. It claims to show a growing gap between what workers 'produce' and what they get paid. But workers' 'productivity' is actually measured in terms of income — the average hourly income.

[Blair Fix: Debunking Productivity](#)

[Blair Fix: Productivity does not explain income](#)

Productive individuals, productive society?

In the 1990s, geneticist William Muir conducted experiments on chickens to see what would improve egg-laying productivity. In one trial, he did exactly what the eugenicists recommend — he let only the most productive hens reproduce. The results were disastrous. Egg-laying productivity did not increase. It plummeted. Why? Because the resulting breed of hens was psychopathic. Instead of producing eggs, these "über-hens" fought amongst themselves, sometimes to the death.

The reason this experiment did not work is that egg-laying productivity is not an isolated property of the individual hen. It is a joint property of the hen and her social environment.

In Muir's experiment, the most productive hens laid more eggs not because they were innately more productive, but because they suppressed the productivity of less dominant chickens.

By selecting for individual productivity, Muir had inadvertently bred for social dominance. The result was a breed of bully chicken that could not tolerate others.

The lesson here is that in social animals, traits that can be measured among individuals (like productivity) may not actually be traits of the individual. Instead, they are joint traits of both the individual and their social environment. Here is evolutionary biologist David Sloan Wilson reflecting on this fact:

“Muir’s experiments ... challenge what it means for a trait to be regarded as an individual trait. If by ‘individual trait’ we mean a trait that can be measured in an individual, then egg productivity in hens qualifies. You just count the number of eggs that emerge from the hind end of a hen. If by “individual trait” we mean the process that resulted in the trait, then egg productivity in hens does not qualify. Instead, it is a social trait that depends not only on the properties of the individual hen but also on the properties of the hen’s social environment”.

Blair Fix: Human Capital Theory RWER95 (pdf)

28.2 IPR Stagnation

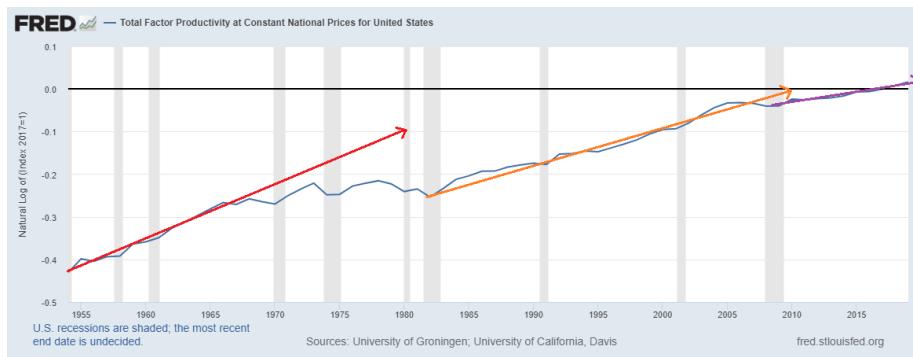
Schwartz Abstract

Explanations for slow global growth (secular stagnation) correctly focus on income inequality and wage formation but are incomplete. They ignore the source of wages and fail to ask why a rising profit share has not produced more investment. Older but essential insights on stagnation from Keynes, Schumpeter and Veblen complement orthodox and post-Keynesian analyses to generate a more robust explanation based on the distributional conflict over profit among firms. These thinkers highlight the importance of corporate profit strategy and organizational structure for investment behavior. A politically mediated process of strategic interaction has transformed the old Fordist dual industrial structure into a tripartite structure composed of high profit volume firms with monopolies based on intellectual property rights (IPRs), physical capital-intensive firms protected by an investment barrier to entry, and low profit volume labor-intensive firms. Profit data from Compustat and Orbis show that IPR-based firms have a lower marginal propensity to invest. Other firms with smaller profit volumes forego investment from fear of creating excess capacity in a slow growth environment. High profit firms also tend to pay higher wages, creating income inequality. Changes in antitrust, employment and intellectual property law can remedy this situation.

Schwartz (2021) Global secular stagnation and the rise of intellectual property monopoly (Paywall)

28.3 TFP

Each period of productivity growth is bit slower than the last, meaning that the exponential growth rate is slowing down.



Adjusting for the changing utilization of capital and labor the growth rate of “true” TFP has stagnated even more than the above graph would suggest. In other words, we’ve been using our machines and buildings and stuff more intensively, disguising some of the true TFP slowdown.

TFP is not the same thing as technology. The word “technology”, as we commonly understand it, includes stuff like computer chips, car engines, and procedures for making cement. Economists would broaden that definition to include things like business management techniques. But even with that broad definition, there’s plenty of stuff that can affect TFP that most of us would agree does not represent actual technology. For example:

If the government adds a bunch of burdensome regulations or taxes, that reduces TFP.

If people’s education level stops increasing, that lowers TFP growth.

If the population gets older, that can reduce TFP (since older workers are, on average,

If people spend more time goofing off at work, that can reduce measured TFP (since we’re measuring output per hour worked).

If people stop moving from less productive places to more productive places (for example, from rural areas to cities).

If a few big companies become more dominant, that can lower TFP, either via monopoly/market power or by crowding out smaller firms.

If demand shifts from sectors where technology is progressing rapidly (for example, manufacturing) to sectors where it is not (like agriculture).

Basically we’re seeing a whole lot of things happen that tend to reduce TFP growth but that have nothing to do with slowing technological progress! We can invent economically useful stuff just as brilliantly as in the past, but if the above stuff happens, TFP will still slow down.

In fact, in a recent book called “Fully Grown: Why a Stagnant Economy Is a Sign of Success”, the brilliant growth economist Dietrich Vollrath — whose excellent blog you should absolutely read — argues that most of the slowdown in TFP comes from slowing educational attainment, lower geographic mobility and economic dynamism, and the shift from goods to services.

Tyler Cowen's 2011 book *The Great Stagnation* (the most subtle and circumspect of the stagnationist books), he identifies non-technological factors as contributing to the stagnation, and he predicts that both technology and productivity growth will bounce back. Stagnationists would be well-advised to read that book.

Noah Smith

29

Economic Regulation

29.1 Climate protection impact on economic growth

Mudge

(*This article is part of a series in which DW is debunking myths surrounding climate change. Read also: Part 1 — Is global warming merely a natural cycle? Part 2 — Is half a degree of warming really such a big deal? Part 3 — Is China the main climate change culprit? Part 4 — Climate protection: Can I make a difference?*)

The first major environmental protection rules hark back to the 1970s. Since then, a debate has raged about their potentially damaging impact on economic growth and competitiveness. One train of thought (Dechezleprêtre (2017)) says countries that adhere less stringently to environmental policies have a production and trade advantage over those nations that are taking climate action measures to reduce emissions. The concern in those countries is that their own emission-heavy industries will be put at a competitive disadvantage.

This so-called *pollution haven hypothesis* predicts that if competing companies diverge only regarding the severity of environmental regulations they face, then those that are bound by relatively stricter measures will lose competitiveness.

On the other hand, the so-called *Porter hypothesis* concludes that more stringent climate rules should encourage investment in developing new pollution-saving technologies. If these technologies lead to energy savings, they may help in turn to offset some of the climate protection costs. Then, there is also the issue of how much it might cost if we fail to mitigate climate impacts.

Is GDP the only valid indicator?

At first glance, using GDP as a measurement tool is an obvious choice to provide a cost-benefit analysis. The question is to what extent it provides an adequate measure of growth and prosperity.

"It is the most developed indicator. I wouldn't say that we should move away from that, but many of these damages that are associated with climate change are not internalized. This means that we as a global society will probably have costs due to lost biodiversity, for example, which are not directly reflected in the GDP," Wilfried Rickels, director of the Global Commons and Climate Research Center at the Kiel Institute for the World Economy, told DW.

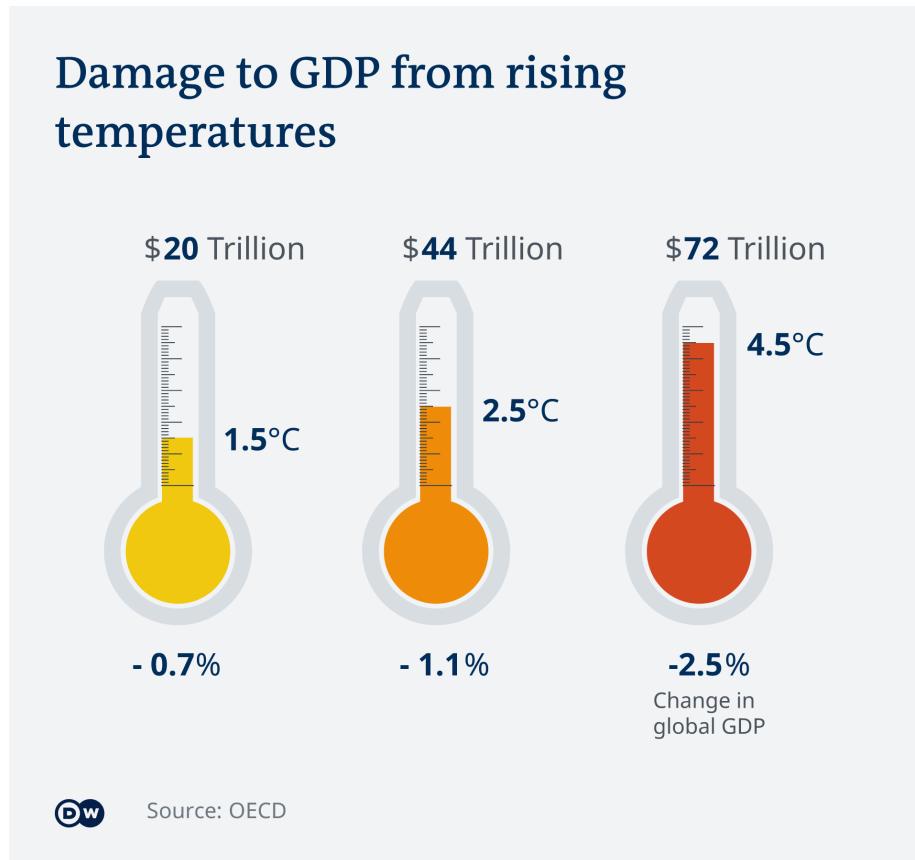


Figure: From OECD - Obviously this is once again Nordhaus unvalid calculations (DH)

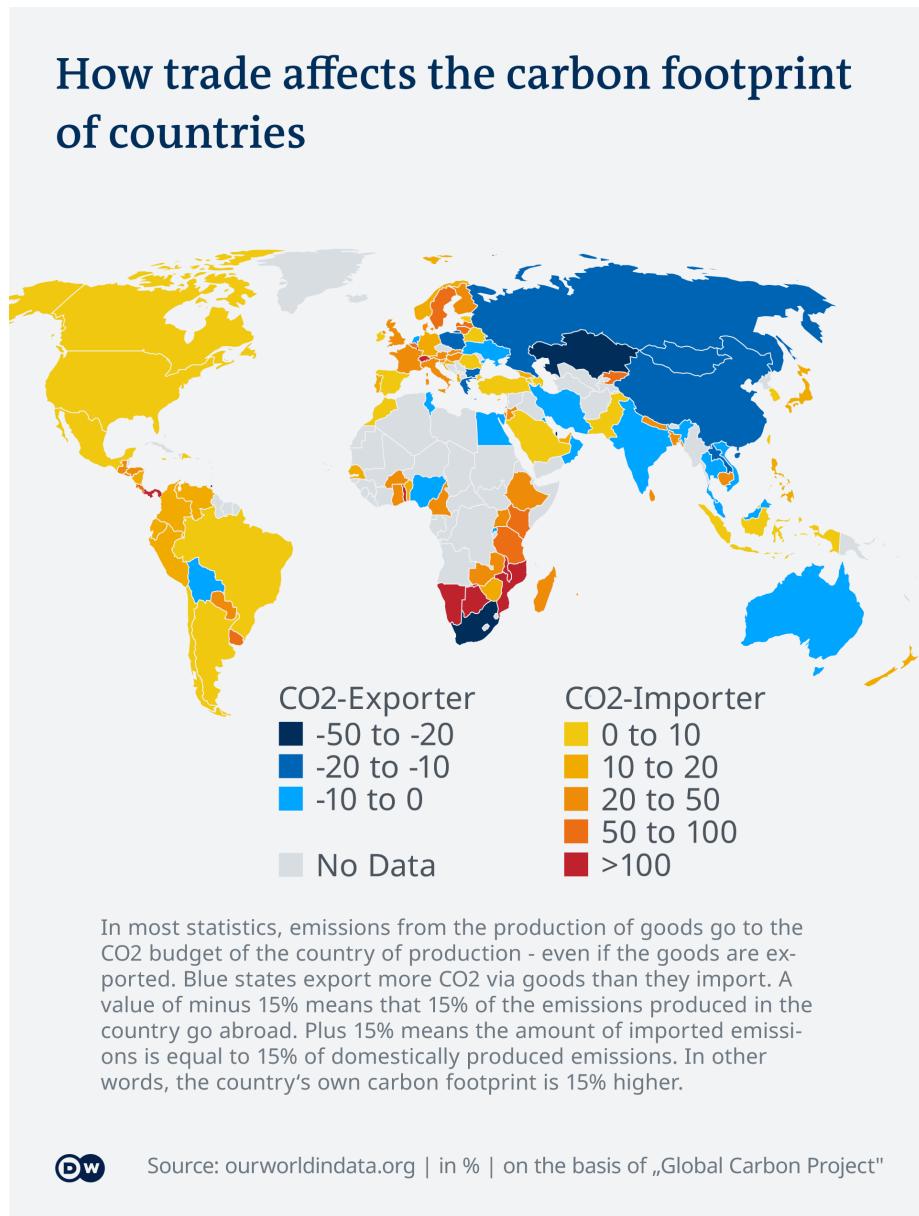
Environmental protection itself contributes to economic growth

As modern economies move toward a so-called resource-efficient and circular economy (RE-CE), there are concerns that — in the short term, at least — jobs will be lost across various sectors of the economy and that job creation will be minimal. However, an OECD report notes that it is important to distinguish

between different sectors.

Most jobs over the next two decades are projected to be created within the construction industry, and renewable power generation and services; while manufacturing sectors, agriculture, food production and fossil-fuel based power are expected to record job losses.

The overriding question is how to balance economic growth with cutting carbon emissions, and ultimately, achieving climate neutrality. At this year's World Economic Forum in Davos, Johan Rockström, director of the Potsdam Institute for Climate Impact Research, pointed to that contradiction. "It's difficult to see if the current GDP-based model of economic growth can go hand in hand with rapid cutting of emissions," he said.



Mudge (2021) Does climate protection stifle economic growth? (Deutsche Welle)

Dechezleprêtre

Ever since the first major environmental regulations were enacted in the 1970s, there has been much debate about their potential impacts on the competitiveness of affected firms. Businesses and policy makers fear that in a world that is increasingly characterized by the integration of trade and capital flows, large

asymmetries in the stringency of environmental policies could shift pollution-intensive production capacity toward countries or regions with less stringent regulation, altering the spatial distribution of industrial production and the subsequent international trade flows. This has caused concern, particularly among countries that are leading the action against climate change, because their efforts to achieve deep emission reductions could put their own pollution-intensive producers at a competitive disadvantage in the global economy.

There are two different views in the environmental economics literature on the effects of asymmetric policies on the performance of companies competing in the same market: the pollution haven hypothesis and the Porter hypothesis.

The pollution haven hypothesis, which is based on trade theory, predicts that more stringent environmental policies will increase compliance costs and, over time, shift pollution-intensive production toward low abatement cost regions, creating pollution havens and causing policy-induced pollution leakage. This is a particularly troubling problem for global pollutants such as carbon dioxide, because it means that on top of the economic impacts on domestic firms, abatement efforts will be offset to some extent by increasing emissions in other regions.

In contrast, the Porter hypothesis (*Porter and van der Linde (1995) Toward a new conception of the environment–competitiveness relationship. Journal of Economic Perspectives 9(4):97–118*) argues that more stringent environmental policies can actually have a net positive effect on the competitiveness of regulated firms because such policies promote cost-cutting efficiency improvements, which in turn reduce or completely offset regulatory costs, and foster innovation in new technologies that may help firms achieve international technological leadership and expand market share.

Some 20 years ago, in their review of the literature on the competitiveness impacts of environmental regulation in the United States, Jaffe et al. (1995) concluded that “there is relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness.” Since then, through hundreds of studies that have used ever larger datasets with increasingly fine levels of disaggregation, employing up-to-date econometric techniques, and covering a wider set of countries, this conclusion has only become more robust. This article has reviewed the recent empirical literature on the impacts of environmental regulations on firms’ competitiveness, as measured by trade, industry location, employment, productivity, and innovation. The cost burden of environmental policies has often been found to be very small. The recent evidence shows that taking the lead in implementing ambitious environmental policies can lead to small, statistically significant adverse effects on trade, employment, plant location, and productivity in the short run, particularly in pollution- and energy-intensive sectors. However, the scale of these impacts is small compared with other determinants of trade and investment location choices such as transport costs, proximity to demand, quality of local workers, availability of raw materials, sunk capital costs, and agglomeration. Moreover,

the effects tend to be concentrated on a subset of sectors for which environmental and energy regulatory costs are significant—a small group of basic industrial sectors characterized by very energy-intensive production processes, limited ability to fully pass through pollution abatement costs to consumers (whether due to regulation or international competition), and a lack of innovation and investment capacity to advance new production processes (Sato et al., 2015a). For these subsectors, where pollution leakage and competitiveness issues represent a genuine risk, a critical avenue for future research is to assess and evaluate the various policy options available to prevent adverse impacts on trade and investment without dampening the incentives to develop cleaner processes and products.

This article has also shown that there is strong evidence that environmental regulations induce innovation activity in cleaner technologies. Thus far the benefits from these innovations do not appear to be large enough to outweigh the costs of regulations for the regulated entities. Of course, this does not preclude the ability of environmental regulations to foster the development of global leaders in innovation, but it does suggest that the evidence for the most controversial interpretation of the Porter hypothesis (i.e., that environmental regulations can lead to an increase in firms' competitiveness) is lacking. As regulatory designs and combinations continue to be explored, further research will be needed to identify the combinations of research and development and environmental policies that best encourage innovation in green technologies.

This review raises the question of why the effects of environmental regulations on international industry relocation have been found to be so small and narrow given the strong concerns about competitiveness in public policy circles. One explanation could be that regulated companies have an incentive to overstate the potential competitiveness impacts of regulations as a strategy to lobby against stringent policies by attributing unpopular off-shoring decisions to public policy rather than to underlying economic factors such as the shifting locus of supply and demand in global manufacturing or decreasing transport costs. An alternative explanation for the lack of empirical support for the large pollution haven effects discussed in the literature is that environmental policy is endogenous, i.e., governments strategically set stringency levels to be low (high) where there is a high (low) risk of competitiveness distortions. This argument suggests that competitiveness concerns could trigger a “race to the bottom” in global environmental protection efforts. To avoid such an outcome, further research is needed to accurately measure and monitor the competitiveness effects of environmental regulations to help ensure that policy is based on robust evidence.

Dechezleprêtre (2017) The Impacts of Environmental Regulations on Competitiveness (pdf)

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Savings

Stropoli

While many economists think more saving leads to productive investment, Sufi, Princeton's Atif Mian, and Harvard's Ludwig Straub make a different argument. They find that these savings are largely unproductive, being remade by the financial system into household and government debt. And their research outlines a cycle whereby the savings of the top 1 percent fuel the debt and dissavings of the lower 90 percent, which in turn leads to more savings at the top.

From the 1980s through 2007, the top 1 percent financed a large portion of the overall rise in household debt for the lower 90 percent, according to the researchers. And as the rich have accumulated capital, the less wealthy have accumulated fewer assets, which means they experience less financial stability overall. Thus, the work argues, the savings glut of the rich, and its role in financing unproductive debt and dissavings of the nonrich, leads to instability not only for the less economically privileged but also for the broad economy.

Mian and Sufi argue in 2018 research that a rapid flow of foreign funds into the US triggered a credit-supply expansion that boosted household debt, which they say was a major factor in igniting the financial crisis.

From 1982 to 2016, the glut of the US rich was, on average, 60–75 percent of the size of the global glut. And at times in the 1990s and 2010s, the amount rich Americans put away even exceeded the global glut.

Credit Suisse's 2020 wealth report finds that the US has about 20 million millionaires, 40 percent of the global total. Meanwhile, the Billionaire Census 2020 from Wealth-X, which provides information and insight on the world's wealthiest individuals, finds the US has about 28 percent of the world's billionaires, who hold a 36 percent share of global billionaire wealth. The world now has a record 2,755 billionaires, according to Forbes.

The top 1 percent of households in the US have just as much influence as emerging-market economies in fueling the debt of the bottom 90 percent.

More savings, less investment

Ideally, all those savings would be channeled into productive investments such as research and development, or practical equipment, or new roads, or even new yachts—investments that would promote growth in the economy. However, from 2000 through 2016, the average annual savings of the top 1 percent exceeded average annual net domestic investment as a percentage of GDP. While the rich saved more, investment in productive assets declined.

Those savings were put to use financing both household and government debt. Between 2000 and 2016, they find that claims on household and government debt account for nearly two-thirds of the rise in asset accumulation of the top 1 percent in the US.

In the 25 years leading up to the 2008–09 financial crisis the top 1 percent financed almost a third of the rise in household debt owed by the bottom 90 percent. In the years since the crisis, and since the housing bubble burst, the savings of the rich have gone more toward government debt

Not all household and government debt is unproductive, of course. More than one entrepreneur has financed a startup on a credit card or with a personal loan. However, much household debt goes toward instruments such as mortgages and home equity loans, which can be used speculatively, in which case they are less productive than, say, investments in manufacturing plants or technology. Thus, the researchers argue that mortgages, while enabling homeownership, can also help perpetuate a cycle of wealth inequality.

The rich are seeking returns on their excess savings because, as Sufi says, many of them “just cannot spend all the money they make.”

The US government, by providing tax breaks on debt interest, and by encouraging banks to lend via debt financing, promotes less-productive investment

Nonfinancial corporations have increased their holdings of money market funds and time deposits by 10 percentage points of national income since 1995.

Since the early 2000s, the amount of corporate saving not invested in new capital has increasingly accumulated as cash.

Say a corporation issues equity to the wealthy, but instead of spending the proceeds on research or equipment, puts that money into a time deposit at a bank, which in turn uses it to fund a mortgage for a less-affluent household. This is how the rich become lenders.

Some politicians, economists, and pundits say that people are borrowing (and consuming) irresponsibly. But banks with all that cash on hand work to expand the credit market and realize returns on the savings glut of the rich. The bottom

90 percent are being convinced to borrow more and more, through lower interest rates, easier credit, and more advertising.

From the 1980s through 2007, the net amount of household debt that the top 1 percent held as a financial asset rose by 15 percentage points of national income, while at the same time the amount of household debt that the bottom 90 percent owed as a liability rose by 40 percentage points. The so-called accumulated dissavings of the bottom 90 percent from 1983 to 2015, relative to the average level from 1973 to 1982, was over twice the national income, the researchers say.

The debt trap

As the savings of the rich go toward the borrowing of the nonrich, there may be a GDP boost in the short run, as it does encourage consumption. But the debt becomes a drag on future demand. The cycle of unproductive debt makes it hard for consumer demand to support full employment in the economy, and it ultimately forces central banks to lower interest rates. While lower rates may strengthen demand for a time, consistently low rates may be problematic. Persistent low demand can foster a high-debt liquidity trap—or debt trap—in which economies are stuck in long periods of sluggish growth.

Stropoli (2021) How the 1 percent's savings buried the middle class in debt

Inequality

Wealth among the superrich has been fueled by a marriage of in-demand skills, globalization, and technology—the combination of which are *allowing businesses to scale up as never before*.

Skills, say many economists, are critical to the modern economy. As the US economy grows, jobs are going unfilled as companies scramble to find skilled people to hire. There's a flip side to this: as certain skills have become scarce, this has raised the amount companies are willing to pay people who have them. The situation has similarly raised the amount of profits skilled company owners can make, and technology and globalization are further magnifying the value of in-demand skills. If this is true, the 0.01 percent are most likely benefiting from what economists call “skill-biased technological change”—the increasing return on certain skills in an economy driven by technology and globalization. Under this well-established theory, a shortage of in-demand skills raises the value of those skills in rapidly expanding markets, and new technology helps some workers’ productivity grow much more than others’, exacerbating inequality.

In the Information Age, the change has been particularly pronounced. “In business, you can use technology to do things you couldn’t do 30 years ago,” says Steve Kaplan. “You can scale your business using technology, and you can use people in India and China and all over the world—you couldn’t do that as effectively 30 years ago.” This, he argues, has been spectacularly positive for poorer people in developing countries. In 1990, the World Bank estimated that roughly 35 percent of the world lived in extreme poverty. Today, less than 11 percent of the world’s population is so impoverished.

And it has been good for wealthy residents of developed countries. For them, the result has taken the form of the “superstar” or “winner-take-all” phenomenon, first identified in a landmark 1981 paper by the late Sherwin Rosen, who taught at the University of Chicago. “In certain kinds of economic activity there is concentration of output among a few individuals,” wrote Rosen. “Relatively small numbers of people earn enormous amounts of money and dominate the activities in which they engage.”

Technology allows a hedge fund to be able to manage \$20 billion and invest it,” says Steve Kaplan. “I don’t think people had the systems and information to do that 20 to 30 years ago. Now they have the systems and the information to do that. That technological change is here and is not going away. If anything, it’s getting stronger.”

Gold (2021) The 000.1 Pct

31

Climate Economics

31.1 A Blocking Neoclassical Framework

Brookes and Wagner

With its fixation on equilibrium thinking and an exclusive focus on market factors that can be precisely measured, the neoclassical orthodoxy in economics is fundamentally unequipped to deal with today's biggest problems. Change within the discipline is underway, but it cannot come fast enough.

The economics discipline has failed to understand the climate crisis – let alone provide effective policy solutions for it – because most economists tend to divide problems into small, manageable pieces. Rational people, they are wont to say, think at the margin. What matters is not the average or totality of one's actions but rather the very next step, weighed against the immediate alternatives. Such thinking is indeed rational for small discrete problems. Compartmentalization is necessary for managing competing demands on one's time and attention. But marginal thinking is inadequate for an all-consuming problem touching every aspect of society. Economists also tend to equate rationality with precision. The discipline's power over public discourse and policymaking lies in its implicit claim that those who cannot compute precise benefits and costs are somehow irrational. This allows economists – and their models – to ignore pervasive climate risks and uncertainties, including the possibility of climatic tipping points and societal responses to them. And when one considers economists' fixation with equilibrium models, the mismatch between the climate challenge and the discipline's current tools becomes too glaring to ignore. Yes, a return to equilibrium – getting “back to normal” – is an all-too-human preference. But it is precisely the opposite of what is needed – rapidly phasing out fossil fuels – to stabilize the world's climate. These limitations are reflected in benefit-cost analyses of cutting emissions of carbon dioxide and other greenhouse gases. The

traditional thinking suggests a go-slow path for cutting CO₂. The logic seems compelling: the cost of damage caused by climate change, after all, is incurred in the future, while the costs of climate action occur today. The Nobel prize-winning verdict is that we should delay necessary investment in a low-carbon economy to avoid hurting the current high-carbon economy.

The very structure of academic economics all but guarantees that marginal thinking continues to dominate. The most effective way to introduce new ideas into the peer-reviewed academic literature is to follow something akin to an 80/20-rule: stick to the established script for the most part; but try to push the envelope by probing one dubious assumption at a time. Needless to say, this makes it extremely difficult to change the overall frame of reference, even when those who helped establish the standard view are looking well beyond it themselves.

Because equilibrium thinking underpins the traditional climate-economic models that were developed in the 1990s, these models assume that there are tradeoffs between climate action and economic growth. They imagine a world where the economy simply glides along a Panglossian path of progress. Climate policy might still be worthwhile, but only if we are willing to accept costs that will throw the economy off its chosen path. Against the backdrop of this traditional view, recent pronouncements by the International Monetary Fund and the International Energy Agency are nothing short of revolutionary. Both institutions have now concluded that ambitious climate action leads to higher growth and more jobs even in the near term. The logic is straightforward: climate policies create many more jobs in clean-energy sectors than are lost in fossil-fuel sectors, reminding us that investment is the flipside of cost. That is why the proposal for a \$2 trillion infrastructure package in the United States could be expected to spur higher net economic activity and employment. Perhaps more surprising is the finding that carbon pricing alone appears to reduce emissions without hurting jobs or overall economic growth. The problem with carbon taxes or emissions trading is that real-world policies are not reducing emissions fast enough and therefore will need to be buttressed by regulation.

The framework of neoclassical economics is still blocking progress. The discipline is long overdue for its own tipping point toward new modes of thinking commensurate with the climate challenge.

Brookes and Wagner (2021) Economics needs a Climate Revolution

31.2 Long-term Economic effects of Climate Change

Kahn Abstract

We study the long-term impact of climate change on economic activity across countries, using a stochast

ic growth model where labour productivity is affected by country-specific climate variables—defined as deviations of temperature and precipitation from their historical norms. Using a panel data set of 174 countries over the years 1960 to 2014, we find that per-capita real output growth is adversely affected by persistent changes in the temperature above or below its historical norm, but we do not obtain any statistically significant effects for changes in precipitation. Our counterfactual analysis suggests that at a persistent increase in average global temperature by 0.04°C per year, in the absence of mitigation policies, reduces world real GDP per capita by 7.22 percent by 2100. On the other hand, abiding by the Paris Agreement, thereby limiting the temperature increase to 0.01°C per annum, reduces the loss substantially to 1.07 percent. These effects vary significantly across countries. We also provide supplementary evidence using data on a sample of 48 U.S. states between 1963 and 2016, and show that climate change has a long-lasting adverse impact on real output in various states and economic sectors, and on labor productivity and employment.

Kahn Memo

By using deviations of climate variables from their respective historical norms, while allowing for nonlinearity, we *avoid the econometric pitfalls associated with the use of trended variables*, such as temperature, in output growth equations. As it is well known, and is also documented in our paper, temperature has been trending upward strongly in almost all countries in the world, and its use as a regressor in a growth regression can lead to spurious estimates.

To measure the damage caused by climate change, economists have sought to quantify how aggregate economic growth is being affected by rising temperatures and changes in rainfall patterns; see a recent survey by Dell et al. (2014)

The literature which attempts to quantify the effects of climate change (temperature, precipitation, storms, and other aspects of the weather) on economic performance (agricultural production, labour productivity, commodity prices, health, conflict, and economic growth) is relatively recent and mainly concerned with *short-run* effects

Moreover, there are a number of grounds on which the econometric evidence of the effects of climate change on growth may be questioned. Firstly, the literature relies primarily on the cross-sectional approach and as such does not take into account the time dimension of the data (i.e., assumes that the observed relationship across countries holds over time as well) and is also subject to the

endogeneity (reverse causality) problem given the possible feedback effects from changes in output growth onto the climate variable.

Secondly, the fixed effects (FE) estimators used in more recent panel-data studies implicitly assume that climate variables are strictly exogenous, and thus rule out any reverse causality from economic growth to rising average temperatures.

In his computable general equilibrium work, Nordhaus accounts for the fact that faster economic activity increases the stock of greenhouse gas (GHG) emissions and thereby the average temperature. At the same time, rising average temperature could reduce real economic activity. This equilibrium approach has important implications for the econometric specification of climate change–economic growth relationship. In fact, recent studies on climate science provide strong evidence that the main cause of contemporary global warming is the release of greenhouse gases to the atmosphere by human activities.

Consequently, when estimating the impact of climate change on economic growth, temperature (T_{it}) may not be considered as strictly exogenous, but merely weakly exogenous/predetermined to income growth; in other words economic growth in the past might have feedback effects on future temperature. While it is well known that the FE estimator suffers from small-T bias in dynamic panels with N (the cross-section dimension) larger than T (the time series dimension). This bias exists regardless of whether the lags of the dependent variable are included or not, so long as one or more regressor is not strictly exogenous. In such cases, inference based on the standard FE estimator will be invalid and can result in large size distortions unless $N=T \neq 0$, as $N; T \neq 1$ jointly. Therefore, caution must be exercised when interpreting the results from studies that use the standard FE estimators in the climate change–economic growth literature given that N is often larger than T . Thirdly, econometric specifications of the climate change–macroeconomic relation are often written in terms of real GDP per capita growth and the level of temperature, T_{it} , and in some cases also T_{it}^2 ; see, for instance, Dell et al. (2012) and Burke et al. (2015). But if T_{it} is trended, which is the case in almost all countries in the world (see Section 3.1), inclusion of T_{it} in the regression will induce a quadratic trend in equilibrium log per capita output (or equivalently a linear trend in per capita output growth) which is not desirable and can bias the estimates of the growth–climate change equation. Finally, another major drawback of this literature is that the econometric specifications of the climate change–growth relation are generally not derived from or based on a theoretical growth model. Either an ad hoc approach is used, where real income growth is regressed on a number of arbitrarily-chosen variables, or a theoretical model is developed but not put to a rigorous empirical test.

We contribute to the climate change–economic growth literature along the following dimensions. Firstly, we extend the stochastic single-country growth models of Merton (1975), Brock and Mirman (1972), and Binder and Pesaran (1999) to N countries sharing a common technology but different climate condi-

tions. Our theoretical model postulates that labour productivity in each country is affected by a common technological factor and country-specific climate variables, which we take to be average temperature, T_{it} , and precipitation, P_{it} , in addition to other country-specific idiosyncratic shocks. As long as T_{it} and P_{it} remain close to their respective historical norms (regarded as technologically neutral), they are not expected to affect labour productivity. However, if climate variables deviate from their historical norms, the effects on labour productivity could be positive or negative, depending on the region under consideration. For example, in a historically cold region, a rise in temperature above its historical norm might result in higher labour productivity, whilst for a dry region, a fall in precipitation below its historical norms is likely to have adverse effects on labour productivity. 2 Secondly, contrary to much of the literature which is mainly concerned with short-term growth effects, we explicitly model and test the long-run growth effects of persistent increases in temperature. Thirdly, we use the half-panel Jackknife FE (HPJ-FE) estimator proposed in Chudik et al. (2018) to deal with the possible bias and size distortion of the commonly-used FE estimator (given that T_{it} is weakly exogenous). When the time dimension of the panel is moderate relative to N , the HPJ-FE estimator effectively corrects the Nickel-type bias if regressors are weakly exogenous, and is robust to possible feedback effects from aggregate economic activity to the climate variables.

Our results suggest that a persistent change in the climate has a long-term negative effect on per capita GDP growth.

Our empirical findings apply equally to poor or rich, and hot or cold countries.

We show that an increase in average global temperature of 0.04°C per year—corresponding to the Representative Concentration Pathway (RCP) 8.5 scenario (see Figure 1), which assumes higher greenhouse gas emissions in the absence of mitigation policies—reduces world's real GDP per capita by 7.22 percent by 2100. Limiting the increase to 0.01°C per annum, which corresponds to the December 2015 Paris Agreement, reduces the output loss substantially to 1.07 percent.

To put our results into perspective, the conclusions one might draw from most of the existing climate change-macroeconomy literature are the following: (i) when a poor (hot) country is 1°C warmer than usual, its income growth falls by 1–2 percentage points in the short- to medium-term; (ii) when a rich (temperate) country is 1°C warmer than usual, there is little impact on its economic activity; and (iii) the GDP effect of increases in average temperatures (with or without adaptation and/or mitigation policies) is relatively small—a few percent decline in the level of GDP per capita over the next century (see, Figure 2). In contrast, our counterfactual estimates suggest that all regions (cold or hot, and rich or poor) would experience a relatively large fall in GDP per capita by 2100 in the absence of climate change policies (i.e., the RCP 8.5 scenario). However, the size of these income effects varies across countries depending on the projected paths of temperatures.

Burke et al. (2015) consider an alternative panel specification that adds quadratic climate variables to the equation and detect: (i) non-linearity in the relationship; (ii) differential impact on rich versus poor countries; and (iii) noisy medium-term growth effects— their higher lag order (between 1 and 5) estimates reported in Supplementary Table S2, show that only 3 out of 18 estimates are statistically significant. Overall, apart from the econometric shortcomings of existing studies, robust evidence for the long-run growth effects of climate change are nonexistent in the literature. However, our results show that an increase in temperature above its historical norm is associated with lower economic growth in the long run— suggesting that the welfare effects of climate change are significantly underestimated in the literature. Therefore, our findings call for a more forceful policy response to climate change.

Kahn (2019) LONG-TERM MACROECONOMIC EFFECTS OF CLIMATE CHANGE: A CROSS-COUNTRY ANALYSIS (pdf)

Dell Abstract

A rapidly growing body of research applies panel methods to examine how temperature, precipitation, and windstorms influence economic outcomes. These studies focus on changes in weather realizations over time within a given spatial area and demonstrate impacts on agricultural output, industrial output, labor productivity, energy demand, health, conflict, and economic growth, among other outcomes. By harnessing exogenous variation over time within a given spatial unit, these studies help credibly identify (i) the breadth of channels linking weather and the economy, (ii) heterogeneous treatment effects across different types of locations, and (iii) nonlinear effects of weather variables. This paper reviews the new literature with two purposes. First, we summarize recent work, providing a guide to its methodologies, datasets, and findings. Second, we consider applications of the new literature, including insights for the “damage function” within models that seek to assess the potential economic effects of future climate change.

Dell Memo

The difficulty in identifying causative effects from cross-sectional evidence has posed substantial and long-standing challenges for understanding the historical, contemporary, and future economic consequences of climate and climate change.

In the last few years, there has been a wave of new empirical research that takes a different approach. These new studies use panel methodologies, exploiting high-frequency (e.g., year-to-year) changes in temperature, precipitation, and other climatic variables to identify these variables’ economic effects. As nomenclature, this new literature uses “weather variation” to describe shorter-run temporal variation. The word climate is reserved for the distribution of outcomes, which may be summarized by averages over several decades, while weather describes a particular realization from that distribution and can provide substantial variability.

The primary advantage of the new literature is *identification*. By exploiting exogenous variation in weather outcomes over time within a given spatial area, these methods can causatively identify effects of temperature, precipitation, and windstorm variation on numerous outcomes, including agricultural output, energy demand, labor productivity, mortality, industrial output, exports, conflict, migration, and economic growth. This literature has thus provided a host of new results about the ways in which the realizations of temperature, precipitation, storms, and other aspects of the weather affect the economy.

This literature has important implications for the “damage function” in climate change models. The opportunity here is to bring causative identification to the damage functions, elucidating the set of important climate–economy channels and their functional forms. The challenge lies in bridging from the evidentiary basis of short-run weather effects to thinking about longer-run effects of changes in the distribution of weather, which may be either larger (e.g., due to intensification effects) or smaller (e.g., due to adaptation) than the short-run impacts. While certain climate change aspects are difficult to assess, we examine a number of empirical methodologies that can help bridge toward longer-run effects while maintaining careful identification.

climate studies often seek to estimate the contemporaneous effect of temperature on economic activity for the purpose of assessing the potential impacts of forecasted temperature changes over the next several decades. The cross-sectional relationship, which represents a very long-run equilibrium, may incorporate processes that are too slow to accurately inform the time scale of interest, or it may include historical processes (such as colonialism) that will not repeat themselves in modern times.

To the extent that one is interested in isolating the impact of climatic variables such as temperature—apart from the many other factors that they are correlated with and have influenced over the very long run—a different approach is to use longitudinal data to investigate the effects of weather shocks. This approach, which is the focus of this review, has emerged in recent years and emphasizes variation over time within a given spatial entity.

The literature uses a nomenclature of “weather variation” for shorter-run temporal variation, as opposed to “climate variation,” where the word climate is used to describe the distribution of outcomes while weather refers to a particular realization from that distribution.

A related issue is the inclusion of lags of the dependent variable, y_{it} . Including these lags biases coefficient estimates in short panel models,⁴ yet excluding the lagged dependent variable may also bias the estimates if it is an important part of the data-generating process. While what comprises a “short” panel will depend on the data-generating process, Monte Carlo experiments suggest that the bias can be nonnegligible with panel lengths of $T = 10$ or even $T = 15$.

A further implementation question involves the appropriate functional form for the weather variables. One common approach measures C_{it} in “levels” (e.g.,

degrees Celsius for temperature or millimeters for precipitation). In the panel set up, the identification thus comes from deviations in levels from the mean.⁷ Another common approach, aimed at revealing nonlinear effects, considers the frequencies at which the weather realizations fall into different bins.

A different approach emphasizes “anomalies,” where the weather variable is calculated as its level difference from the within-spatial-area mean and divided by the within-spatial-area standard deviation. The first part—the difference in mean—is already captured in a broad sense by the panel model. The second part—scaling by the standard deviation—takes a particular view of the underlying climate–economy model where level changes matter not in an absolute sense but in proportion to an area’s usual variation.

Alternatively, outcome-specific approaches may be preferred where existing research provides guidance. For example, knowledge of biological processes in agriculture suggest refined temperature measures such as “degree-days” for crop growth, possibly with crop-specific thresholds.

As a general rule, imposing specific functional forms on the data, such as crop degree-days, is useful to the extent that one has confidence in the specific model of the process that translates weather to economic outcomes. The more agnostic about the model, the more general the researcher would like to be about the functional form.

There are two notable interpretative issues with the panel models that, while not calling into question the experimental validity of the regression design, do raise questions about their external validity for processes such as global warming. One interpretive challenge is whether and how the effects of medium- or long-run changes in climatic variables will differ from the effects of short-run fluctuations. A second issue is that panel models, in focusing on idiosyncratic local variation, also neutralize broader variation that may be of potential interest, including general equilibrium effects that spill across spatial borders or are global in nature, like effects on commodity prices.

Data

There are currently four principal types of weather data: ground station data, gridded data, satellite data, and reanalysis data. The most basic type of data are from ground stations, which typically directly observe temperature, precipitation, and other weather variables such as wind speed and direction, humidity, and barometric pressure. Gridded data provide more complete coverage by interpolating station information over a grid. Satellite data use satellite-based readings to infer various weather variables. Finally, reanalysis data combine information from ground stations, satellites, weather balloons, and other inputs with a climate model to estimate weather variables across a grid.

Different interpolation schemes can produce different estimates, particularly in short time periods and particularly for precipitation. Precipitation has a far greater spatial variation than temperature, especially in rugged areas, and thus

is more difficult to interpolate.

While satellite data can provide important weather information for areas with a limited ground network, satellite data are not necessarily a panacea. Satellites were launched relatively recently, so their data does not extend back nearly as far historically as other datasets. Furthermore, an individual ground station is more accurate than the satellite data for that particular location, in part because satellites do not directly measure temperature or precipitation, but rather make inferences from electromagnetic reflectivity in various wavelength bands. Lastly, a satellite-based series is not drawn from a single satellite, but rather from a series of satellites. Sensors have changed subtly over the years and, within a particular satellite, corrections are needed due to subtle changes in the satellite's orbit over time and other factors.

The key difference between reanalysis and gridded data is that, rather than use a statistical procedure to interpolate between observations, a climate model is used.

One approach is to aggregate spatially; that is, to overlay administrative or other boundaries with the gridded weather dataset and take a simple area-weighted average of weather variables within the administrative unit, which can be done easily using GIS software. However, this approach will lead large areas with little economic activity and sparse populations (such as deserts, rain forests, or the Arctic) to dominate the weather averages of large spatial units such as the United States, Russia, and Brazil. A second approach is, therefore, to aggregate using a fixed set of population weights, so that the relevant concept is the average weather experienced by a person in the administrative area, not the average weather experienced by a place.

Overall, the studies discussed in this section document that temperature, precipitation, and extreme weather events exert economically meaningful and statistically significant influences on a variety of economic outcomes. These impacts illustrate the multifaceted nature of the weather–economy relationship, with numerous applications for understanding historical, present, and future economic outcomes and possible policy responses. For example, the effects of weather variables on mortality rates, labor productivity, energy demand, and agricultural output can inform investments and policy design around public health, air-conditioning, energy infrastructure, and agricultural technologies. Moreover, these studies can help inform classic issues of economic development, especially the role of geographic features in influencing development paths. Finally, these analyses may inform estimates of the economic costs of future climatic change. The possibility of future climatic change has been a primary motive for the recent, rapid growth of this literature.

Results

Cross-country empirical analyses show a strong negative relationship between hot climates and income per capita.

Panel studies exploit the exogeneity of cross-time weather variation, allowing for causative identification.

In a world sample from 1950 to 2003, Dell, Jones, and Olken (2012) examine how annual variation in temperature and precipitation affects per capita income. They show that being 1°C warmer in a given year reduces per capita income by 1.4 percent, but only in poor countries. Moreover, estimating a model with lags of temperature, they find that this large effect is not reversed once the temperature shock is over, suggesting that temperature is affecting growth rates, not just income levels. Growth effects, which compound over time, have potentially first-order consequences for the scale of economic damages over the longer run, greatly exceeding level effects on income, and are thus an important area for further modeling and research.

While the production function is often calibrated through the use of experimental data, it has been criticized for not realistically modeling real farmer behavior in real settings. For example, many studies do not allow farmers to adopt new crops when the temperature input into the production function changes, nor do they allow farmers to switch their cultivated land to livestock or nonfarm use. To address these concerns, Mendelsohn, Nordhaus, and Shaw (1994) developed a second approach, which they called the Ricardian approach, that instead used cross-sectional regressions with land values to recover the net impacts of climate on agricultural productivity. By analyzing farm land prices as a function of climate and a host of other characteristics, they estimated that the impacts of climate change would be much smaller than those estimated by the production function approach and might even be positive.

In estimating a cross-sectional relationship like equation (2) for irrigated areas, which transport water from other locations, the localized climate is not the key determinant of production.

Understanding nonlinearities becomes important when considering the impact of global climate change because a right-shift in the distribution of average temperature causes a disproportionate increase in the number of very hot days.

The possibility of adaptation was a major argument for the approach of Mendelsohn, Nordhaus, and Shaw (1994), since presumably, changes in land values would incorporate future adaptation effects.

Modern lab experiments have investigated the impact of temperature on productivity. Subjects are typically randomly assigned to rooms of varying temperatures and asked to perform cognitive and physical tasks. Examples of tasks shown to respond adversely to hot temperatures in laboratory settings include estimation of time, vigilance, and higher cognitive functions, such as mental arithmetic and simulated flight.

Observational and experimental studies also show a strong relationship between temperature and the productivity of factory, call center, and office workers, as well as students. Within the range of temperatures from 22–29°C, each addi-

tional $^{\circ}\text{C}$ is associated with a reduction of about 1.8 percent in labor productivity. The relationship is complex and find that other aspects (e.g., humidity, amount of outdoor air, carbon dioxide levels) have complex interactions with temperature. A meta-analysis of these studies concludes that increasing temperature from 23 to 30°C reduces productivity by about 9 percent.

Industrial output using aggregated data center approximately on a 2 percent output loss per 1°C .

Large effects of windstorms on industrial production. Effects of precipitation on industrial output appear slight, although only one study looks at extremely heavy precipitation and in that case finds modest negative effects.

Energy

The literature has looked extensively at how climatic variables, in particular temperature, influence energy consumption. This relationship, which has received renewed attention in light of potential climate change, has long been important for the design of electricity systems, where demand varies with climate and weather. Understanding temperature effects matters for the energy consequences per se and for potential feedback loops, incorporated into some climatic models, where energy demand influences greenhouse gas emissions, which in turn affects future energy demand.

A clear U-shape relationship between energy demand and temperature, with an extra day below 10°F or above 90°F raising annual energy demand by 0.3–0.4 percent.

These panel-data papers, in using temperature bins, depart from a prior practice of using “heating degree days” (HDD) and “cooling degree days” (CDD), which count the number of days below and above a threshold temperature, with each day weighted by its temperature difference from the threshold. This degree-days approach misses the convexity found in the nonparametric approach, where extreme temperatures provoke much stronger energy demand increases. The convexity of the U-shape appears important both in getting the energy demand estimation correct and in light of climate change models, which show an increasing number of very hot days. Partly for this reason, Deschênes and Greenstone (2011) and Auffhammer and Aroonruengsawat (2011) find that the net effect of warming over the twenty-first century is likely to increase energy demand substantially, *ceteris paribus*, with these studies estimating 11 percent and 3 percent demand increases respectively.

Trade and Innovation

Trade can, in principle, dampen or exacerbate local effects of productivity losses. Another potentially first-order adaptation mechanism is innovation.

The unusual identification opportunity provided by weather shocks has allowed a rigorous analysis of weather–economy linkages, and implications for breadth, heterogeneity, and functional forms. While much work remains in developing a

detailed understanding of the underlying mechanisms, especially for macroeconomic and political economy outcomes, the new literature shows that weather variation has substantive effects in contemporary periods. This begins to suggest policy targets, whether the goal is preventing substantial economic damages or protecting public health and security.

From short to long run: Econometrics

While temperature changes over the next thirty years will plausibly be within this range (recall the IPCC middle estimates were between 1.8–3.1°C by 2100), the ninety-fifth percentile estimate is warming of 7°C by 2100. If the impacts of climatic variables are linear throughout this range, then extrapolation is not an issue *per se*. However, if there are nonlinearities that are different from those operating within historical experience, one cannot directly extrapolate from equation (3) to climate scenarios far outside this range.

This issue suggests a limited capacity for panel models to provide quantitative estimates of damages from extreme warming.

These issues highlight that, even though panel models of the form of equation (3) correctly identify the causal effect of weather shocks on contemporaneous economic outcomes, they may not estimate the structural equation of interest for understanding the likely effects of future global climate change. Moreover, even leaving aside the potential of catastrophic climate scenarios, such as rapid sea-level rise or the release of methane from melting permafrost that could greatly increase global temperature, the panel estimates are neither obviously an upper bound nor a lower bound for the effect of climate change. If the adaptation force dominates, then the effects of weather shocks will tend to be larger than the effects of climate change; if the intensification force dominates, then the effects of weather shocks will tend to be smaller than the effects of climate change.

Longer-difference estimates are perhaps the closest empirical analogue to the structural equation of interest for climate change.

To the extent that adaptation requires forward-looking investments, adaptation choices will depend not only on the underlying damage functions and adaptation possibilities, but also on agents' expectations. Responses will depend on whether agents both were aware of the change in average temperature, and whether they perceived it to be a permanent change or just an accumulation of idiosyncratic shocks.

The challenge is that economies are changing and the longer the time difference taken in (8), the further back in time the analysis goes (by necessity), and the further removed from present-day economic conditions the analysis becomes. To the extent that different economies presented very different standards of living, technologies, and institutions through the twentieth century, one may still make headway by examining historical heterogeneous treatment effects along various dimensions of economic development. On the other hand, the future presum-

ably promotes new technologies and other features that may pull economies outside the range of historical experiences, calling for caution in drawing sharp conclusions from increasingly historical studies.

Long-run studies illustrate that factor reallocation may be an important mechanism.

IAMs

Our focus is on the damage function, the component of IAMs that specifies how increased temperatures affect economic activity.

IAMs used for economic policy analysis typically include four broad components: 1) a model projecting the path for greenhouse gas (GHG) emissions; 2) a model mapping GHG emissions into climatic change; 3) a damage function that calculates the economic costs of climatic change, and; 4) a social welfare function for aggregating damages over time and potentially across space.

All IAMs must make a wide variety of modeling choices, with large uncertainties remaining across each component.

The possibility of positive feedback loops implies that modeled climate change predictions are right-skewed; in other words, there are “fat tail” probabilities for massive climatic change in the next century.

IAMs must specify a social welfare function that discounts the future path of consumption.

The concavity of the utility function. This property influences not only how one weighs future versus current generations, but also how one weighs rich versus poor economies at a single point in time.

Different IAMs model the climate-damage function in somewhat different ways. For example, the DICE/RICE models use a Cobb-Douglas production function with capital and labor as inputs, multiplied by TFP, which grows at a constant, exogenously specified rate. Output is then reduced by the climate-damage function. For example, in the DICE model, the damage function is

$$D(T) = \frac{1}{1 + P_i} T + P_i - 2T^2$$

DICE calibrates the parameters to match cross-sectional estimates of climate damages reviewed in Tol (2009).

In the FUND model, rather than specify an aggregate damage function directly, climate damages are calculated at the region-by-sector level and aggregated up; that is, FUND posits separate models for agriculture, forestry, energy consumption, and health (deaths from infectious, cardiovascular, and respiratory disease), while also considering water resources, extreme storm damage, sea level rise, and the value for ecosystems, with potentially separate regional parameters for each of these models.

An important challenge with the current damage functions is that, for the most part, they do not incorporate the type of rigorous empirical evidence on climate damages reviewed here. In a recent review of IAMs, when discussing the calibration of the $D(T)$ function, Pindyck (2013) writes “the choice of values for these parameters is essentially guesswork. The usual approach is to select values such that $[D(T)]$ for T in the range of 2°C to 4°C is consistent with common wisdom regarding the damages that are likely to occur for small to moderate increases in temperature. . . . The bottom line here is that the damage functions used in most IAMs are completely made up, with no theoretical or empirical foundation.”

The implications of the econometric evidence discussed here can be thought of in two respects: how we model and calibrate the climate-damage function at a point in time, and how the climate-damage function evolves over time.

A key modeling choice for the damage function is whether climate affects the level of output or the growth path of output. The main IAMs assume that the impact of climate is on the level of output only with the growth of total-factor productivity continuing exogenously. Because growth effects, even small ones, will ultimately dominate even large-level effects, ruling out growth effects substantially limits the possible economic damages these models allow.

An alternative way of specifying the damage function is to allow climate to affect the long-run growth rate directly. Understanding the functional form through which climate affects economic output is critical. While it is hard to know definitively the correct functional form for the loss function, even small impacts on productivity growth could, over time, swamp effects on the level of output.

Building IAMs is a challenging exercise with enormous uncertainty.

We are optimistic that the damage function can be substantially informed by the recent wave of new empirical research, which has begun to provide key insights.

Integrating across the many studies reviewed, several broad themes emerge.

First, there is a wide range of channels through which weather shocks affect economic outcomes. Shocks, especially temperature, affect agricultural output, industrial output, energy demand, labor productivity, health, conflict, political stability, and economic growth. Labor productivity effects alone may suggest potentially economywide mechanisms. Moreover, the magnitudes of the effects are often substantive. An interesting linkage appears across studies of labor productivity, industrial output, and economic growth, where estimates converge around a 1–2 percent loss per 1°C in poor countries.

Second, the panel studies provide an emerging set of key insights about functional forms. Effects are often not simple linear functions independent of context. High sensitivity to extreme temperatures, but little or no sensitivity to temperature changes within moderate temperature ranges. International and

internal trade effects, including studies of how integrated markets both mute and transmit shocks.

Panel methodologies can also study medium-run and longer-run changes directly. Keeping in mind that countries have warmed substantially on average in the last several decades, with substantial variance within and across countries, there is ample capacity to study medium-run changes. The recent warming rate is also very similar to that predicted by many climate models through at least the middle of the current century. Noting that climate change is not about a permanent climate shock, but rather about a stochastic warming process along an upward trend, recent historical experience, which has occurred on such a stochastic warming trajectory, provides a highly relevant setting to understand warming effects.

Dell (2014) What Do We Learn from the Weather? The New Climate–Economy Literature (pdf)

32

Resource Economics

32.1 Sustainability

‘Sustainable Growth’ - An Oxymoron

Daly Memo

It is impossible for the world economy to grow it's way out of poverty and environmental degradation. Sustainable growth is impossible.

In its physical dimensions the economy is an open sub-system of the Earth ecosystem which is finite, nongrowing and materially closed. As the economic sub-system grows it incorporates an even greater proportion of the total ecosystem into itself and must reach a limit at 100 percent, if not before. Therefore its growth is not sustainable.

The term “sustainable growth” when applied to the economy is a bad oxymoron - self-contradictory as prose, and unevocative as poetry.

Sustainable Development (qualitatively) OK Even ‘green growth’ is not sustainable.

In the past 200 years we have developed a culture dependent on exponential growth for its economic stability.

To delude ourselves into believing that growth is still possible and desirable if only we label it ‘sustainable’ or ‘green’ will just delay the inevitable transition and make it more painful.

Precisely because quantitative and qualitative change are very different it is best to keep them separate and call them by different names. To *grow* means ‘to increase in size by the addition of material through assimilation or accretion’. To *develop* means ‘to expand or realize the potentialities of; to bring gradually to a fuller, greater, or better state’. When something develops it gets different.

The concept of optimal scale of the aggregate economy relative to the ecosystem is totally absent from current macroeconomics.

Microeconomics, which is almost entirely devoted to establishing the optimal scale of each micro level activity by equating costs and benefits at the margin, has neglected to inquire if there is not also an optimal scale for the aggregate of all micro activities.

Nonrenewable resources should be depleted at a rate equal to the rate of creation of renewable substitutes. Projects based on exploitation of nonrenewable resources should be paired with projects that develop renewable substitutes. The net rents from the nonrenewable extraction should be separated into an income component and a capital liquidation component. The capital component would be invested each year in building up a renewable substitute. The separation is made such that by the time the nonrenewable is exhausted, the substitute renewable asset will have been built up by investment and natural growth to the point where its sustainable yield is equal to the income component. The income component will have thereby become perpetual, thus justifying the name 'income'æ. which is by definition the maximum available for consumption while maintaining capital intact.

Daly (1990) Sustainable Growth. An Impossibility Theorem (pdf)

32.2 Resource Extraction

Bardi on Hubbert

The well known “Hubbert curve” assumes that the production curve of a crude oil in a free market economy is “bell shaped” and symmetric. The model was first applied in the 1950s as a way of forecasting the production of crude oil in the US lower 48 states. Today, variants of the model are often used for describing the worldwide production of crude oil, which is supposed to reach a global production peak (“peak oil”) and to decline afterwards. The model has also been shown to be generally valid for mineral resources other than crude oil and also for slowly renewable biological resources such as whales. Despite its widespread use, Hubbert’s model is sometimes criticized for being arbitrary and its underlying assumptions are rarely examined. In the present work, we use a simple model to generate the bell shaped curve using the smallest possible number of assumptions, taking also into account the “Energy Return to Energy Invested” (EROI or EROEI) parameter. We show that this model can reproduce several historical cases, even for resources other than crude oil, and provide a useful tool for understanding the general mechanisms of resource exploitation and the future of energy production in the world’s economy.

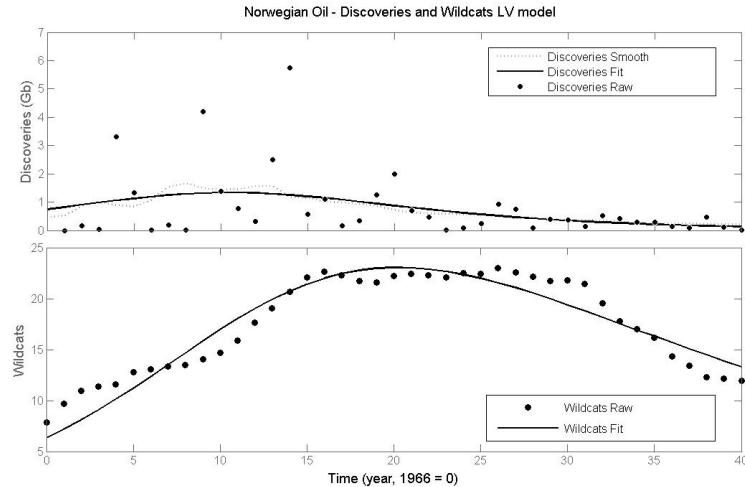


Figure: Fitting of the data for oil discovery in Norway and of the number of wildcats. In this case, the number of wildcats is proportional to the capital used by the oil industry in the effort of discovering the resource, oil wells.

Bardi (pdf)

32.3 Peak Theory

Insofar as economic growth is driven by oil consumption growth, post-peak societies must adapt. Hubbert believed:

Our principal constraints are cultural. During the last two centuries we have known nothing but exponential growth and in parallel we have evolved what amounts to an exponential-growth culture, a culture so heavily dependent upon the continuance of exponential growth for its stability that it is incapable of reckoning with problems of non growth.

Wikipedia: Hubbert Peak Theory

Hubbert () Exponential Growth as Transient Phenomenon in Human History
(pdf)

33

Demographics

33.1 China

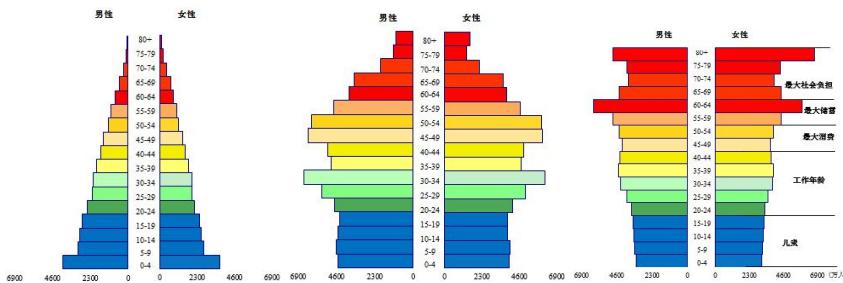


Figure: China Population Pyramid 1950 2019 2050

Batson

The working paper on demographics recently published by the People's Bank of China is a pretty interesting document, and has gotten more than the usual amount of attention. It doesn't read much like the cautious, dry and technical papers previously released by this august institution. There's not much quantitative analysis or rigorous logical argument; it's more like an extended op-ed, arguing vigorously that major demographic changes for China are coming and that the country needs to wake up to that fact and adapt quickly.

This call to arms is well-timed. It seems likely that the much-delayed figures for China's 2020 population census will confirm what many demographers have been saying for a while: that China's fertility rate has been overstated, and therefore that its demographic transition and the aging of its population are going to happen even faster than standard forecasts project.

Batson 2021 Demographics might change everything for China

Hao

Abstract: Since the industrial revolution, the death rate and birth rate have fallen successively, which has created a demographic transition and brought people to the world. Mouth explosion, demographic dividend, aging and declining birthrate. Developed countries, as pioneers in the transition, underestimate people. The role of the population and the seriousness of aging and declining birthrates overestimate the importance of education technology, encourage childbirth, and improve the elderly effect. Since the founding of the People's Republic of my country, the population of our country has expanded from a rapid growth to a slowdown, and the population structure has grown from a pyramid to a long one. It is square, and our country's population transition time is shorter, aging is faster, and declining birth rate is more serious. Our country must recognize. The demographic situation of the Qing Dynasty has changed. It is necessary to realize that the demographic dividend was used comfortably at the time, and it is a debt that needs to be repaid afterwards; It is necessary to realize that population inertia is a huge force across generations, and its reactionary force will cause the population to change in the opposite direction; Realize that education and technological progress cannot compensate for the decline in population. To this end, we should fully liberalize and encourage childbirth, Really solve the difficulties of women in pregnancy, childbirth, nursery school, and school, comprehensively implement strategies, and work hard for a long time. Now we have a long-term plan for 2035 and a century-old goal.

Memo:

1. The transformation of the world population

- (1) The four stages of demographic transition 2 Since the industrial revolution at the end of the eighteenth century and the beginning of the nineteenth century, 3 economic and social development has led to population deaths. The birth rate and birth rate have successively declined, but due to the time lag between the two declines, the world has experienced “low growth (I) -Accelerated Growth (II)-Growth Slowdown (III)-Low Growth (IV)” four stages of population transformation. In the first stage (agricultural society before the industrial revolution is usually at this stage), productivity is underdeveloped, and the population is dead. The death rate is high, but in order to maintain the stability of the population size, the birth rate is usually high. This leads to the population age structure Pyramid shape, low dependency ratio for old age, high dependency ratio for children 4, slow economic growth. Phase II (initial and mid-stage of industrialization), with income growth, nutrition, hygiene and medical conditions Improvement, the mortality rate of the population declines rapidly, but the birth rate is usually difficult to follow. This leads to a rapid population size Increase, the population structure develops from a pyramid shape to a rectangular shape 5, that is, the decline in the mortality rate causes the elderly population to occupy The ratio and the proportion of

the labor force have risen, pushing the top and middle of the pyramid to widen, but the birth rate has not decreased accordingly. Therefore, the bottom narrowing is not obvious. During this period, both the old-age dependency ratio and the child dependency ratio showed a downward trend. The growth rate is accelerating. In stage III (the middle and late stages of industrialization), the mortality rate of the population further decreased, but the rate of decline decreased. Contrary to what Malthus expected, the birth rate did not increase with the improvement of nutritional conditions, but decreased. (Google Translation)

Hao (2021) Cognition and countermeasures about China's population transition
PBC WP2021/2

34

Development Economics

Trainer

Thinking about development is dominated by a conventional conception which takes for granted the centrality of increasing production for sale, integration into the globalized market place, moving to more sophisticated technologies, and the goal of rising to affluent rich-world living standards. Basic criticisms of this conception of development are briefly summarized, firstly to do with the way it has primarily benefitted the rich and secondly regarding its grossly unsustainable resource implications. Global biophysical resource endowments prohibit its realization. There has been remarkably little thinking from conventional or critical sources on the goals and means which a sustainable alternative must take. The Simpler Way project is concerned to show the necessity for, and desirability and workability of, the development of mostly small scale, cooperative, highly self-sufficient and self-governing local economies focused on meeting basic needs, and not concerned with economic growth, globalization, competing in the global market place, or aspiring to rich-world “living standards”. It is argued that only some form of Simpler Way can enable satisfactory global development within sustainable resource and ecological limits.

The major fault in most if not all previous development thinking has been failure to grasp the need for materially simple lifestyles and systems.

Conventional development can be regarded as a form of legitimised plunder.

Alternative, appropriate development ... The simpler way

The basic element in appropriate development is the small, highly self-sufficient and largely co-operative local economy.

The transition can be a process of gradually building a new “Needs-Driven-Economy” underneath the old “Profit-Driven-Economy”. It can begin by a few coming together as a Community Development Cooperative to organize the

provision of some neglected basic goods and services, for example by setting up community gardens, poultry co-ops or aged care rosters. Their long term goal would be to increase these cooperative, socially desirable non-market activities until they might largely replace the old economy.

Trainer (2021) Third World Development RWER 95 (pdf)

34.1 Structural Reforms

Braun on Draghi's 'Reform Thesis'

Draghi was a structural reformer avant la lettre: He uses the term “reform” exactly as it would come to be used in “structural reforms”. Except that the concept didn’t exist at the time.

Draghi’s thesis fully articulates the theory that came to bring us structural reforms: A planner opting for short-run stimulus will never reach the optimal long-run path. By contrast, enforcing optimum long-run policies today will *not* have negative short-run consequences.

Noting that “the common finding is a positive relationship between real wages and employment”, Draghi seeks to refute that finding, describing it an artifact of faulty methodological choices.

Structural reformers *must* reject the idea of a positive wage-employment relationship because SRs are supposed to boost employment precisely via lower real wages.

Braun - Twitter Thread on Mario Draghi’s Thesis

Toozé on Draghi/Yellen new assignments

It would be absurd to blame either Draghi or Yellen personally for the sequence of shifts and shocks that has destabilized capitalist democracies since the 1990s or the crisis of confidence these have triggered among centrist liberals. But as people of huge influence and as representatives of a class of experts who have ruled the roost for the last 30 years, they can hardly plead innocence either. It was on their watch that growth slowed, inequality between social classes and regions became ever deeper, and the risk of inflation tipped into that of deflation. It was on their watch that the financial system was allowed to become a flywheel of mass destruction. It was on their watch that the risks of climate change and pandemic threats went unaddressed.

If broad-based growth cannot be restarted, the implications are alarming.

Whereas the market revolutionaries of the 1970s and ’80s were radicals, squashing the last bastions of the old left and bulldozing organized labor out of the way, Draghi and Yellen came to the fore in the 1990s as managers of what is now known as the Great Moderation.

Inheritors of the market revolution, committed to managing and improving the status quo, Draghi's and Yellen's march through the institutions has been glorious, but their careers have also been defined by constant adjustment to political and economic shocks that they did not foresee and could not control. These shocks have driven Yellen and Draghi to explore the political and economic boundaries of technocratic power.

At MIT and Yale in the 1970s, they imbibed what was known as the neoclassical synthesis. The central idea was that though the microeconomics of markets were important, markets would function properly only so long as the macroeconomic environment was set correctly. Keynesianism and market economics were not opposites but complements.

In the 1980s, Yellen played an important part in shaping the further development of the neoclassical synthesis known as New Keynesian economics. Working alongside the likes of Joseph Stiglitz and George Akerlof, she mapped how labor market imperfections could give rise to macroeconomic problems. Those rigidities in wages and prices, in turn, also enabled macroeconomic policy to work. It was because markets were slow to adjust that unexpected movements in interest rates, taxes, and government spending could have real effects.

Draghi's work at MIT was less intellectually generative than Yellen's. But his dissertation is nevertheless revealing. It includes a chapter in which he describes how planners trying to manage an economy subject to short-run fluctuation are more successful if they focus on long-run goals. Long-range strategy, regardless of short-term cost, will do better than a hectic effort to optimize at every moment.

Though they owe little to the Chicago school, it does not follow that Draghi and Yellen were not exponents of neoliberalism. On the contrary: They were strong advocates of markets. Competition and properly designed incentives were the recipe for productivity and growth.

In the world economy, they favored the free capital movement and flexible exchange rates that defined the so-called Washington Consensus of the 1990s. It was Rudiger Dornbusch, the pope of international macroeconomics at MIT and one of Draghi's chief mentors, who described the project of his generation as being the taming of "democratic money." In the wake of the collapse of the Bretton Woods financial order and the U.S. dollar's gold peg, the chief enemies of good economic governance were shortsighted trade unions pushing for higher wages and vote-chasing politicians. Once trade unions were curbed and politicians confined to their proper tasks, Friedmanite monetarists hoped that prices could be stabilized by mechanical monetary rules.

But by the early 1980s, that had proved naive. For the MIT crowd, what keeping money safe from democracy amounted to was placing it under the control of competent experts credibly committed to providing markets with the stable framework they needed. The independent central bank was their institutional bastion.

The global financial order developed by economic elites—from the 19th-century gold standard to the gold-pegged dollar of the Bretton Woods system to the worldwide preoccupation with independent central banks after Bretton Woods dissolved—has always involved imposing constraints on policymakers. In the 1980s, devices such as exchange rate pegs were all the rage in Asia as well as Europe for signaling self-discipline to financial markets.

For all their inside status and expertise, neither Yellen nor Draghi gave any public sign of anticipating the crisis that was to come. The same was true for the vast majority of their cohort, whether MIT or Chicago. The scale of the systemic risk posed by the financial system of the advanced economies simply did not register until it was too late.

The consistent failure to deliver adequate fiscal policy responses to the crisis after 2008 went against all the preconceptions of 1970s MIT-style macroeconomics.

Where were the spendthrift politicians when you needed them? The fiscal undershoot by the Obama administration could perhaps be explained by miscalculation and Republican partisanship. But the fact that a centrist majority in the heart of Europe, faced with dangerous populist challenges from the left and right, would choose to die on the hill of budget balance was not part of the plan.

It was up to the ECB to act. In 2015, to the horror of German conservatives, Draghi finally launched a QE program. This was a technical economic measure. But it had spectacular political effects. It enabled the European Council to play hardball with the radical left-wing government in Greece without causing the bond markets to panic. One might say it marked the Americanization of the ECB.

Seven years on from the collapse of Lehman Brothers, a majority on the Fed board was swinging toward tightening. The point was not so much that the U.S. economy needed restraining as that they were deeply uncomfortable with interest rates remaining at zero. It stoked speculation in financial markets and gave the Fed nowhere to go if it needed to counter a downturn. Negative interest rates along the lines adopted by Japan were not something that the Fed wanted to contemplate.

The basic framework of 1970s macroeconomics that framed Draghi and Yellen's training and outlook, like that of the rest of their cohort, was that properly structured markets would take care of growth. Well-regulated financial systems were stable. The chief priority for economists was to educate and restrain politicians to ensure that inflation remained in check and public debts were sustainable.

Financial instability is a mortal risk. For now, it is being held at bay. But the world saw as recently as March 2020 how rapidly even the largest financial market—the market for U.S. Treasurys—can be destabilized. To tame that risk, the Fed and the ECB, under Yellen's and Draghi's non-economist successors—Jerome Powell and Christine Lagarde, respectively—have adopted

an astonishingly undogmatic and expansive approach to stabilization.

The Italian political class is abdicating in favor of a retired, unelected official in his 70s.

Faced with a decisive historical challenge—restarting growth after decades of stagnation—Italy’s political class has chosen to delegate executive power to someone who has never been elected to office. It is the ultimate victory of technocracy but also a do-or-die challenge.

The truly strategic challenge facing progressive politics in the United States as in Europe is to find a new model of inclusive and environmentally sustainable economic growth

In the 1990s, you didn’t need to be a naive exponent of the post-Cold War end-of-history argument to think that the direction of travel for global politics was clear. The future belonged to globalization and more-or-less regulated markets. The pace was set by the United States. That enabled technocratic governments to be organized around a division between immediate action and long-term payoff. That was the trade-off that Draghi evaluated in his MIT Ph.D. in the 1970s. The drama of Draghi and Yellen’s final act is that for both of them, and not just for personal reasons, the trade-off is no longer so clear-cut. If the short-term politics fail, the long-term game may not be winnable at all. “Whatever it takes” has never meant more than it does today.

Toozé (2021) Draghi/Yellen - Can they control what comes next?

34.2 TechFare

Bhagat

Big Tech has long thrived on regulatory evasion and the exploitation of legal grey areas.

In this literature, then, the tendency is to assume that it is an absence of state intervention that has underpinned the technology industry’s growing economic (and political) power. With our conception of techfare, however, we aim to push beyond these explorations of how Big Tech evades state control. Instead of focusing on state absences, we set out to highlight an equally significant dynamic: how the technology industry has become deeply entwined with the activities of the neoliberal state.

As is well known, neoliberalism has yielded specific forms of state intervention to discipline and normalize the surplus population and to regulate social insecurity. Filling the void left by the retrenchment of social and welfare spending, these forms include Jamie Peck’s workfare, Susanne Soederberg’s debtfare, and Loïc Wacquant’s prisonfare. As the technology industry has inserted itself more deeply into consumer credit markets and surveillance activities, it has augmented both debtfare (which normalizes and encourages reliance on private

sources of credit to augment wages and regulate social insecurity) and prisonfare (which criminalizes poverty through policies that extend the reach of the police, courts, jails, and prisons). And, as the two vignettes below show, it has done so in ways that not only support the ongoing efforts of the neoliberal state, but that also underpin the growth and profitability of Big Tech itself.

The penetration of Big Tech into the realm of consumer finance has clear parallels with what Gabor and Brooks (2017) call the fintech-philanthropy-development nexus. Gabor and Brooks argue that fintech has accelerated the financial inclusion of the poor and enhanced financial institutions' ability 'to bank the unbanked. Big Tech, too, is adopting these logics of financial inclusion: the technology giants have vast stores of user data and trusting consumer bases that have allowed them to extend financial services globally. For instance, the total alternative credit model—a combination of fintech and lending by Big Tech companies—reached \$800 billion in 2019. In Asia, Africa, and Latin America the presence of Big Tech credit grew rapidly, coinciding with the decline of fintech credit volumes due to market regulation in China.

Our snapshots surrounding consumer finance and surveillance act as central examples of arenas where techfare augments extant modes of neoliberal regulation in the face of social insecurity. In aligning with debtfare, we are interested in how the vacuum left by welfare retrenchment and the decline of traditional financial actors has paved the way for Big Tech to become a player in consumer finance through new innovations on payday loans, credit cards, and other lending services that explicitly target low-income earners. In relation to prisonfare, we also highlight how Big Tech profits off of surveillance by extending the carceral state to the level of the neighbourhood and the household. Facial recognition is often seen as a public safety tool. But its potential to erode privacy and criminalize vast numbers of people while generating both revenue and data for Big Tech is an important direction for future research.

Bhagat (2021) The Techfare State: The 'New' Face of Neoliberal State Regulation

34.3 How Asia Works

Smith on Studwell

I like How Asia Works because it tells a coherent story about how countries get rich. Basically, Studwell says it's a three-step process:

1. Land reform: Forcibly buy up tenant farms from landlords and give it to the tenants; this increases farm productivity per unit of land area, gives rural people more to do, provides small farmers with some startup capital should they choose to sell their farms and move to town, and pushes landlords themselves to move to cities and use their talents to start more productive businesses.

2. Export discipline: Push companies to export instead of just selling domestically. Cut off support to companies that try to export and fail. This will push companies to increase productivity in order to compete in world markets, especially by learning foreign technology.
3. Financial control: Push banks to support exporters instead of putting their money into real estate bubbles and the like.

It's very difficult to test whether this model really works, or whether the successful development of countries like South Korea and Taiwan was due to something else. We can look at evidence for pieces of the theory — for example, the idea that small farms tend to be more productive than medium-sized ones seems fairly well-supported in the data, and there's also some evidence that pushing companies to export does cause them to raise their productivity.

But Studwell's model is so complex that it's hard to test all the pieces together. And if you need all the pieces in place — for example, if export promotion doesn't work without the "discipline" of winding up failing firms, or if land reform fails if you don't allow farmers to sell their land, or if export discipline itself doesn't work without land reform — then testing the pieces individually won't give us the answers we want.

Because it's so hard to test, the theory serves less as a tried-and-true policy prescription and more as a launching point for ideas about how to manage a developing economy

Smith on Krugman, Fujita and Venables' *The Spatial Economy*

We might start to wonder if successful development policies simply determine countries' place in a queue. My longtime readers will also know that in addition to How Asia Works, I love Krugman, Fujita, and Venables' *The Spatial Economy*. And in the final section of that (highly technical) book, the authors turn what was a humble theory of urbanization into a grand theory of global development. And the upshot of that grand theory is that countries have to basically wait in line to get rich. There's just no way for them to all hop on the rapid industrialization train all at once. Better policy can let you cut to the front of the line, but then the countries you cut in front of are out of luck.

This is a highly stylized, pretty speculative theory, which is even harder to prove than Studwell's. But it kinda-sorta fits the observed pattern in Asia — first Japan and Hong Kong and Singapore grew quickly, then Taiwan and South Korea, then China, now Vietnam and Indonesia. Malaysia and Thailand got a head start on China but then slowed down after the financial crisis of '97, while China accelerated — perhaps because China "cut in line" in front of the Southeast Asian tigers. But now, with China slowing down, perhaps Malaysia is back at the front of the line.

Anyway, this would be a depressing, fatalistic sort of world, where development is a zero-sum-game in the short term. Hopefully it's not true — I'd much rather

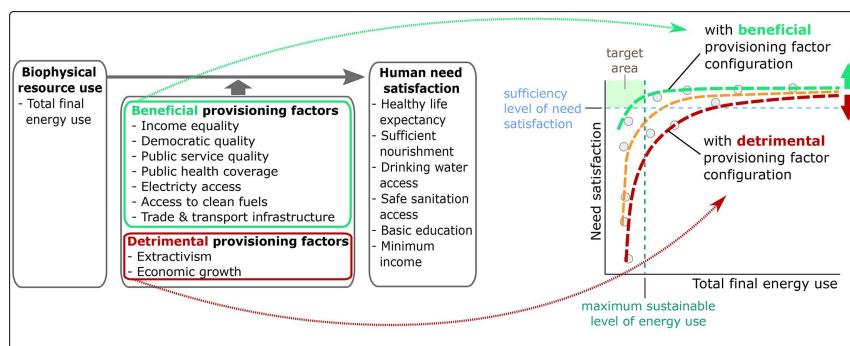
believe in a Studwellian world where the right smart growth policies can boost lots of countries at once. But we may never know which is right.

Noah Smith on joe Studwell

34.4 Social Provisioning of Needs

Vogel Abstract

Meeting human needs at sustainable levels of energy use is fundamental for avoiding catastrophic climate change and securing the well-being of all people. In the current political-economic regime, no country does so. Here, we assess which socio-economic conditions might enable societies to satisfy human needs at low energy use, to reconcile human well-being with climate mitigation. Using a novel analytical framework alongside a novel multivariate regression-based moderation approach and data for 106 countries, we analyse how the relationship between energy use and six dimensions of human need satisfaction varies with a wide range of socio-economic factors relevant to the provisioning of goods and services ('provisioning factors'). We find that factors such as public service quality, income equality, democracy, and electricity access are associated with higher need satisfaction and lower energy requirements ('beneficial provisioning factors'). Conversely, extractivism and economic growth beyond moderate levels of affluence are associated with lower need satisfaction and greater energy requirements ('detrimental provisioning factors'). Our results suggest that improving beneficial provisioning factors and abandoning detrimental ones could enable countries to provide sufficient need satisfaction at much lower, ecologically sustainable levels of energy use. However, as key pillars of the required changes in provisioning run contrary to the dominant political-economic regime, a broader transformation of the economic system may be required to prioritise, and organise provisioning for, the satisfaction of human needs at low energy use.



Vogel Memo

Our analytical framework conceptualises the provisioning of human needs satisfaction in an Ends–Means spectrum. Our framework considers energy use as a

means, and need satisfaction as an end, with provisioning factors as intermediaries that moderate the relationship between means and ends. We thus operationalise O'Neill et al.'s (2018) framework by reducing the sphere of biophysical resource use to energy use (for analytical focus), and reducing the sphere of human well-being to human need satisfaction (for analytical coherence). Our operationalisation of human need satisfaction follows Doyal and Gough's (1991) Theory of Human Need, reflecting a eudaimonic understanding of well-being as enabled by the satisfaction of human needs, which can be evaluated based on objective measures.

Only 29 countries (28%) in our sample reach sufficient levels in all need satisfaction dimensions assessed here (health, nutrition, drinking water access, safe sanitation, education, minimum income). Each of these need-satisfying countries uses at least double, many even quadruple, the 27 GJ/cap deemed the maximum level of energy use that could be globally rendered sustainable. Our bivariate regression analysis confirms that while energy use is significantly correlated with need satisfaction, high levels of energy use seem neither necessary nor particularly beneficial for need satisfaction. Whereas at low levels of energy use, need satisfaction steeply increases with energy use, need satisfaction improvements with additional energy use quickly diminish at moderate levels of energy use and virtually vanish at high levels of energy use.

High energy use alone is not sufficient to meet human needs. At low to moderate levels of energy use, there is a large spread in observed need satisfaction outcomes, which cannot be explained by energy use alone.

Need satisfaction outcomes are statistically better explained when a relevant provisioning factor is included as an intermediary that moderates the relationship between need satisfaction and energy use. Across multiple dimensions of human need, the relationship between need satisfaction and energy use varies significantly and systematically with the configuration of certain provisioning factors.

We distinguish three types of provisioning factors. *Beneficial provisioning factors* are associated with socio-ecologically beneficial performance (higher achievements in, and lower energy requirements of, human need satisfaction). Countries with high values of a beneficial provisioning factor tend to achieve higher levels of need satisfaction at a given level of energy use, and tend to reach a particular level of need satisfaction with lower levels of energy use, compared to countries with median values of the provisioning factor. *Detrimental provisioning factors* are associated with socio-ecologically detrimental performance (lower achievement in, and greater energy requirements of, human need satisfaction). Countries with high values of a detrimental provisioning factor tend to exhibit lower need satisfaction at a given level of energy use, and tend to reach a particular level of need satisfaction only at higher levels of energy use, compared to countries with median values of the provisioning factor. Lastly, non-significant provisioning factors do not show significant interactions with the relationship between energy use and need satisfaction.

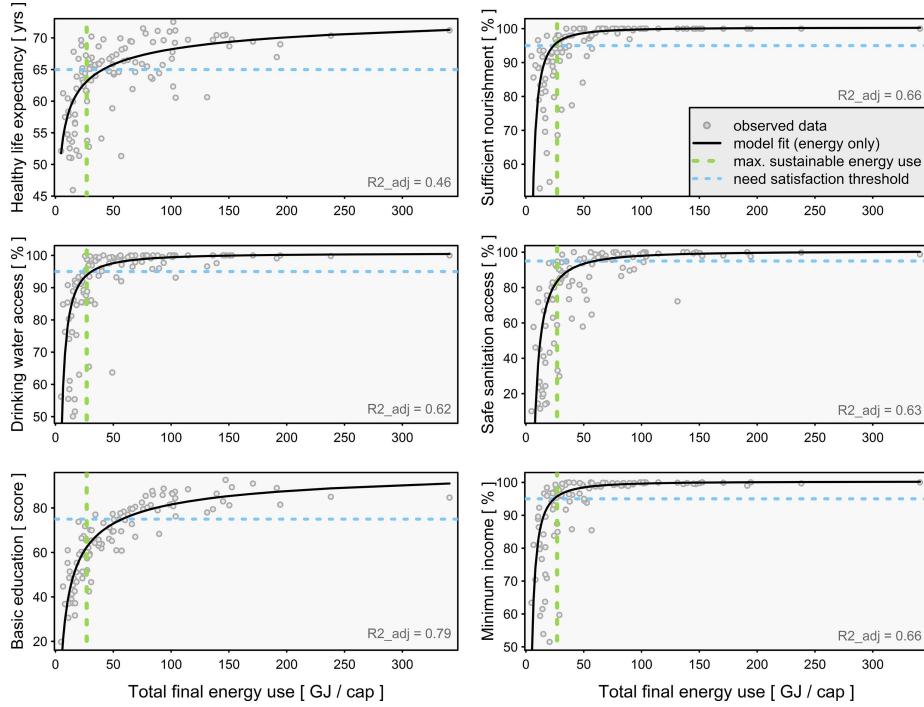


Figure: Most human needs are currently not sufficiently met within sustainable levels of energy use. Cross-country relationships between different need satisfaction variables (y) and total final energy use (x) are shown as black lines, with data shown as grey dots. The green dashed line illustrates the 27 GJ/cap deemed the maximum level of energy use that can globally be rendered sustainable. Thresholds for sufficient need satisfaction are shown by the dotted blue lines. R^2_{adj} is the coefficient of determination, adjusted for the number of predictors.

Vogel (2021) Socio-economic conditions for satisfying human needs at low energy use: An international analysis of social provisioning (pdf)

35

Economic Measurements

35.1 Our BESDA economy

35.1.1 GDP and EBITDA

While the deficiencies of GDP as a measure have been well known, less emphasized has been the fact that every single financial statement with which we build GDP exhibits the same deficiency of being a limited barometer of value. Ironically, the main users of these financial statements, in the business and financial sectors, are wise to the incompleteness of certain metrics within financial statements, but act in a way that indicates they are oblivious – or perhaps just willing to overlook – the incompleteness of financial statements writ large. To explain, consider that GDP exhibits clear parallels with the profit metric of EBITDA (earnings before interest, taxes, depreciation and amortization). Though there are technical differences of formulation, GDP and EBITDA both represent partial measures of “wealth creation” disembedded from a fuller conception of value. However, while financiers are wise to the deficiencies of EBITDA, they have not acknowledged that the same pattern of incompleteness reappears at the level of the overall financial statement – and then at the yet higher level of GDP. With the “DA”, EBITDA conveys the profitability of a company as if it would never again have to spend a dollar on keeping its factories, equipment, property and software in good repair and up to date. In other words, EBITDA excludes the cost of maintaining in good condition the whole infrastructure upon which a company depends! It is the homeowner’s fantasy of how wealthy they would be if they never had to fix or repair anything in their house ever again.

EBITDA came to prominence during the leveraged buyout (LBO) boom of the 1980s. As Moody’s recounted in 2000: “LBO sponsors and bankers have promoted the use of EBITDA for its obvious image benefits. EBITDA creates the appearance of stronger interest coverage and lower financial leverage.” As a general rule, beware profit metrics promising image benefits. Forbes was blunter

still: “EBITDA is essentially a tool that shows what a company would look like if it wasn’t actually that company.” EBITDA is now clearly recognized as a “wool-over-your-eyes” measure, such that accounting authorities deny it official status. It is a “non-GAAP” metric – not a Generally Accepted Accounting Principle. Its ongoing ubiquity – besides being trivially easy to calculate – is because it masks the fact that a business may be overleveraged – that it may have borrowed against its future more than it can ever repay.

GDP is a “wool-over-all-of-our-eyes” metric for the same reason that it excludes the full cost of maintaining in good condition the social and ecological infrastructure upon which the whole economy depends. In steering society by GDP, we are effectively managing the planet on an EBITDA basis. GDP is not just a benignly incomplete measure of wealth, it is the tool with which we are conning ourselves.

Businesspeople – and homeowners - know how these stories end. Eventually the under- investment in infrastructure catches up with you. Of course, by then, you hope to have passed the asset – and the problem – on to someone else. This is feasible, if not best form, where the asset is not the whole planet. The deception works for as long as you can get away with the under-investment and the factories and software hold up. Buffet’s partner, Charlie Munger, is characteristically more forthright on the topic: “I think that, every time you see the phrase ‘EBITDA earnings’, you should substitute the phrase ‘bullshit earnings.’” By analogy, GDP is “bullshit wealth”. That we have been able to enjoy the comforts of its deception without mishap for so long is simply because it was introduced against higher levels of social and ecological infrastructure that we have not yet completely run down. The under-investment is only now becoming apparent.

35.1.2 A BESDA economy

Long-term or ESG (environmental, social and governance) investors may protest that they understand all this but that their own investment process insulates them from such blinkered thinking. (“We don’t use EBITDA”). Yet the point is that the whole financial system is operating on a “before ecological and social depreciation and amortization” basis – call it BESDA, perhaps. So, every single financial metric on the Bloomberg screen is a BESDA metric – profits- BESDA, earnings per share-BESDA, return on capital-BESDA, return on equity-BESDA, etc. The millions of financial numbers processed daily by our increasingly automated markets – which, in turn, steer our economy and drag our culture along behind, ripping up nature in its wake – are all BESDA numbers. It might not only be EBITDA with which we are conning ourselves, but every financial number in the book. They all represent different degrees of disembedded value, some of which we have unmasked, some of which we have not. We have a sustainability challenge because the entire financial system repeats the problems of the discredited EBITDA metric at the level of the whole economy. This is

the invisible conceptual cage we have wrapped around our decision-making and from within which the ESG movement is frantically trying to make a difference. Alas, given the incompleteness of our markets, the ESG movement increasingly resembles a hopeful grafting of good intentions onto an unchallenged accounting reality that remains the largely intact source of our problems. This is the root cause of our collective “greenwish” in which we are hoping that well-intended efforts to make the world more sustainable are much closer to achieving the necessary change than they really are

TRUECOST

Trucost, the sustainable consulting firm, estimated in 2013 that large swathes of primary industry – including agriculture and energy companies – would simply not be profitable if they had to pay the full costs of their 14 environmental damage. In 2011, the American Economic Review, published similar work showing that the solid waste combustion, sewage treatment and oil- and coal-fired power production industries generated air pollution damages – air pollution alone – that were greater than 15 than their economic value added (EVA). On this fuller accounting perspective, these are effectively EVS – economic value subtracted – industries.

Duncan Austin: Pigou and the dropped stitch of economics RWER95 (pdf)

35.2 GDP

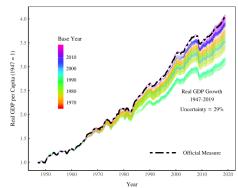
For measurement to be accurate, the units must be stable. Unlike natural scientists, however, economists are not in the business of carefully defining units using universal physical constants. Economists instead use prices, a social construct, as their unit of analysis.

The problem is that prices are unstable units of measurement. Relative prices between commodities vary wildly over time. This instability means that prices fail the only requirement of a good unit — to be uniform over time.

Instead of reporting the severe uncertainty in ‘real’ GDP, governments report a single official value. This value hides a myriad of subjective decisions that are used to ‘correct’ for unstable prices.

Instead of wasting time with a useless quantity that reveals nothing profound about the world, we should seek new pluralistic methods for understanding aggregate economic activity.

Price instability translates into uncertainty in the growth of ‘real GDP’. While the US government reports only one official measure of ‘real’ GDP, it quietly maintains a database of ‘vintage’ GDP estimates. These are estimates calculated with different base years. Using this ‘vintage’ data, we can quantify the uncertainty in the growth of ‘real’ GDP caused by unstable prices.



Notice that the official measure of US ‘real’ GDP is at the upper end of the range of uncertainty. We doubt this is a coincidence. In fact, it is common for national governments to boost GDP growth by changing the base year. India recently showed a small increase in GDP growth by choosing a new base year. While this boost was small, it can sometimes be spectacularly large. Nigeria, for instance, recently changed its base year from 1990 to 2010. As a result, real GDP doubled, making Nigeria the largest economy in Africa. Base-year changes have led to similar boosts to GDP growth in Ghana, Kenya, Tanzania, Uganda and Zambia.

The NIPA Handbook, the US Bureau of Economic Analysis notes:

The fundamental problem confronting the efforts to adjust GDP and other aggregates for inflation is that there is not a single inflation number but rather a wide spectrum of goods and services with prices that are changing relative to one another over time. The index numbers for the individual components can be combined statistically to form an aggregate index, but the method of aggregation that is used affects the movements of the resulting index.

Ambiguous

The growth of ‘real’ GDP is fundamentally uncertain. Or perhaps a better word is ambiguous.

Mainstream economists reach a very different conclusion. Their response is to simultaneously admit that calculating ‘real’ GDP requires arbitrary choices, but then to report a single value as though it was the ‘truth’.

ChainWeighting

The US government currently calculates ‘real’ GDP by adjusting nominal GDP with an aggregate index formed through the multiplication of successive Fisher indexes in adjacent time periods. In popular parlance, this method is called ‘chain-weighting’. Rather than choose a single base year in which to fix prices, chain-weighting uses a technique that resembles a rolling base year. The method is meant to simulate the effect of changing prices and spending patterns over time. This method was adopted in the mid-1990s. The official justification was that structural changes in the US economy, especially rapidly falling computer prices, compelled the government to end the fixed base year method.

GDP treats everything with a price as contributing positively to society. Again, this comes down to the assumption that all prices reveal utility. If machine guns

sell for the same price as MRI machines, neoclassical theory tells us that both contribute the same utility to society.

In response to such absurdities, ecological economists have developed alternative indicators that subtract the value of social ‘bads’ from the value of social ‘goods’. While well-motivated, this approach still assumes that we can aggregate the ‘real’ value of ‘goods’ and ‘bads’. But because prices are unstable, this aggregate is still ill-defined.

‘Real’ GDP is a regressive measure of social progress. Not only is it ill-defined and based on flawed premises, it equates market value with social welfare. This justifies the income of the powerful.

Alternatives

The key, we believe, is to separate the study of economic distribution from the study of economic scale. The former is the appropriate domain of prices. The latter is best measured using biophysical units.

Prices: Distribution

We believe it is important to distinguish between economic *distribution* and economic *scale*. ‘Real’ GDP assumes that prices can be used to measure economic scale. In contrast, we assume that prices do nothing of the sort. Prices are a tool for distributing resources. The proper place for prices, then, is for understanding economic distribution.

Scale: Energy

To measure the scale of the economy, we think it is appropriate to focus on energy. Physicist Eric Chaisson argues that energy is the universal currency of science. By measuring economic scale using energy, we put economics in line with the rest of science. And if we are concerned with sustainability, there is no better starting point than to focus on energy use. After all, the profligate use of fossil fuels under a capitalist economy is the primary driver of climate change.

Energy has many forms as it flows through society. One possibility is to focus on primary energy consumption, and see how this relates to changes in social structure. Another possibility is to measure ‘useful work’ — the consumption of end-use energy. Still another possibility is to measure the aggregate flow rate, which is a measure of all annual energy conversions in an economic system.

The study of economic growth, which should focus on biophysical flows.

Continuing to use ‘real’ GDP as a measure of social progress implicitly accepts a theory (neoclassical economics) that has long been used as an ideological justification for capitalist power.

35.2.1 GDP Revisions

Assa Abstract

What are the implications of changes in measurement standards of GDP for global convergence debates? What are the political economy implications? To answer the former question, we examine the changes in national accounting standards from the early 1990s. Revisions to the System of National Accounts (SNA) – the international standard for constructing GDP – include several major changes to how production is measured, including the reclassification of financial intermediation services, R&D, and weapons systems as productive activities – all areas in which countries in the West has had an advantage in recent decades. In addition, there has been an increase in the proportion of imputations in the 1993 and 2008 revisions, which privileges the economic structures of the West. Overall, we find that these changes have had the effect of boosting the GDP of the West relative to the rest of the world and thus to an underestimation of global convergence compared to previous measures of GDP. To answer the second question, the paper unpacks the political economy implications of national accounting standards favouring Western economies along several axes, including the impacts on voting shares in international institutions, domestic policy incentives and epistemological debates about sustainable development.

Assa and Kvangraven (2021) Measurement for Convergence Debates and the Political Economy of Development

Assa Abstract

Over the last half century, a large literature has developed on both the nature and the drivers of uneven development. While different methodologies and theoretical approaches to the issue of convergence abound, the use of GDP growth as a measure of economic growth has, remarkably, gone unquestioned. This paper reviews the convergence debates to date, and examines what the changes to the System of National Accounts (SNA) - the international standard for constructing macroeconomic indicators such as GDP - imply for assessing economic convergence. The 1993 and 2008 revisions to the SNA include several major changes to how production is measured - including the reclassification of financial intermediation services, R&D, weapons systems and owner-occupied dwellings as productive activities - all areas in which developed countries have had an advantage in recent decades. We argue that these changes to the production boundary constitute a form of ‘kicking away the ladder,’ i.e. redefining the yardstick of development to fit the new strengths of developed economies. We analyze data series for a range of countries concurrently available under the 1968 SNA, 1993 SNA and 2008 SNA standards. The earlier measure shows a larger and faster convergence of most countries in ‘the Rest’ with those of ‘the West’. Going a step further, we build on Basu and Foley’s (2013) Measured Value-Added concept as a proxy of ‘Core GDP’. This indicator omits any sector for which value-added is imputed based on net incomes, in the absence of an independent measure of output. This allows us to examine more countries

and a longer, more consistent time series than concurrent SNA data, but the conclusions are the same - developing countries have caught up more in Core-GDP terms than the contemporary imputation-heavy measure of GDP would suggest. These findings suggest that the current measure of GDP has become decoupled from core employment-generating activities, and is therefore a misleading measure of growth in an economy. Furthermore, it is inconsistent with the understanding the Sustainable Development Goals of inclusive and sustainable growth. Finally, the paper considers the political economy implications of the changes in GDP methodology, such as the justification of voting shares in international financial institutions, epistemological consequences, and domestic political economy considerations.

Assa and Kvangraven (2018) Imputing Away the Ladder: Implications of Changes in National Accounting Standards for Assessing Inter-country Inequalities (pdf)

Kvangraven

Economic growth was first measured by governments in the 17th century. In the modern era, the United Nations took over responsibility for measuring output in 1953, and was joined in 1993 by the World Bank, IMF, OECD and EU. They all feed into decisions about the international measurement rules, which are taken by the UN inter-secretariat working group on national accounts (ISWGNA), and all countries are meant to comply. This reflects a gradual move away from national governments controlling the statistics to financial institutions having a larger say.

Both in 1993 and again in 2008, the so-called “production boundary”, which determines what is included in GDP, was broadened by the ISWGNA to include many activities that were hitherto excluded or at most seen as intermediate inputs.

Thanks to these reforms, financial intermediation, research and development, and the production of weapons all began to be counted within GDP data across the world. For example, in 1993 the income banks earned on interest from lending to households was included in GDP for the first time. And then in 2008, even bank money that had nothing to do with intermediation services began to be included.

Since western countries such as the UK and US have specialised in these activities in recent decades – the US is first in weapons and second in financial services and R&D, while the UK leads on financial services – the changes have disproportionately benefited their GDP numbers.

Kvangraven in The Conversation

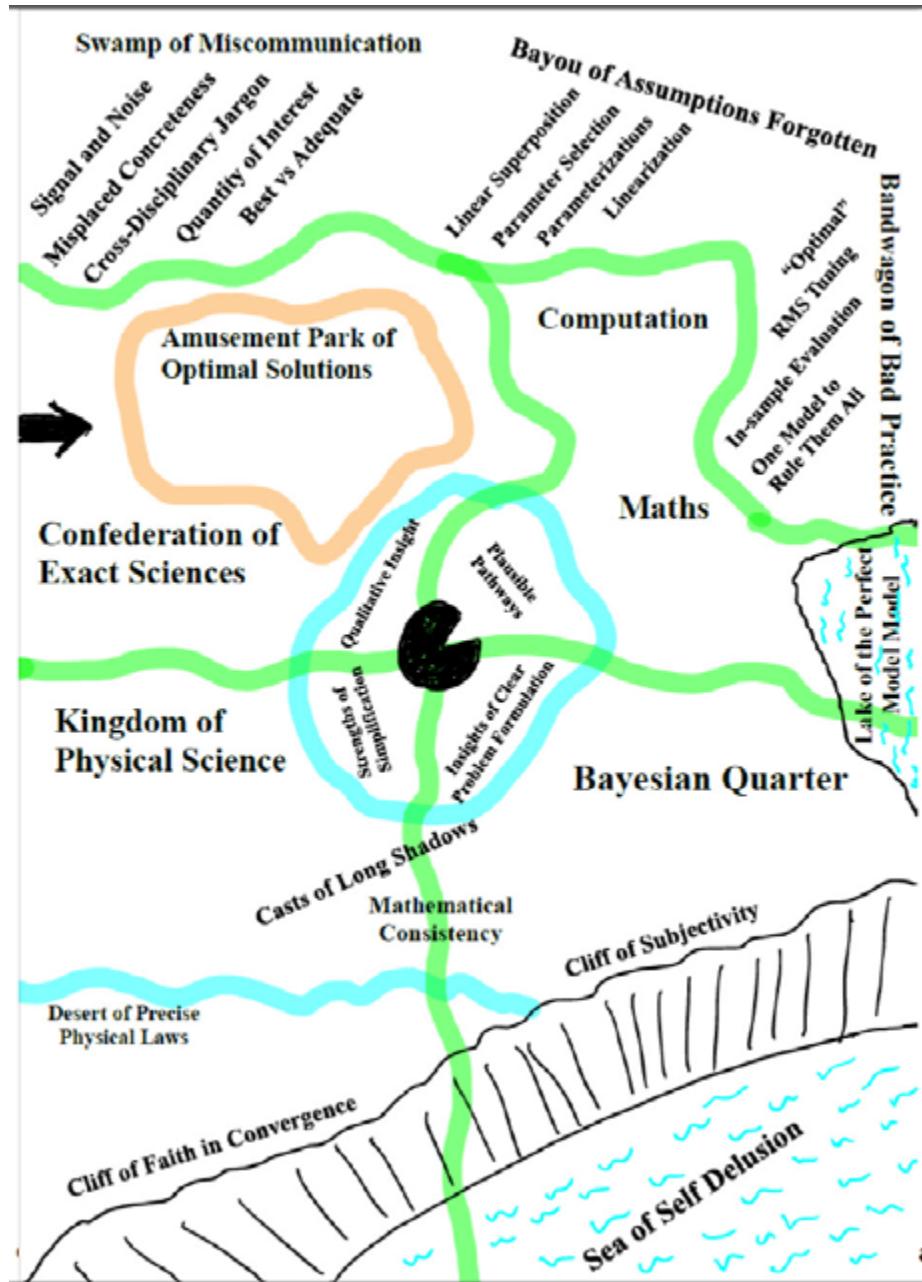
36

Economic Modelling

36.1 Model-land

Thompson Abstract

Both mathematical modelling and simulation methods in general have contributed greatly to understanding, insight and forecasting in many fields including macroeconomics. Nevertheless, we must remain careful to distinguish model-land and model-land quantities from the real world. Decisions taken in the real world are more robust when informed by estimation of real-world quantities with transparent uncertainty quantification, than when based on “optimal” model-land quantities obtained from simulations of imperfect models optimized, perhaps optimal, in model-land. The authors present a short guide to some of the temptations and pitfalls of model-land, some directions towards the exit, and two ways to escape. Their aim is to improve decision support by providing relevant, adequate information regarding the real-world target of interest, or making it clear why today’s model models are not up to that task for the particular target of interest.



Thompson (2019) Escape from Model-land (pdf)

36.2 End of Theory

Bookstaber

The End of Theory: Financial Crises, the Failure of Economics, and the Sweep of Human Interaction

Our economy may have recovered from the Great Recession—but not our economics. In The End of Theory, Richard Bookstaber discusses why the human condition and the radical uncertainty of our world renders the standard economic model—and the theory behind it—useless for dealing with financial crises. What model should replace it? None. At least not any version we've been using for the past two hundred years. Instead, Bookstaber argues for a new approach called agent-based economics, one that takes as a starting point the fact that we are humans, not the optimizing automatons that standard economics assumes we are.

Bookstaber's groundbreaking paradigm promises to do a far better job at preventing crises and managing those that break out. As he explains, our varied memories and imaginations color our economic behavior in unexpected hues. Agent-based modeling embraces these nuances by avoiding the mechanistic, unrealistic structure of our current economic approach. Bookstaber tackles issues such as radical uncertainty, when circumstances take place beyond our anticipation, and emergence, when innocent, everyday interactions combine to create sudden chaos. Starting with the realization that future crises cannot be predicted by the past, he proposes an approach that recognizes the human narrative while addressing market realities.

Sweeping aside the historic failure of twentieth-century economics, The End of Theory offers a novel and innovative perspective, along with a more realistic and human framework, to help prevent today's financial system from blowing up again.

Bookstaber (Book Page)

36.3 Jackson-Victor

The “new normal”: Hyper-Capitalism, Proto-Socialism, and Post-Pandemic Recovery

Jackson Abstract

Post-pandemic recovery must address the systemic inequality that has been revealed by the coronavirus crisis. The roots of this inequality predate the pandemic and even the global financial crisis. They lie rather in the uneasy relationship between labor and capital under conditions of declining economic growth, such as those who have prevailed in advanced economies for almost half a century. This paper explores the dynamics of that relationship using a simple stock-flow consistent (SFC) macroeconomic model of a closed economy.

It examines in particular the role of two key factors—the savings rate and the substitutability (elasticity of substitution) between labor and capital—on the severity of systemic inequality under conditions of declining growth. The paper goes on to test the efficacy of three redistributive measures—a graduated income tax, a tax on capital and a universal basic income—under two distinct structural scenarios for an economy with a declining growth rate. We find that none of these measures is sufficient to control structural inequality when institutions aggressively favor capital over labor (hyper-capitalism). Taken in combination, however, under conditions more favorable to wage labor (proto-socialism), these same measures have the potential to eliminate inequality, almost entirely, even as the growth rate declines.

Jackson Memo

The two key structural factors, which determine the evolution of inequality under a declining growth rate, are (1) the savings rate and (2) the elasticity of substitution between labor and capital. Depending on the configuration of these factors, two radically different futures may emerge. Under one future, which we have described here as “hyper-capitalism” (Scenario 1), a constant savings rate and high substitutability between capital and labor lead to accelerating inequality, even under a progressive combination of redistributive measures. Under another kind of future, which we describe as proto-socialism (Scenario 2), a declining savings rate and low substitutability between capital and labor, lead to declining inequality, which in combination with progressive redistributive policies, have the potential to eliminate inequality almost completely.

Hyper-capitalism is likely to emerge in a world where labor is increasingly (and easily) substituted with capital and the interests of the owners of capital are privileged over the rights of workers. These privileges encourage capitalists to continue to save even as the growth rate declines, leading to a rising capital to output ratio and an escalating inequality. Such a scenario could, for example, accompany a world in which an aggressive drive towards automation or the implementation of artificial intelligence (AI) by monopolistic companies removes the need for wage labor across large swathes of the economy. Failure to protect the livelihoods of the immiserated work force facilitates continued savings and investment by asset owners. By the same token, it concentrates incomes (and wealth) increasingly in a minority of the population, leading to the kinds of dystopian trends in inequality illustrated in Scenario 1. Proto-socialism on the other hand aims for strong institutions to protect the rights of workers, introduce a job guarantee, and establish an adequate minimum wage. Such interventions slow down the substitution of capital for labor. Attempts by capitalists to maintain a constant savings rate under these conditions lead (Figure 3a) to a dramatic collapse in the rate of return on investment, and a partial reversal in the relative fortunes of workers and capitalists. Faced with the prospect of declining rates of return, these conditions are more likely to lead to a decline in the rate of savings (Scenario 2) and a reduction in the capital intensity of the economy, features that will reinforce a more equal distribution

of incomes. In short, proto-socialism is likely to involve a transition away from resource-intensive mass production processes and toward the evolution of an economy of quality and service (Jackson, 2017). It might well also involve institutional innovations which better represent the interests of workers in the management of firms (Ferrera, 2017), better distribute the rewards of innovation to the populace (Varoufakis, 2016) and allow government to operate as an “employer of last resort” (Minsky, 1986). It will not have passed unnoticed that the sectors that emerge stronger under proto-socialism are precisely the labor-intensive sectors associated with care, distribution and maintenance—the frontline services of the pandemic—described at the beginning of this paper. Other labor-intensive sectors such as those associated with crafts, creativity, and community-based recreation and leisure (Jackson, 2021) are also likely to flourish under these conditions. Proto-socialism, in other words, could provide a robust basis for a post-pandemic recovery—even under conditions of low-growth.

Jackson (2021) Confronting inequality in the “new normal” : Hyper-capitalism, proto-socialism, and post-pandemic recover (pdf)

Thanks to ? and Peter Victor. This paper is crucial to challenging the assumption, represented in the IPCC’s existing scenarios, that slower growth rates mean rising inequality. It all depends on policy, and the power of labour vis-à-vis capital. (Jason Hickel)

36.4 Eurogreen Model

Feasible alternatives to green growth

Abstract D’Alessandro

Climate change and increasing income inequality have emerged as twin threats to contemporary standards of living, peace and democracy. These two problems are usually tackled separately in the policy agenda. A new breed of radical proposals have been advanced to manage a fair low-carbon transition. In this spirit, we develop a dynamic macrosimulation model to investigate the long-term effects of three scenarios: green growth, policies for social equity, and degrowth. The green growth scenario, based on technological progress and environmental policies, achieves a significant reduction in greenhouse gas emissions at the cost of increasing income inequality and unemployment. The policies for social equity scenario adds direct labour market interventions that result in an environmental performance similar to green growth while improving social conditions at the cost of increasing public deficit. The degrowth scenario further adds a reduction in consumption and exports, and achieves a greater reduction in emissions and inequality with higher public deficit, despite the introduction of a wealth tax. We argue that new radical social policies can combine social prosperity and low-carbon emissions and are economically and politically feasible.

D'Alessandro (2020) Feasible alternatives to green growth (Paywall) SI (pdf)

D'Alessandro Presentation

Green Growth

The main response to the global challenges posed by climate change are currently based on Green Growth policy proposals, namely:

- mainstream and institutional paradigm focused on technological optimism;
- market-oriented view: trickle-down effect should improve welfare and job creation;
- one-size-fits-all solution: GDP growth

Critiques to the ability of market mechanisms and innovations to:

- foster material decoupling (Wiedmann, 2015)
- meet planetary boundaries (Steffen, 2015, O'Neill, 2018)
- avoid critical transitions (Scheffer, 2012)
- ensure social justice: within-country inequality (Piketty, 2014)
- overcoming the rebound effect: % RES and CO2 per capita

Green Deal

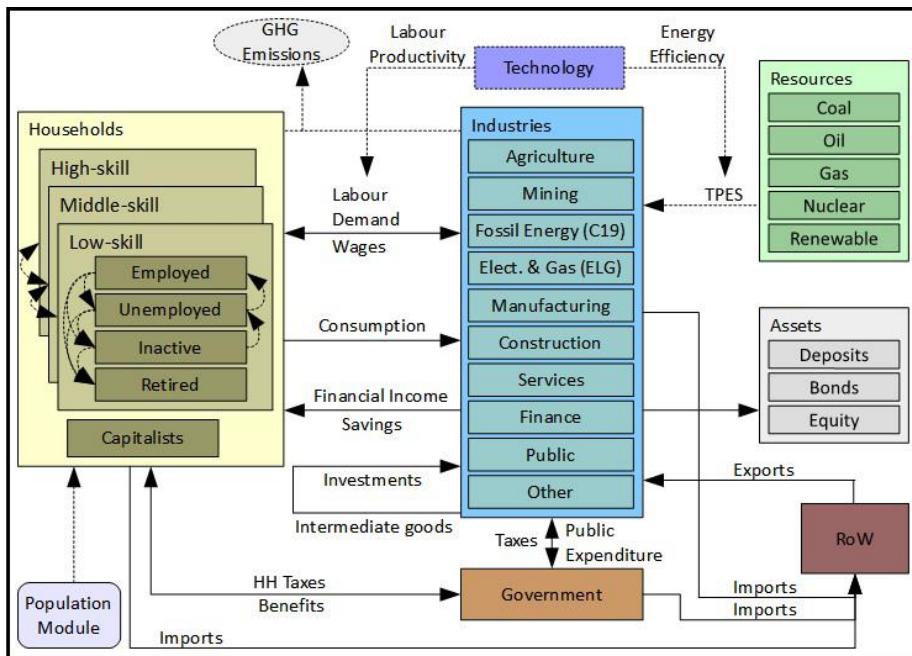
Recognizes the need to address inequality and environmental issues in a unified perspective combining social policies with green growth measures

Post-Growth

Advocates that continuous economic growth and ecological sustainability are incompatible: down-shift of economic scale. Social policies becomes essential to face inequality

EUROGREEN

A macrosimulation model tailored to compare the long-run effects, synergies and trade-off of these three alternative narratives.



Indicators

GHG emissions with respect to 1990. Targets: -40% in 2030 and -80% in 2050 • Gini coefficient for income inequality: from 0% (no ineq.) to 100% (max ineq.). Computed over 13 groups (3 skill by 4 work status + capitalists) including incomes from labour, financial assets and wealth • Deficit/GDP: fiscal sustainability • GDP growth • Unemployment: total and by skill • Energy Mix: shift in source composition in electric power generation and TPES.

Discussion

- Our results suggest that there are no win-win solutions • Similar reductions in emissions can result in radically different social consequences in terms of income distribution, employment, and fiscal stability. • Green Growth Paradox The effectiveness of GHG reductions depends on the failure to promote GDP growth.
- Techno-scepticism: Environmental policies alone fails to deliver the advocated improvements in employment and income distribution • Radical social policies (JG and WTR) can combine social prosperity and low-carbon emissions • Lower aggregate demand helps emission target achievement

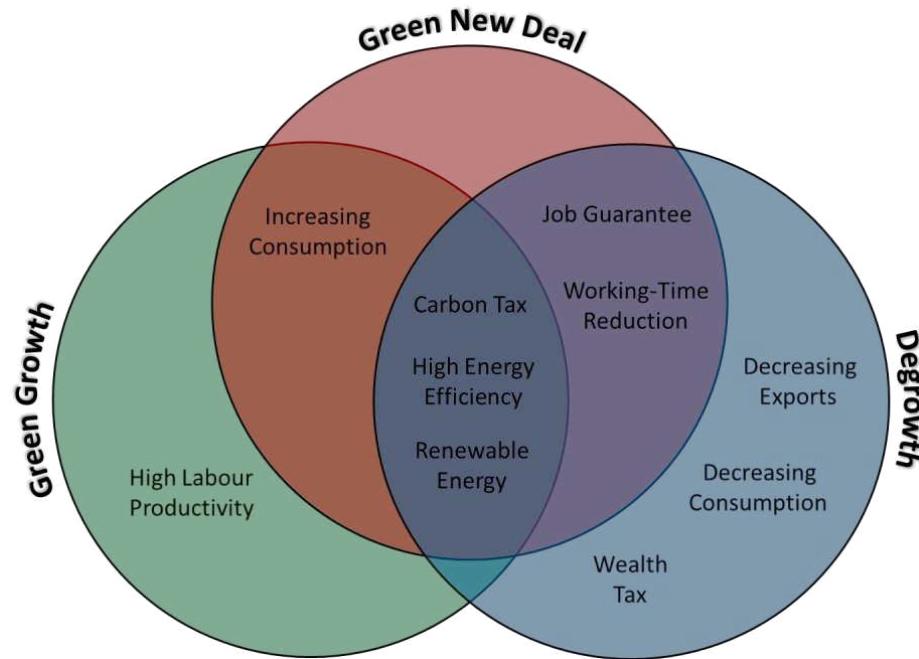
D'Alessandro (2020) feasible Alternatives - Presentation (pdf)

O'Neill

** 'Green Growth' will increase inequality and unemployment unless accompanied by radical social policies.**

The economy is embedded within society, which is in turn embedded within

the biosphere. Economic processes are therefore analysed in terms of flows of biophysical resources and social outcomes not just in terms of flows of money, as in conventional macroeconomic models.



Ecological macroeconomic models allow for multiple non-substitutable goals to be explored (e.g. sustainability, equity, and human well-being). These models have been developed to address issues such as the link between growth and inequality 5 and the effect of climate change on financial stability.

Green growth reduces greenhouse gas emissions, but inequality and unemployment both rise. The Green New Deal dramatically lowers unemployment and reduces inequality, but at the expense of an increase in the government deficit-to-GDP ratio. Degrowth reduces emissions and inequality further than the other two scenarios, but it leads to a higher increase in the deficit-to-GDP ratio (because GDP decreases). In short, there is no win-win scenario.

These results have important implications. First, they suggest that a purely market-based green growth strategy is likely to have serious negative side effects. These side effects may be corrected by complementing environmental policies with strong social policies, such as working-time reduction, a guaranteed jobs programme, and a wealth tax. Second, the results suggest that degrowth can dramatically reduce environmental impact and lead to improved social outcomes (e.g. more leisure time, higher employment, greater equality), provided the appropriate policies are in place. Third, a Green New Deal, with an explicit focus on achieving a just transition 7, may represent a compromise that advocates of both green growth and degrowth can support.

The Eurogreen Model makes a number of important contributions, but like any model it also has limitations. Importantly, the model does not assess whether the degree of decoupling assumed in its green growth scenario is actually possible, an assumption that has been challenged empirically.

The degrowth scenario does not include a number of additional changes that have been put forward by degrowth authors, such as alternative business models, new measures of progress, or public money creation 9 . For example, central banks could potentially create money to help fund a low-carbon transition (as they created money to bail out the banks), which would reduce the government deficit.

We need to choose our economic policies carefully. We cannot expect economic growth to deliver sustainability, or green growth to deliver social equity. If we want to achieve a sustainable and just society, then we need to move beyond the pursuit of growth, and target these outcomes directly.

ONeill (2020) Beyond Green Growth (pdf)

Russel (2020) Climate crisis: Is it time to ditch economic growth? (DW)

Mudge (2020) Fact check: Does climate protection stifle economic growth?

37

Agent Based Macro

Poledna Abstract

We develop the first agent-based model (ABM) that can compete with benchmark VAR and DSGE models in out-of-sample forecasting of macro variables. Our ABM for a small open economy uses micro and macro data from national and sector accounts, input-output tables, government statistics, census and business demography data. The model incorporates all economic activities as classified by the European System of Accounts as heterogeneous agents. The detailed structure of the ABM allows for a breakdown into sector level forecasts. Potential applications of the model include stress-testing and predicting the effects of changes in monetary, fiscal, or other macroeconomic policies.

Poledna (2021) Economic Forecasting with ABM (pdf)

38

Cost Benefit Analysis

Spash

Decades ago environmental CBA developed a range of methods for imputing monetary values, but with limited applicability under specific conditions (Hanley & Spash, 1993; Spash, 2005). For a start, these methods only apply to marginal changes in environmental goods or services, not least because the value of money itself (its marginal utility) alters when there are large changes affecting income; also, economic welfare measures assume other things (e.g. all other prices) remain the same which is violated by large changes. Clearly things like mass extinction of species and human induced climate change are not small, marginal, changes. Two approaches are employed by social CBA: revealed and stated preference methods. The first relies upon existing markets that can be associated with environmental attributes (e.g. air pollution affecting house prices) and so is severely restricted. The second uses surveys designed to illicit, primarily, willingness-to-pay for environmental changes. Dasgupta attends to one stated preference approach: the contingent valuation method (CVM). He claims that: ‘CVM is attractive because it appeals to our democratic instinct, that people should be asked for their opinion on matters that may be of concern to them’ (Dasgupta, 2021, p. 304). In addition, the CVM is promoted as widely applicable (unbounded by existing markets) to revealing values for everything from aesthetics to biodiversity loss. The ability to include a range of value categories contributing to an individual’s utility extends to including: ‘respondents’ sense of a species’ existence value—perhaps even its intrinsic value’ (Dasgupta, 2021, p. 304). Normally environmental economists define a set of four values: direct use, option, existence and bequest value. However, Dasgupta (Dasgupta, 2021, p. 301), for no apparent reason, claims a different set of six sources of value for biodiversity that mix-up objects of value with types of values. While all his examples are consequentialist and based on creating utility for humans, he confuses concepts of existence value with sacred values, moral worth and intrinsic value. So let us turn to the value problems.

Economic welfare theory requires that people should be compensated, not pay, for an environmentally degrading imposition on them (e.g. pollution, biodiversity loss). However, this is generally not undertaken because people could ask large sums, destroying the economic calculus, so economists prefer to restrict respondents replies to their income (i.e. ability to pay) regardless of their own theoretical requirements for validity. Besides being the incorrect measure, willingness-to-pay is not a democratic approach seeking an opinion, as claimed by Dasgupta. Despite their attempts to control respondents, CVM produces results deemed unacceptable because people appear willing-to-pay too much or refuse to bid (i.e. protest).

Attempts have then been made to redesign the surveys to get the responses economists want and hence they developed choice experiments, cited as a problem solving advance by Dasgupta (2021, p. 304). Here respondents have restricted ability to protest, or violate the economists model of how they should behave, and can only refuse to answer completely and fall into the ignored non-respondent category. Failing ‘success’ with survey design, collected data may be subject to manipulation to get the desired values.

The welfare economics underlying social CBA assumes that all values can be reduced to individual preferences as expressions of utility.

Refusing to make trade-offs is also a principled position disallowed by mainstream economics or treated as an anomaly.

The valuation question of social CBA, ‘what is your maximum willingness-to-pay for more/less X?’, implicitly assumes there is no moral objection to the question itself.

More frogs do not equate to fewer tigers. What then is ‘natural capital’?

Health (mortality/morbidity) as a capital investment is even worse. Producing money numbers here requires the conjuring trick of talking about abstracted non-real people who are represented as ‘statistical lives’, under the VSL. For example, the results are used in transportation assessment to decide upon road building programmes and the installation of safety equipment. However, the public rejection of this approach is exposed when there is a train crash, people are killed and the public discover the lack of safety equipment is due to the calculation that it cost more than the expected fatalities times the VSL. Politicians rarely defend the numbers in such circumstances, although their transport departments may continue to use them on a daily basis.

IPCC

A major example of the failings of VSL arose during the third assessment report of the Intergovernmental Panel on Climate Change (IPCC). Willingness-to-pay informed VSL, based on Fankhauser (1995, p. 47), gave a range from \$0.2–\$16.0 million with an average of \$3 million, and \$1.5 million adopted as the VSL for developed countries. Adjustment was made for income to give ‘an arbitrary value of \$300,000 for middle income and \$100,000 for low income countries’. The

result was a factor of fifteen difference between VSL in high (\$1.5 million) and low (\$0.1 million) income countries. A storm raged when the IPCC chapter employing this approach appeared (see Spash, 2002a, Chapter 7). Representatives from industrially developing nations, led by India and China, refused to accept the report citing it as absurd, discriminatory, unethical, technically inaccurate and anti the poor.

Shortly after the IPCC VSL controversy a prime example of commensurability problems arose when CBA was applied to climate change by Nordhaus (1998a, 1998b). He claimed increased morbidity/mortality would be outweighed due to increased leisure opportunities by a factor of 30 to 10 in China and by 38 to 3 in the USA. An example Nordhaus was using at the time concerned claiming that golfers may view global warming as a boon to year-round recreation. So, if we extend this logic to global studies, more golfing days in Florida could compensate for dead people in China. The commensuration of values in The Review is no different. Classes of capital are values, equated and summed. Human capital is an aggregation of values so that, for example, more 'education' can compensate for increased risk of death. More than this, if education pays better financial dividends than avoiding loss of life then, according to the economic accountants, the optimal world should have more education and more death.

38.0.0.1 Discounting

The mechanism chosen by Dasgupta to allocate natural resources between current and future generations is a social discount rate (SDR). Alternatives, such as allocation on grounds of justice, rights or needs, are therefore excluded,

While acknowledging the major ethical objections to discriminating against future generations via discounting, Dasgupta (2021, Chapter 10) nevertheless chooses a positive discount rate. He justifies this using the dubious argument that since returns on judiciously chosen investments are positive (by assumption), fairness requires discriminating against future generations, because otherwise the current generation would be unduly limited in consumption and condemned to excessive poverty. This is a productivist logic based on assuming the future is always better-off.

Dasgupta follows standard neoclassical theory in treating future outcomes (flows of costs and benefits) for public policy projects as subject to a social time preference (STP). The basic position here is to follow a formulae, called the Ramsey rule, that determines the SDR and STP as follows:

$$SDR = r + hg = STP$$

where g is annual per capita growth of consumption, α is the elasticity of marginal utility of consumption and r is the utility discount rate, consisting of a component for pure time preference, β , and, in HM Treasury practice, a component for certain types of risk, L . Components of the formulae are so uncertain that

economists appeal to surveying themselves to get estimates, as if this provided objective data.

In The Review commitment to an actual number is vague, and subject to speculation as to economic growth and uncertainty. Elsewhere Dasgupta (2008) has argued that γ could be zero, while, contrary to others, he argues for a much higher γ in the range 2–3 or more. The basic rate used by HM Treasury, in its Green Book, is 3.5%, where $\delta = 0.5$, $L = 1$ so that $\gamma = 1.5$ with the remainder consisting of consumption growth $g = 2$ and $\alpha = 1$. If Dasgupta's argument for $\gamma = 0$ is adopted then the STP would be between 5.5% and 7.5%, but he has argued favouring $\gamma = 0$ which would give 5.0–7.0%. This is extremely high.

For comparison consider how Nordhaus uses such rates to recommend catastrophic global warming as economically rational. He states that 'the cost-benefit optimum rises to over 3°C in 2100' (Nordhaus, 2018, p. 452), and his Figure 5 shows a 2100 optimum around 3.6°C and rising, because he recommends discounting the future at around 5% (Nordhaus, 2018, p. 455), writing off any importance of future damages by 2100 (damages would weigh around 2% of their value today meaning, for example, under VSL an action saving 2 people today at the cost of killing 97 people in 2100 would be a net gain, an optimal choice). This is neither unique to Nordhaus nor new, for example, the economic working group of the IPCC third assessment used discount rates between 5% and 12%. A common claim, also made by Nordhaus, is that empirically observable rates of return should be used. However, in actual economies the rate of return on risk free investment has been zero or negative in real terms for years (Freeman et al., 2018, p. 16), but discounting has persisted regardless of the theoretical justifications.

In fact there is no such thing as a singular rate in actual economies. The recognition that differential rates for different projects is theoretically justified, and specifically for projects with environmental impact, has led HM Treasury to discount at a lower rate (1.5%) for project impacts on health and life. However, while recognized as formally correct Dasgupta rejects this on the grounds, not of theory but, that it will be 'cumbersome' in practice and 'lead inevitably to errors'. Indeed he states it would be 'unsafe' because (now) the 'social evaluator' (or 'citizen investor') cannot be trusted to get things right. Instead he recommends a single rate applied to all projects. The reader might wonder at such pragmatism, for if all the problems of neoclassical economics can be so easily dismissed on a whim as impractical and too cumbersome for his social/citizen evaluator/investor this rather begs the question why he bothers us with his models, theories and extensive mathematical detours and what other fallibilities his central decision-maker might suffer from. That markets are not guides to intergenerational fairness, ethics or equity, would seem to bring the whole approach into question. In his paper on discounting for climate change Dasgupta concludes: 'Intergenerational welfare economics raises more questions than it is able to answer satisfactorily'. However, as usual, Dasgupta's recognition of the problems has no impact on his esteem for and continued use of

neoclassical economics and, unsurprisingly, he recommends discounting on this basis.

Spash (2021) The Dasgupta Review deconstructed: an exposé of biodiversity economics (pdf)

39

Tax

39.1 Corporate Tax

Profit Shifting

OECD Process

There remain significant difficulties in the OECD process, with its two-pillar proposals. First, there is no common ground on ‘Pillar One’. This is the element which would go beyond the archaic arm’s length principle and introduce some element of formulary apportionment (that is, allocating a share of each multinational’s global profits to the places where they actually do business, in the form of sales and employment). The US (under Biden, as under Trump) wants Pillar One to apply to all businesses; the EU is focused on the big tech multinationals; and the OECD proposal to identify ‘consumer-facing’ businesses falls somewhere in between these.

As things stand, the OECD proposal is highly complex and would retain arm’s length pricing for most profits, and therefore result in relatively little reduction in profit shifting – making it largely unattractive for most countries. At the same time, the proposal would require global treaty change, meaning that it could very easily be blocked – including by the US Congress, regardless of whether the Biden administration had come around to support it.

‘Pillar Two’ contemplates a global minimum corporate tax rate. This has the potential to go a long way to stop profit shifting, not by making it harder to achieve but by making it much less rewarding – since multinationals would, in theory, end up being taxed at the minimum rate even if they managed to shift the profits to a zero rate jurisdiction.

Here again though, the current OECD proposals are highly complex, and have been very unambitious. And an argument about ‘rule order’ – in simple terms,

whether the home country of a multinational goes first in levying any top-up tax, or the various host countries – has exposed the major distributional question. Despite some initial optimism, most non-OECD members have by now become thoroughly disillusioned with the process. An outcome that favours OECD members, despite lower-income countries bearing disproportionately high revenue losses due to profit shifting, would be unconscionable – but, sadly, not entirely unexpected.

Lastly, the insistence that the two pillars are inseparable, and must be delivered jointly, creates a hugely complicated contraption requiring great resources to move ahead, but with little certainty over any benefits.

Way Forward

Stepping out of the limitations of the OECD process, things very quickly start to look much brighter. This is for three main reasons.

First, the two pillars can be separated – and that means the unworkable and unambitious ‘Pillar One’ can be left behind, along with the requirement for global treaty change. Instead, a global minimum corporate tax can be taken forward by a coalition of the willing. (In fairness to the OECD secretariat, they have raised this possibility at times also, recognising the practical difficulties of their Pillar One.) With the US and Germany (and the European Commission) committed to a minimum tax, broad agreement on the shape could be reached relatively quickly.

Second, the OECD leadership’s longstanding insistence on a very low minimum rate of 12.5% can be set aside. The Biden administration has indicated a rate of 21%. The Independent Commission for the Reform of International Corporate Taxation has proposed 25% as an absolute minimum; while discussions among various groups of lower-income countries have suggested higher rates still, to ensure that they are not disadvantaged. Negotiating upwards from 21% – and with the possibility of different countries taking their own approaches as appropriate – would provide a quite different dynamic.

And third, the setting aside of Pillar One creates the possibility of pursuing a more ambitious approach to the minimum tax. Our proposal for the METR, or Minimum Effective Tax Rate for multinationals, does just this. We propose a method that builds on the technical efforts of the OECD secretariat, who have done sterling work in establishing various approaches to identify and to apportion taxable profits, but shifts the politics substantially.

METR

In effect, the METR combines the two pillars by identifying under-taxed profits, and then apportioning these for ‘top-up’ taxation on a formulary basis, according to the location of multinationals’ real activity. In this way, the METR cuts through any ‘rule order’ debates and instead treats all countries, home or host, on an equivalent basis.

Politically, the momentum for globally inclusive solutions at the UN, rather than the rich countries' club at the OECD, will continue to grow – and especially if a one-sided minimum tax solution emerges from the OECD now. The FACTI panel report called for the negotiation of a UN tax convention, which would provide the basis for an intergovernmental body under UN auspices to set corporate tax rules in future – including a global minimum tax rate designed to benefit all.

That the US administration is now leading the push for an ambitious global minimum tax rate confirms this as the new norm. The decisions set to be made in the next couple of months, over technical design and political inclusion, will determine just how effective this can be in bringing an end – finally – to the decades-long race to the bottom in corporate tax.

With the confirmation of this new narrative, it seems likely that what is left undone in the OECD process will be resolved through a combination of unilateral and UN action.

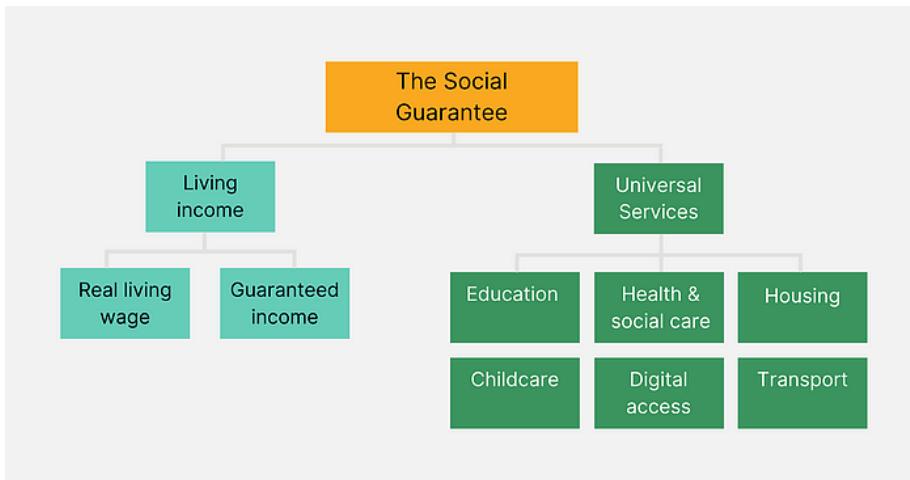
Global Corporate Minimum Tax

40

Welfare

40.1 The Social Guarantee

The Social Guarantee enshrines every person's right to life's essentials: education, health and social care, a decent home, childcare, nutritious food, clean air and water, energy, transport and access to the internet. For this to happen, all people must have access to collectively provided services that meet their needs, as well as to a fair living income.



SocialGuarantee.org

40.2 Net Domestic Consumer Surplus

Fouquet

Roger Fouquet is currently working on estimating the Net Domestic Consumer Surplus (NDCS) for the United Kingdom over the last three hundred years. NDCS measures the area below the demand curve for each consumer category and above the price line, and sums all the consumer categories to produce an aggregate value. NDCS offers a new macroeconomic indicator of economic welfare and a complement to GDP.

The preliminary results indicate that the broad trend in Net Domestic Consumer Surplus (NDCS) per capita is similar to GDP per capita – showing the improvements in welfare from the end of the nineteenth century, major increases since the 1950s and a *decline following the Great Recession of 2007-8*.

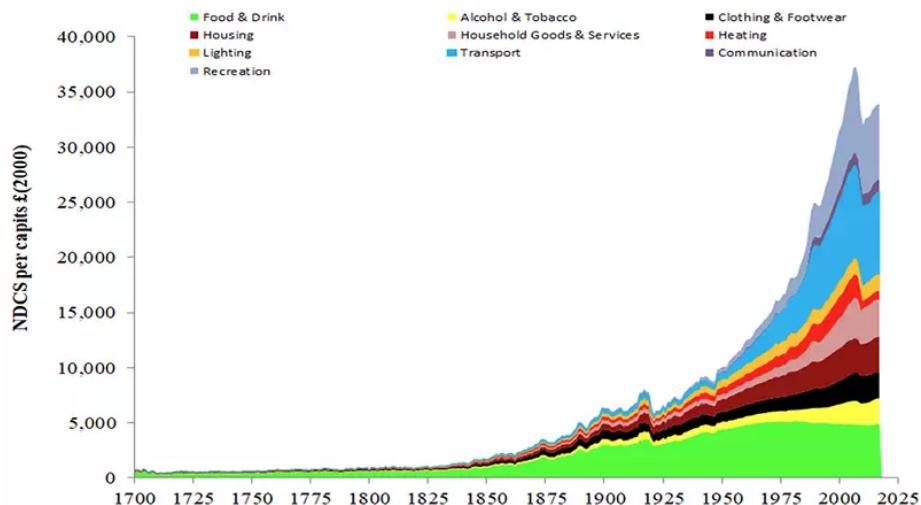
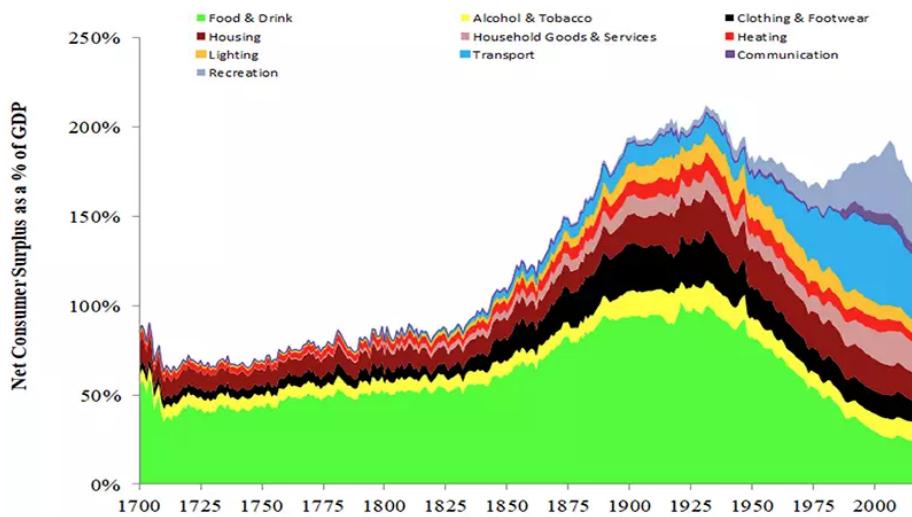


Figure: Net Domestic Consumer Surplus (NDCS) per capita in the UK, 1700-2017

GDP per capita heavily under-estimates the consumer welfare gains at early stages of economic development and over-estimates the consumer welfare gains at later stages of economic development. For instance, each pound or dollar produced today is not generating as much consumer welfare as 90 years ago.



Fouquet

41

Countries

41.1 Norway

41.1.1 Oil and Gas

09602: Påløpte investeringer. Utvinning av råolje og naturgass, og rørtransport (mill. kr), etter kvartal. Investeringer i alt, Innvesteringeskostnader.

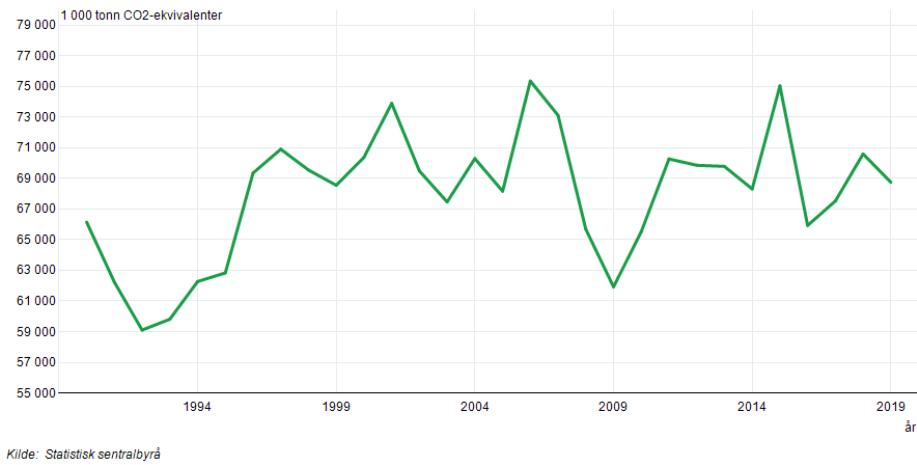


Kilde: Statistisk sentralbyrå

ssb

41.1.2 Emissions

09288: Klimagasser fra norsk økonomisk aktivitet, etter år. Alle næringer og husholdninger, Klimagasser i alt, Utslipp til luft (1 000 tonn CO₂-ekvivalenter).



ssb

41.2 China

China basically destroyed every idea western intellectuals had about economic growth and development. Practically nobody admits how embarrassing this is for economists and political scientists.

administrations. Local governments embrace capitalism, advance policy innovations, and compete to produce economic results. Under Mao, the bureaucracy was ossified and doggedly anticapitalist. But, today, as one Chinese official declared with a dash of irony, “Our nation cares about businesses. In fact, I feel that no capitalist state can match our devotion to the capitalist sector.”³⁴

For mainstream political economists, China’s great transformation—both economic and bureaucratic—is intriguing but also troubling.³⁵ In *Why Nations Fail*, Acemoglu and Robinson struggle to make sense of China’s rise. According to them, growth is preconditioned on the establishment of nonextractive and inclusive institutions, essentially, democratic institutions. But even today China is not a democracy. National elections are barred. Members of the judicial and legislative bodies are handpicked by the ruling party. Extractive practices are still rife in parts of China. During the early phase of reforms, there

was no formal protection of private property rights.

In defense, Acemoglu and Robinson surmise that sooner or later, China’s hyper-growth will run out of steam.³⁶ Yet even if growth slows, which is expected for any economy that reaches middle-income status, the burning question remains: how did China come *this* amazingly far? Their reply is that “a critical juncture,” namely Mao’s death, followed by Deng’s efforts to build a reform coalition, turned China around. Furthermore, they claim, growth under extractive institutions was possible because an extremely poor country like China had plenty of “catching up” to do. Finally, they sum up: “Some luck is key, because history always unfolds in a contingent way.”³⁷

Luck, of course, influences any outcome. But assigning three decades of sustained economic and institutional remaking to luck is hardly satisfying. Moreover, all poor countries have ample room for “catching up,” so why didn’t they catch up the way China did?

(Yuen Yuen Ang)

I think Acemoglu's focus on democracy and non-extractive institutions is a bit of outlier in the growth lit, which mostly would contend that China's high levels of average human capital and physical capital investments should lead to substantial growth.

I think China actually is democratic and non-extractive at the local level, something that Acemoglu misses by focusing on national stuff. A big part of the post-Mao reforms was turning local development over to local governments and making them accountable for performance.

To be honest China since Deng Xiaoping has followed the Fredrich List- Alexander Hamilton form of political economy. They are following the same policies from Meiji Japan and Imperial Germany.

Twitter Thread

42

Economics

42.1 Economics is Pseudo-Science

Kyger and Fix

‘Essentialism’, as we see it, is the reification of a theory — a transformation from ‘provisional explanation’ to ‘timeless truth’.

Mainstream economics makes so many false claims that we could write a book debunking them. (Which is why Steve Keen did just that [7].) Although economics presents itself as a hard science, under the hood it is essentialist dogma, held in place by tradition.

Outside economics, the term has an unambiguous meaning: a ‘natural law’ is an empirical regularity with no known exception. The laws of thermodynamics are a prime example. Left alone, objects ‘naturally’ converge to thermodynamic equilibrium. Leave a hot coffee on the table and it will soon cool to room temperature. The outcome is the same today as it was yesterday. It is the same for you as it is for me. It is a ‘natural law’.

By documenting and explaining this empirical regularity, we are following the recipe laid out by Locke, Hume, and Kant. Observe the real world and try to explain consistent patterns. When economists appeal to ‘natural law’, however, they are doing something different. Take the so-called ‘natural’ rate of unemployment. If this rate were like the laws of thermodynamics, unemployment would gravitate towards a single value. Try as you might, it would be impossible to change unemployment from this ‘natural’ rate.

Needless to say, unemployment does not work this way. Instead, it fluctuates greatly, both in the short term, and over the long term. So when economists refer to the ‘natural’ rate of unemployment, they don’t mean an empirical regularity. They mean an essence. As Milton Friedman defined it, the ‘natural’ rate of

unemployment is that which is “consistent with equilibrium in the structure of real wages” [9]. So whenever (and wherever) the labor market is in ‘equilibrium’, unemployment is at its ‘natural’ rate.

So how do you tell when the market is in ‘equilibrium’? Good question ... nobody knows. That’s because market ‘equilibrium’ is not something economists observe. It is something economists imagine and then project onto the world. It is an essence.

To convince yourself that this is true, pick any economics textbook and search for the part where the authors measure market ‘equilibrium’. Find the section where they construct the ‘laws’ of supply and demand from empirical observations. Look for where they measure demand curves, supply curves, marginal utility curves, and marginal cost curves. Seriously, look for these measurements. You will not find them.⁵

You won’t find them because they are unobservable. These concepts are *essences*. The equilibrium-seeking free market is an idea that economists project onto the world, and then use to interpret events. Anything that fits the vision is ‘proof’ of the essence. Anything that seems contradictory is dismissed as a ‘distortion’.

And that brings us to economics education. The core content in Econ 101 has changed little over the last half century (if not longer). And that’s not because the ‘knowledge’ is secure. It’s because the content of Econ 101 is a tradition. The point of Econ 101 is to indoctrinate the next generation in the ‘essence’ of economics. This powerful combination of essentialism and traditionalism has made economics a “highly paid pseudoscience”

In his essay ‘The Methodology of Positive Economics’, Friedman argues that you cannot test a theory by comparing its assumptions to reality [13]. Instead, you must judge the assumptions by the predictions they give. If the predictions are sound, says Friedman, so too are the assumptions. (For why this is a bad idea, see George Blackford’s essay ‘On the Pseudo-Scientific Nature of Friedman’s as if Methodology’)

Scientists want to know if their hypothesis is ‘correct’. The problem, though, is that making this judgment is inherently subjective. The evidence for (or against) a hypothesis is always contingent and incomplete. And so scientists must make a judgment call.

The purpose of statistics is to put numbers to this judgment call by quantifying uncertainty. It’s a useful exercise, but not one that removes subjectivity.

Unfortunately, in many corners of science, statistical tools have become reified as the thing they were never designed to be: a decision-making algorithm. Scientists apply the tools of (standard) statistics as though they were an essential truth, a ritualistic algorithm for judging a hypothesis.

Fortunately, there is a growing movement to reform hypothesis testing. One option is to pre-register experiments to remove researchers’ ability to game

statistics. Another option is to lower the ‘traditional’ level of statistical significance. While we welcome both changes, we note that they do not solve the fundamental problem, which is that judging a hypothesis is always subjective. For that reason, we favor a transition to Bayesian statistics. Bayesian statistics is up front about the subjective element of judging a hypothesis. In fact, when you use the Bayesian method, this subjectivity gets baked into the calculations (in what Bayesian’s call a ‘prior probability’).

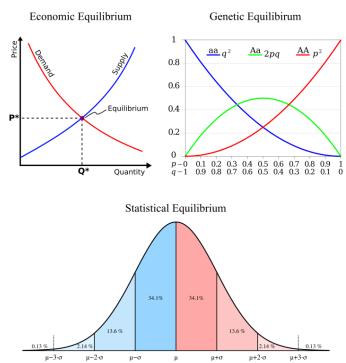


Figure: Essentialist totems in economics, biology and statistics. Clockwise from top left: the neoclassical model of the equilibrium-seeking market, the Hardy-Weinberg model of genetic equilibrium, and the normal distribution — the ‘equilibrium’ behavior of infinitely many random samples.

As physicist Sabine Hossenfelder shows in her book *Lost in Math*, the appeal to aesthetics leads scientists astray more often than it leads them to the truth.

Kyger and Fix (2021) Essentialism and Traditionalism in Academic Research

42.2 Economic Goods and Services

Roser

Economic goods are scarce in relation to the demand for them

Uneconomic Breathing!!

An economic good or service is provided by people to each other as a solution to a problem they are faced with and this means that they are considered useful by the person who demands it.

And a last characteristic that is helpful in deciding whether you are looking at an economic product is ‘*delegability*’. An activity is considered to be production in an economic sense if it can be delegated to someone else. This would include many of the goods and services on that long list we considered earlier, but would exclude your breathing, for example.

Many discussions about economic growth are extraordinarily confused. People often talk past one another. I believe the reason for this is that the discussion of what economic growth is, gets muddled up with how it is *measured*.

Growth is often measured as an increase in income or inflation-adjusted GDP per capita. But these measures are not the definition of it.

Roser (2021) What is economic growth?

42.3 Economics Discipline

Rodrik on CORE-ECON

A key advantage of the CORE approach is that it tackles issues like inequality and climate change head-on. But the pedagogically more interesting move is that it replaces the standard benchmarks of economics with alternative benchmarks that are more realistic and useful. For example, in contrast to conventional economics, CORE assumes that individuals are pro-social and myopic, rather than selfish and far-sighted. Competition is imperfect, with winner-take-all characteristics, rather than perfect. Power is ever-present in the form of principal-agent relationships in labor and credit markets, instead of being treated as either diffuse or exogenous. Economic rents are ubiquitous and often required for well-functioning economies, not rare or the result of policy error.

Such a new paradigm for teaching and doing economics will produce better understanding of social outcomes. But we should recognize that it will not produce a new paradigm for economic policy. And that is as it should be. All of our previous policy paradigms – whether mercantilist, classical liberal, Keynesian, social-democratic, ordoliberal, or neoliberal – had important blind spots because they were conceived as universal programs that could be applied everywhere and at all times. Inevitably, each paradigm's blind spots overshadowed the innovations it brought to how we think about economic governance. The result was overreach and pendular swings between excessive optimism and pessimism about government's role in the economy.

The right answer to any policy question in economics is, “It depends.” We need economic analysis and evidence to fill out the details of what the desired outcome depends upon. The keywords of a truly useful economics are contingency, contextuality, and non-universality. Economics teaches us that there is a time for fiscal expansion and a time for fiscal retrenchment. There is a time when government should intervene in supply chains, and a time when it should leave markets to their own devices. Sometimes, taxes should be high; sometimes, they should be low. Trade should be freer in some areas, and regulated in others. Mapping the links between real-world circumstances and the desirability of different types of interventions is what good economics is about. Our societies are confronted with vital challenges that require new economic approaches and significant policy experimentation. The Biden administration has launched a

bold and long-overdue economic transformation. But those who are seeking a new economic paradigm should be careful what they wish for. Our goal should be not to create the next ossified orthodoxy, but to learn how to adapt our policies and institutions to changing exigencies.

Rodrik

CORE-ECON

42.4 Second Best Theory

A classic finding in the economic literature – the theory of second best – illustrates that, in the presence of many market failures, leaving one failure unaddressed is suboptimal. Conversely, addressing a particular market failure has the potential to improve the overall allocation of resources, even if it worsens some other market failure.

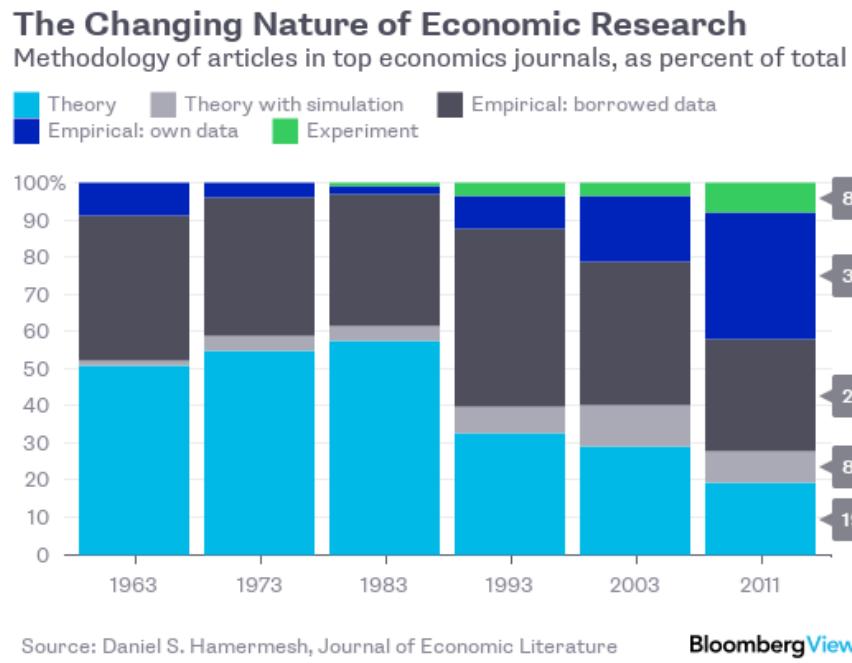
Scnabel (2021)

42.5 Economics Empirical Turn

Noah Smith

In recent decades, three huge and important changes have happened in the economics profession. All of these changes work against both the free-market wave of the 70s and 80s and the rise of well-funded “economism” in the public sphere.

First, the profession has become much more empirical.



Whether or not something works in theory is less important now than whether it works in practice. Papers still have theory sections, but they're more phenomenological — proposed explanations for observed phenomena, rather than a mathed-up form of philosophy. Meanwhile, new econometric methods relying on quasi-experiments are rapidly becoming dominant.

The empirical turn means that economists are more open to being persuaded by the evidence. The second change was an increased willingness of academic economists to enter the public discussion. Leading media figures like Thomas Piketty, Paul Krugman, and Gabriel Zucman now lean to the left, and the influence of the generally left-leaning Econ Twitter is growing. Both of these help balance out the legacy institutions of the 80s free-market media machine.

But the third and most important change is in the econ profession itself. The free-market revolt is over. Economists' concern about inequality is growing rapidly.

Noah Smith (2015) Is economics an excuse for inaction?

42.6 History of Economics

Noah Smith

There's a sort of popular myth that economics began with Adam Smith's decla-

ration that the “invisible hand” of the market would lead to a good society. In fact, while Smith did recognize the importance of market forces and self-interest, his vision of a good society didn’t stop there.

Adam Smith decries the existence of inequality and poverty, blames property rights for this inequality, advocates progressive taxation as a remedy, and is innately suspicious of profit. He sounds more like Thomas Piketty than Milton Friedman.

Smith’s suspicion of profit and enthusiasm for redistribution are baked into the very core of economic theory. The zero-profit condition says that in a well-functioning market, the rate of profit should be no more than the cost of capital — if you see companies making big margins, you should suspect that the market isn’t working.

Meanwhile, Smith’s call for redistribution is inherent in the Second Welfare Theorem, considered one of the basic theorems of economics — and something that every intro student is taught. The Second Welfare Theorem says that if you change the initial distribution of wealth in society, you can basically get any outcome you like. This puts the burden of proof on those who think we shouldn’t redistribute wealth — it forces them to bring proof that the harms from taxation are just too high. Though there have been some economists who opposed redistribution, enthusiasm for the idea is traditionally very dominant within the profession. Even Milton Friedman, that great champion of laissez-faire, supported the idea of a negative income tax that would give people more cash the poorer they were.

Over the decades, leading economists found other reasons for government intervention in the economy. Just a few examples:

- John Maynard Keynes, the father of modern macroeconomics and an incredibly influential figure, came up with the idea of fiscal stimulus to solve the problem of recessions — an idea that is almost universally accepted today among economists.
- Paul Samuelson, arguably the most influential economist of the 20th century, and the author of much of the modern economics curriculum, came up with the theory of public goods — things like infrastructure and research and public parks that the private sector won’t provide on its own.
- Kenneth Arrow, one of the profession’s leading lights, explained why the free market doesn’t work in the health care industry.
- Joseph Stiglitz, yet another Nobel prize winner, showed that under some simple assumptions, land should be taxed at 100% of its value — basically, total redistribution of the wealth from land ownership (the idea was originally due to the 19th century economist Henry George).
- Along with George Akerlof, Michael Spence, and others, Stiglitz pioneered the theory of asymmetric information, which shows yet another reason

free markets break down (and which provides another justification for government health insurance).

This is by no means an exhaustive list. But it shows how economists at the very top of the field — the people cited are not just Nobel winners but legendary names within the profession — spent their effort finding reasons to justify action by the ruling class to alleviate inequality, poverty, and market breakdown.

The libertarian economics of the 70s and 80s had its roots in the Mont Pelerin Society and the University of Chicago economics department in the mid 20th century. Economists like Friedrich Hayek, Milton Friedman, and George Stigler were consciously and openly ideological in their promotion of small-government ideology. This culminated in Friedman's famous 1980 television special, *Free to Choose*, in which he combined libertarian principles with (often simplistic and obsolete) economic theory to endorse laissez-faire approaches across a broad swath of policy issues.

This free-market revolt left lasting marks on the profession. The new discipline of “law and economics” was dominated by the Chicago school, providing strong support to big business in its quest to become even bigger.

Macroeconomics became temporarily dominated by anti-interventionists. Economists like Robert Lucas and Ed Prescott made models claiming that recessions are optimal economic outcomes (!!), and that attempts to fight them only make things worse.

The free-marketers had a deep impact on econ education. Greg Mankiw's textbooks, which generally favor free-market ideas, have become the standard introductory undergrad textbook, and are only now starting to be displaced by materials like Krugman's textbooks and the CORE Project.

Noah Smith (2015) Is economics an excuse for inaction?

43

Economists

43.1 Joan Robinson

In the autumn of 1975, there was one name “on everyone’s list for this year’s Nobel Prize in Economics,” Business Week magazine trumpeted: the Cambridge economist Joan Robinson. The week before the prize announcement, the magazine predicted that Robinson would be the first woman to win the prize. A major interpreter of John Maynard Keynes and Karl Marx, she was one of the most prominent economists of her generation.

But when the names of the winners were read out at the Royal Swedish Academy of Sciences, Robinson’s name was not among them. When she died in 1983, just shy of her eightieth birthday, she had not won the prize – despite words of support from laureates as different as Paul Samuelson and Milton Friedman.

What went wrong? More than perhaps any other factor, one man was to blame: Mao Zedong. Robinson’s writing in praise of Mao’s China – from her defense of the ruinous Great Leap Forward to her zesty praise of the Cultural Revolution – was likely what lost her the Prize. Fang Qin, an economist at Fudan University in Shanghai, put it plainly: “She is considered the most important female economist in history, but she did not win the Nobel Prize because she publicly praised the Cultural Revolution.”

“How could it happen that, under cover of Mao Tse-tung thought, a medieval drama of ambition and treachery could play itself out?”

Gewirtz (2017) Mao NobelPrize

At the outset of this debate over capital theory, Professor Joan Robinson argued that capital could not be aggregated using any single measure because capital assets include a tremendous variety of goods: physical equipment, real estate, trademarks, financial products, and so on. 61 The normal remedy — and

a move that lies at the heart of the neoclassical theory of capital — is to group these disparate entities together as a homogeneous stock or fund, using their market value to render them commensurate. Piketty adopts this approach, yet a problem arises when we want to calculate the rate of return on capital that has been aggregated in this way. According to standard economic theory, the return on capital should be equivalent to its rental price at equilibrium — that is, to the cost of hiring capital at a given moment, independent of any short-term shocks or anomalies. This return should be equal to the “marginal product” of capital, because (assuming equilibrium) the cost of capital will equal the value of the additional production it enables. The problem with this solution is that calculating the equilibrium price of capital assets requires assuming a given rate of interest, as shown by several technical results from the 1960s and 1970s.⁶² But (again according to standard economic theory) the rate of interest is itself endogenously related to the price of capital assets: it is supposed to reflect the marginal product of capital. Calculating the rate of return on capital would thus seem to require assuming the very thing that the calculation is supposed to discover, making the exercise circular.

Grewal (2014) Review of Piketty (full pdf)

43.2 Pierro Sraffa

But what determines the rate of return on a capital asset if it is not simply the value of the additional production it enables? The force of the debate over this question stemmed from the ideological stakes of the conventional answer. The theory of marginal productivity was thought to naturalize capital and its share of national income, rationalizing profit as simply what was owed to one factor of production, capital, just as wages were what was owed to labor.⁶⁴ Against this, Professor Piero Sraffa’s seminal contribution was to show that the rate of return could not be derived from the marginal product of capital but was rather an independent variable — given, he suggested, by factors “outside the system of production,” such as monetary policy.⁶⁵ In effect, according to Sraffa, the equilibrium price of capital goods reflects a history of social struggle over the terms of economic cooperation and cannot be understood simply in terms of the aggregate production function.

Grewal (2014) Review of Piketty (full pdf)

43.3 Mario Draghi

Judah on Darghi

There is a Europe of the mind: of Beethoven, summer holidays and the smell of coffee. Then there is Europe as it actually functions today — the Europe of Mario Draghi.

Understand Draghi and you understand how power works in the EU.
He has built a technocratic Europe and risen to its heights.

Whilst his generation was wild, flirting with extremism and dreaming of new worlds on campus, Draghi was tame and burdened by responsibility. An outsider in May '68.

He was well trained by the Jesuits. They taught him to be prudent, reserved and to listen. He's a social Catholic. It is a class marker that inexorably ties him to Massimiliano Massimo, the Jesuits' Roman Eton, where Draghi studied with the sons of ministers and tycoons. It is the sign of a severe, rigorous education at the hands of scholar-priests; and it is privilege. For Europeans, it is often a way to draw attention to his manner: pedagogic; precise, shadowy and, if necessary, ruthless. The Jesuits have a mantra from their founding Saint Ignatius of Loyola about serving the vision of God: *todo modo*, which in English means *whatever it takes*.

As a wave of political killings followed '68, Draghi learned the first lesson of political life. Always find the right mentor. His name was Frederico Caffè. Amidst the clamour he lived, his students said, "like a monk". Caffè was influential: Italy's great Keynesian economist. Convinced Draghi was brilliant, he introduced him to Franco Modigliani, the Italian economist at MIT, who accepted him as a student. But he still had to complete his thesis. "It was on the single currency and I concluded that the single currency was madness, something absolutely not to do," said Draghi, at an event honouring his mentor.

Those who would shape the economic discourse of the age taught Draghi at MIT. He proudly points out that five of his professors won Nobel Prizes — Paul Samuelson, Bob Solow, Franco Modigliani, Peter Diamond, and Robert Engle. His peers — Ben Bernanke, Paul Krugman, Kenneth Rogoff, Olivier Blanchard — would become high priests of the Federal Reserve, New York Times, austerity and the IMF respectively. As the new world of floating exchange rates, free flowing capital and empowered central bankers was starting to emerge, a circle of economists was coalescing. Together they shaped the neoliberal age.

Draghi was not looking for dogma. Unlike his mentors, Draghi's economics has never set into a theory but has kept moving, always one point to the left from wherever the centre is. He sees it as pragmatism. By forty, he had disappointed the left wing Caffè. Draghi was now a Director at the World Bank. In April 1987, overtaken with grief that neoliberalism has triumphed over the left in economics, his disciples dead or fading, Caffè, the great Keynesian, disappeared. He was never seen again. Some say he committed suicide; others that he had taken himself to a monastery in the Alps, to hide from the world he saw coming.

Heading the Treasury from 1991; it was here that the fortysomething civil servant did whatever it took to join the single currency: regulating Italy's banks, managing its debt and privatizing over €100bn. Draghi was more than indispensable. He built Italian neoliberalism.

There was no better school than Rome for Euro politics: it was already a game of weak politicians and powerful technocrats

Capitalism, he believed, had rules. As long as the politicians got out of the way and the technocrats set the right structure, stable growth would follow. This was the MIT philosophy. Across continents, his former student peers were rising and rising. As economists they believed in intervention: to help make the market function.

This was why the Euro was imperative. Capitalism could provide the rules — and the structure — that Italy lacked. Politicians would now be curtailed in macroeconomic policy. Signing up to a single currency put the fundamental levers of the macroeconomy — key fiscal and monetary policies — beyond domestic politics. This strategy was known as *il vincolo esterno*, the external bind.

This is what elites feared in the 1990s: without *il vincolo*, a return to the 1970s.

Draghi's generation believed they had got it all right. Then 2008 hit. The financial crisis revealed these engineers had made a terrible mistake. They had broken a system they would now spend the rest of their careers trying to fix.

This would transform central bankers from the technocratic rule setters of capitalism into the political crisis managers who guided it — and in so doing reorder power in the EU forever.

By signalling that Frankfurt was only prepared to put its liquidity behind a certain type of politics he opened the door to ousting Berlusconi. A technocratic government replaced him — which the fallen leader called an EU “coup”.

“In every press conference since I became ECB President, I have ended the introductory statement with a call to accelerate structural reforms in Europe.” Central Bankers had crossed the line: no longer technocrats, they were now politicians.

In Frankfurt, Draghi would master the three modes of European power: the charismatic — the politics of persuasion — with which he would claim power for his bank; the technical — the politics of rules — with which he would be the EU enforcer in Greece; and the analytical — the politics of numbers — with which he would win the battle to guide capital flows with quantitative easing. Together these would come together into Draghipolitik — with which he would move the German dial. His challenge was in the very design he agreed to.

Genuinely free markets, which had opened in the 1970s with the lifting of capital controls, closed. Directed capitalism came to Europe with the ECB incentivising markets to buy riskier assets by buying over \$2.8 trillion safer ones by 2018. It was the ultimate act of intervention without redistribution.

A whisperer, an enforcer, a number cruncher. These are not the qualities one expects of a great man. But that is to misunderstand how the EU works. Its

machine was built to depoliticise politics; and those who do that best, thrive; the unassuming bureaucrat becomes Napoléon.

As the crisis made the state more dependent on finance; finance became more dependent on the state. And men like Draghi were central to it. These victories reveal enormous skill. They turned the ECB into an even more powerful institution than the Bank of England. But they also underline how badly his generation got it wrong. They had bet on a half-built house for Europe as the key to stability. But a monetary union without a fiscal union brought instability. They had bet on setting neoliberal rules for capitalism and stepping back: and it had blown up. They had bet on austerity: then faced a depression. These errors made them — the world's elite central bankers who then had to fix it all — more powerful than most politicians.

All through life, Draghi's personal and political bets have paid off. But at the same time, his great bet, the one he took with Italy — *il vincolo esterno* — has failed. The geopolitics failed: it has not helped manage German power. The economics failed: Italy has maintained one of the toughest fiscal regimes in Europe, running a primary surplus almost every year since 1995. Yet Italy has got poorer. In 2000, its average standard of living was 98.6 per cent of that of Germany. Today, Italian per capita income is 20 per cent below those over the Alps. These are the long term consequences of austerity, bottled reform and the Euro making exports uncompetitive. The debt Italy ran up in the 1980s has become its albatross. Draghi's growth never came.

Italy has been trapped in a loop of increasingly weak populists, punctuated by weak technocrats.

"The truth," said the historian Marcel Gauchet, "is that Europeans do not know what they have built." This is what the struggles of Draghi reveal.

The real politics of Europe is the politics of Eurozone debt.

A Euro collapse is now unlikely. That is his legacy. The risk that Europe faces now is that the Euro system — the unfinished house — slowly does to the EU as a whole what it has done to Italy, putting it on a permanently lower growth trajectory. The EU needs collectivised debt for more collective stimulus.

Until someone can pull off the next painful step of consolidation, the risk is that the Union continues to lose the battle for globalisation.

But the price of Draghipolitik is this: it is consolidation without democracy. Empowered elites with alienated voters. Politics only men like him can play.

But what is this Europe? This system, Draghi's system, is one that has depoliticised itself in order to survive. That it has. But at the cost of no longer being able to distinguish between stability and stagnation. A system that can only do the bare minimum. Not whatever it takes.

Judah on Draghi

43.4 Paul Romer

NY Times on Paul Romer

Paul Romer was once Silicon Valley's favorite economist. The theory that helped him win a Nobel prize — that ideas are the turbocharged fuel of the modern economy — resonated deeply in the global capital of wealth-generating ideas. In the 1990s, Wired magazine called him “an economist for the technological age.” The Wall Street Journal said the tech industry treated him “like a rock star.”

Not anymore.

Today, Mr. Romer, 65, remains a believer in science and technology as engines of progress. But he has also become a fierce critic of the tech industry’s largest companies, saying that they stifle the flow of new ideas. He has championed new state taxes on the digital ads sold by companies like Facebook and Google, an idea that Maryland adopted this year.

And he is hard on economists, including himself, for long supplying the intellectual cover for hands-off policies and court rulings that have led to what he calls the “collapse of competition” in tech and other industries.

“Economists taught, ‘It’s the market. There’s nothing we can do,’ ” Mr. Romer said. “That’s really just so wrong.”

Mr. Romer’s current call for government activism, he said, reflects “a profound change in my thinking” in recent years. It also fits into a broader re-evaluation about the tech industry and government regulation among prominent economists. They see markets — search, social networks, online advertising, e-commerce — not behaving according to free-market theory. Monopoly or oligopoly seems to be the order of the day.

Of all the economists now taking on big tech, though, Mr. Romer is perhaps the most unlikely. He earned his undergraduate and doctoral degrees from the University of Chicago, long the high church of free-market absolutism, whose ideology has guided antitrust court decisions for years.

Mr. Romer spent 21 years in the Bay Area, mostly as a professor first at Berkeley and then Stanford. While in California, he founded and sold an educational software company. In his research, Mr. Romer uses software as a tool for data exploration and discovery, and he has become an adept Python programmer. “I enjoy the solitary exercise of building things with code,” he said.

“People I like are frequently unhappy with me,” he said.

Mr. Romer, who joined the faculty of New York University a decade ago, said that preparing for his Nobel lecture in 2018 prompted him to think about the “progress gap” in America. Progress, he explained, is not just a matter of economic growth, but should also be seen in measures of individual and social well-being.

In the United States, Mr. Romer saw worrying trends: a decline in life expectancy; rising “deaths of despair” from suicides and drug overdoses; falling rates of labor participation for adults in their prime working years, from 25 to 54; a growing wealth gap and increasing inequality.

Such problems, to be sure, have many causes, but Mr. Romer believes one contributing cause has been an economics profession that belittled the importance of government. His new growth theory recognized that the government played a vital part in scientific and technological progress, but mainly by funding basic research.

Looking back, Mr. Romer admits that he was caught up in the “small government bubble” of the time. “I substantially underestimated the role of the government in sustaining progress,” he said.

“For real progress, you need both science and government — a government that can say no to things that are bad,” Mr. Romer said.

NY Times

43.5 Dennis Snower

Behavioural Economics can't fix it

This is probably the most exciting and fruitful time ever to become an aspiring economist. Why? Because economics is reaching its Copernican Moment – the moment when it is finally becoming clear that the current ways of thinking about economic behavior are inadequate and a new way of thinking enables us to make much better sense of our world. It is a moment fraught with danger, because those in power still adhere to the traditional conventional wisdom and heresy is suppressed.

Behavioral economics began as a compendium of “anomalies” that the neoclassical system could not explain. Some of these anomalies have been addressed by behavioral theories such as prospect theory or social preference theory, but many have not. Different theories explain different anomalies; there is no overarching theory to explain them all.

And since behavioral economics is devoted primarily to individual fixes, it has retained many of the basic axioms above, such as methodological individualism, consumption as central for wellbeing, understanding economic events in terms of probability theory and the tendency toward equilibrium. However, these axioms are also open to question.

Regarding methodological individualism, who says that the individual is the only level of selection? After all, Homo Sapiens owe their evolutionary success largely to their ability to cooperate with one another, in larger number than other mammals.

Regarding consumption as central to wellbeing, who says that our material appetitive needs dwarf our social needs, such as the need to care and be cared for, or the need to belong to a community, or the need to shape your fate through your own efforts?

Regarding our ability to understand economic events in terms of probability theory, who says that we can imagine all conceivable future states of the world and that we can assign probabilities to each of them? After all, many of the most important events that young people look forward to in the future — whom they will marry, where they will live, what jobs they will get, how much they will earn, what their state of health will be, when they will retire, how long they will live — are simply unknown unknowns.

Not only has the neoclassical system encountered endless discrepancies between predictions and evidence and thus has accumulated endless fixes, but it also has had little success in addressing the great economic questions of our time. For example: If the free-market system is meant to satisfy our needs efficiently, why is it despoiling our environment? Why is it generating inequalities and other inequities that threaten the social cohesion of our societies? Why does it leave so many people economically insecure, vulnerable to unemployment and trapped in dead-end jobs? Why does it not correct for the excesses of consumerism, workaholism and digital addictions, frequently leading to anxiety, depression, burnout, substance abuse and crime? Why is it giving us so little guidance in promoting public compliance with social distancing rules during the Covid-19 pandemic, even though such compliance has economic causes and consequences? Why does it keep so many businesses focused on short-term profit and shareholder value, even though so many business leaders are genuinely concerned about the environment and the wellbeing of their customers and employees?

Now the practitioners' patience with mainstream economics is wearing thin. Unlike the academic economists, the practitioners must actually address the great economic questions of our time.

Nor can the practitioners be content with the economists' standard policy toolbox, since these instruments are obviously not overcoming the growing problems of climate change, social conflict, "deaths of despair," containment of the Covid-19 pandemic, and much more.

And finally, the practitioners are no longer enamored by the mainstream narrative on the division of responsibilities.

Consumers in their millions are taking an interest in the social, political and environmental consequences of consumption and production activities, school children are out in the streets in protest about climate change, international organizations are beginning to measure economic performance beyond GDP (such as through the OECD's Better Life Index and the UN's Sustainable Development Goals), businesses are beginning to measure business performance beyond shareholder value (such as through Environmental, Social and Governance cri-

teria along with the initiatives of the WEF International Business Council, the OECD Business for Inclusive Growth coalition, the Value Balancing Initiative, the British Academy's Future of the Corporation programme), national governments are beginning to design budgets with regard to notions of wellbeing that extend beyond consumption of goods and services (such as New Zealand's well-being budget). In short, the practitioners are not waiting for the mainstream economics profession to adjust to reality; instead, they are forging ahead on multiple fronts, extending the domain of economics to the existential challenges we face.

Fortunately, we now have access to a powerful body of thought that can guide this new encounter. The evolution of our natural world can be understood in terms of variation, replication and selection. The evolution of ideas can be understood in such terms as well: new ideas keep cropping up; they are transmitted from person to person; and the ideas that get selected to survive are often to be ones that enable us to navigate our environment most effectively. Selection can act not only on individuals, but also on groups. "Selfishness beats altruism within groups. Altruistic groups beat selfish groups. Everything else is commentary." (E.O. Wilson and D.S. Wilson (2007), "Rethinking the Theoretical Foundations of Sociobiology," *Quarterly Review of Biology*, 82(4), 327-348) The level of functional organization thus depends on the relative strength of within-and between-group selection.

This is a different starting point from the one underlying mainstream economics. The discipline of economics is based on classical physics, i.e. the inanimate world. Evolution, by contrast, is appropriate to the animate world. Not a bad point of departure for economics. After all, humans are living creatures. If we choose this path, economics will be reaching its Darwinian – not Copernican – Moment.

This is why now is probably the most exciting and fruitful time ever to become an aspiring economist.

Snower

43.6 Adam Smith

Richard Smith

Adam Smith's economics is an idea whose time has passed. Specialization, planless, anarchic production for market, single-minded pursuit of profit maximization at the expense of all other considerations, was the driving engine that generated the greatest advances in industrial and agricultural productivity, and also the greatest accumulation of wealth the world has ever seen. But that same engine of development, now immensely larger and running at full throttle, is overdeveloping the world economy, overconsuming the world's resources, flooding the world's waters and atmosphere with toxic and warming pollution, and propelling us off the cliff to ecological collapse, if not extinction. Adam

Smith's fatal error – fatal for us – was his assumption that the “most effectual” means of promoting the public interest, the common good of society, is to just ignore it and focus exclusively on the pursuit of individual economic self-interest.

Even with respect to the public interest of the economic welfare of society, Smith's thesis that the invisible hand of the market would automatically bring about “universal opulence which extends itself to the lowest ranks of the people” as “a general plenty diffuses itself through all the different ranks of the society” could hardly have been more mistaken. Two-and-a-quarter centuries after Smith wrote, global capitalist development has produced the most obscenely unequal societies in history.

Two-and-a-quarter centuries after Smith wrote, global capitalist development has produced the most obscenely unequal societies in history, with half the world living on less than two dollars a day, billions of people living in desperate poverty, many times more than the entire population of the world in Smith's day, while a tiny global elite, even just a few hundred individuals, concentrate an ever-growing share of the world's wealth, which they lavish on “opulence” on a hitherto unimagined scale. On this breath-taking failure of social scientific prediction alone, Smith's economic theory ought to have been ridiculed and drummed out of the profession long ago, as such a comparable predictive failure would have been in the natural sciences.

With respect to the public interest of broader societal concerns, which today would include the environment, Smith's philosophy of economic individualism as the means to maximize the public interest – the common good of society – is not only completely wrongheaded, it's suicidal. And it is completely at odds with the world's scientists and scientific bodies who are crying out for a *plan* – a plan to stop global warming, to save the forests, to save the fisheries, to stop ocean acidification, to detoxify the planet, to save the thousands of creatures from extinction, etc.

Leaving the global economy in the hands of private corporations, subject to the demands of the market, is the road to collective eco-suicide.

[Richard Smith \(2015\) Green Capitalism \(pdf\)](#)

[*Noah Smith on Adam Smith*](#)

There's a sort of popular myth that economics began with Adam Smith's declaration that the “invisible hand” of the market would lead to a good society. In fact, while Smith did recognize the importance of market forces and self-interest, his vision of a good society didn't stop there. Here are some Adam Smith quotes:

1. “Our merchants and masters complain much of the bad effects of high wages in raising the price and lessening the sale of goods. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains.”
2. “It is not very unreasonable that the rich should contribute to the public

expense, not only in proportion to their revenue, but something more than in that proportion.”

3. “No society can surely be flourishing and happy of which by far the greater part of the numbers are poor and miserable.”
4. “Wherever there is great property there is great inequality. For one very rich man there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many.”
5. “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”

And so on. Adam Smith decries the existence of inequality and poverty, blames property rights for this inequality, advocates progressive taxation as a remedy, and is innately suspicious of profit. He sounds more like Thomas Piketty than Milton Friedman.

Smith’s suspicion of profit and enthusiasm for redistribution are baked into the very core of economic theory. The zero-profit condition says that in a well-functioning market, the rate of profit should be no more than the cost of capital — if you see companies making big margins, you should suspect that the market isn’t working right. This is the basis of the antitrust movement, which is again gaining strength in America with the appointment of Lina Khan to chair the FTC. Though there are a few populist firebrands in the antitrust movement, much of it is an intellectual movement driven by economists.

Meanwhile, Smith’s call for redistribution is inherent in the Second Welfare Theorem, considered one of the basic theorems of economics — and something that every intro student is taught. The Second Welfare Theorem says that if you change the initial distribution of wealth in society, you can basically get any outcome you like. This puts the burden of proof on those who think we shouldn’t redistribute wealth — it forces them to bring proof that the harms from taxation are just too high. Though there have been some economists who opposed redistribution, enthusiasm for the idea is traditionally very dominant within the profession. Even Milton Friedman, that great champion of laissez-faire, supported the idea of a negative income tax that would give people more cash the poorer they were.

And though economists do generally believe that very high taxes have some costs, a 2013 survey found that 97% of economists favored federal tax hikes, compared to only two-thirds of the general public, and a 2020 survey finds that most economists think raising the top marginal rate wouldn’t hurt economic growth.

Noah Smith (2015) Is economics an excuse for inaction?

43.7 Milton Freeman

Richard Smith

Adherents of the Chicago school simply deny that there is any environmental problem, certainly none that the market can't solve. Thus, in a 1991 interview, Milton Friedman ridiculed environmentalists with his trademark condescending and nasty vitriol:

"The environmental movement consists of two very different parts. One is the traditional conservation groups, who want to save resources et cetera. The other is a group of people who fundamentally aren't interested in conservation at all, and who aren't primarily interested in pollution. They're just long-term anti-capitalists who will take every opportunity to trash the capitalist system and the market economy. They used to be communists or socialists, but history has been unkind to them, and now all they can do is complain about pollution. But without modern technology, pollution would be far worse. The pollution from horses was much worse than what you get from automobiles. If you read descriptions of the streets of New York in the nineteenth century..."

And in his sadoeconomic screed *Free to Choose*, the anti-communist warhorse complained that:

"...whatever the announced objectives, all of the movements of the past two decades—the consumer movement, the ecology movement, the back-to-the-land movement, the hippie movement, the organic food movement, the protect-the-wilderness movement, the zero-population-growth movement, the 'small is beautiful' movement, the antinuclear movement—have always had one thing in common. All have been antigrowth. They have been opposed to new developments, to industrial innovation, to the increased use of natural resources. Agencies established in response to these movements have imposed heavy costs on industry after industry..." [and so on].

Friedman's redneck eco-know-nothingism has long defined the far-right wing of US economic theology but his confident assumption that endless growth is sustainable is shared by the entire profession of mainstream economists.

Richard Smith (2015) Green Capitalism (pdf)

43.8 Paul Krugman

Richard Smith

If we look at the far-left extreme of acceptable economic thought, say Paul Krugman, we hear the same "can't stop progress" mantra: writing in the New York Times Krugman wonders "if there isn't something a bit manic about the pace of getting and – especially – spending in fin-de-siècle America":

"But there is one very powerful argument that can be made on behalf of recent

American consumerism: not that it is good for consumers, but that it has been good for producers. You see, spending may not produce happiness, but it does create jobs, and unemployment is very effective at creating misery. Better to have manic consumers American style, than the depressive consumers of Japan... There is a strong element of rat race in America's consumer-led boom, but those rats racing in their cages are what keep the wheels of commerce turning. And while it will be a shame if Americans continue to compete over who can own the most toys, the worst thing of all would be if the competition comes to a sudden halt."

Paul Krugman is a brilliant economist but the Smithian premises of his theoretical framework cannot allow that we could actually run out of resources to make all those toys.

Richard Smith (2015) Green Capitalism (pdf)

43.9 Herman Daly

Richard Smith

Beyond growth or beyond capitalism?

Recent publications have revived interest in Herman Daly's proposal for a Steady- State Economy. This paper argues, first, that the idea of a steady-state capitalism is based on untenable assumptions, starting with the assumption that growth is optional rather than built- into capitalism. I argue that irresistible and relentless pressures for growth are functions of the day-to-day requirements of capitalist reproduction in a competitive market, incumbent upon all but a few businesses, and that such pressures would prevail in any conceivable capitalism. Secondly, this paper takes issue with Professor Daly's thesis, which also underpins his SSE model, that capitalist efficiency and resource allocation is the best we can come up with. I argue that this belief is misplaced and incompatible with an ecological economy, and therefore it undermines Daly's own environmental goals. I conclude that since capitalist growth cannot be stopped, or even slowed, and since the market-driven growth is driving us toward collapse, ecological economists should abandon the fantasy of a steady-state capitalism and get on with the project figuring out what a post-capitalist economic democracy could look like.

Capitalism without growth?

In the 1970s and 80s, Herman Daly launched a broadside assault on the academic discipline of economics assailing its dogmatic and neo-totalitarian embrace of neoclassical economics and its willful blindness to our looming environmental crisis. In ground-breaking and widely influential books and articles Daly assailed the "stupor of economic discourse" by holding up to his colleagues what he called the "wild facts" of our ecological crisis: the growing hole in the ozone shield, the alarming evidence of rising CO₂ levels, the shocking rates of natural

resource consumption, the frightening rates of extinction and loss of biodiversity and so on, which mainstream economists ignored (and most continue to ignore to this day). The ecological crisis is caused, Daly argued, by too much growth: “the scale of human activity relative to the biosphere has grown too large” and most especially, by ever-growing consumption in the advanced industrialized countries. Daly attacked the mainstream’s “idolatrous” “religion of growth,” its “growthmania,” its “fetish” of limitless consumption.¹³ Daly’s critique of the neoclassical defense of growth is probably the most devastating critique to come from within the profession. But despite his “radical” break with the mainstream’s fetish of growth, Daly did not at all break with his colleagues’ fetish of the market organization of production, the capitalist market economy. On the contrary. His proposal for a Steady-State Economy was based, he said, “on impeccably respectable premises: private property, the free market, opposition to welfare bureaucracies and centralized control.” So in his Steady-State model, Daly embraces capitalism but he rejects the consequences of market-driven economic development, especially overconsumption and environmental destruction.

For more than 30 years Daly has chanted his mantra of “development without growth” but he has yet to explain, in any concrete way, how an actual capitalist economy comprised of capitalists, investors, employees and consumers could carry on from day to day in “stasis”.

Daly rejects any such interference with market organization of production because, like his mainstream colleagues, he believes that “the market is the most efficient institution we have come up with” and the only option we have.³⁸ He can say this because he subscribes to a capitalist conception of efficiency. Capitalist economists since Adam Smith have defined economic efficiency from the standpoint of the production unit – the factory, mill, mine, etc. (which, conveniently, the capitalists own). So in capitalist terms, the most efficient production method, technology, or economic system is the one that gets the most output from the least input, so produces the cheapest widgets and generates the most product/sales/wealth for a given investment of labor and raw materials. So Daly says the market “is wonderful for allocation”. “Markets singlemindedly aim to serve allocative efficiency.”

Richard Smith (2015) Green Capitalism (pdf)

43.10 Wassily Leontief

Leontief

An uneasy feeling about the present state of our discipline has been growing in some of us who have watched its unprecedented development over the last three decades. This concern seems to be shared even by those who are themselves contributing successfully to the present boom. They play the game with professional skill but have serious doubts about its rules.

The trouble is caused, however, not by an inadequate selection of targets, but rather by our inability to hit squarely any one of them. The uneasiness of which I spoke before is caused not by the irrelevance of the practical problems to which present day economists address their efforts, but rather by the palpable inadequacy of the scientific means with which they try to solve them.

The consistently indifferent performance in practical applications is in fact a symptom of a fundamental imbalance in the present state of our discipline. The weak and all too slowly growing empirical foundation clearly cannot support the proliferating superstructure of pure, or should I say, speculative economic theory.

Much is being made of the widespread, nearly mandatory use by modern economic theorists of mathematics. To the extent to which the economic phenomena possess observable quantitative dimensions, this is indisputably a major forward step. Unfortunately, any one capable of learning elementary, or preferably advanced calculus and algebra, and acquiring acquaintance with the specialized terminology of economics can set himself up as a theorist. Uncritical enthusiasm for mathematical formulation tends often to conceal the ephemeral substantive content of the argument behind the formidable front of algebraic signs.

In the presentation of a new model, attention nowadays is usually centered on a step-by-step derivation of its formal properties. But if the author—or at least the referee who recommended the manuscript for publication—is technically competent, such mathematical manipulations, however long and intricate, can even without further checking be accepted as correct. Nevertheless, they are usually spelled out at great length. By the time it comes to interpretation of the substantive conclusions, the assumptions on which the model has been based are easily forgotten. But it is precisely the empirical validity of these assumptions on which the usefulness of the entire exercise depends.

What is really needed, in most cases, is a very difficult and seldom very neat assessment and verification of these assumptions in terms of observed facts. Here mathematics cannot help.

An attempt to compensate for the glaring weakness of the data base available to us by the widest possible use of more and more sophisticated statistical techniques. These are intended to stretch to the limit the meager supply of facts.

Like the economic models they are supposed to implement, the validity of these statistical tools depends itself on the acceptance of certain convenient assumptions pertaining to stochastic properties of the phenomena which the particular models are intended to explain; assumptions that can be seldom verified.

Continued preoccupation with imaginary, hypothetical, rather than with observable reality has gradually led to a distortion of the informal valuation scale used in our academic community to assess and to rank the scientific performance

of its members. Empirical analysis, according to this scale, gets a lower rating than formal mathematical reasoning.

Devising a new statistical procedure, however tenuous, that makes it possible to squeeze out one more unknown parameter from a given set of data, is judged a greater scientific achievement than the successful search for additional information that would permit us to measure the magnitude of the same parameter in a less ingenious, but more reliable way.

The pursuit of a more fundamental understanding of the process of production inevitably leads into the area of engineering sciences. To penetrate below the skin-thin surface of conventional consumption functions, it will be necessary to develop a systematic study of the structural characteristics and of the functioning of households, an area in which description and analysis of social, anthropological and demographic factors must obviously occupy the center of the stage.

Establishment of systematic cooperative relationships across the traditional frontiers now separating economics from these adjoining fields is hampered by the sense of self-sufficiency resulting from what I have already characterized as undue reliance on indirect statistical inference as the principal method of empirical research.

An exceptional example of a healthy balance between theoretical and empirical analysis and of the readiness of professional economists to cooperate with experts in the neighboring disciplines is offered by Agricultural Economics as it developed in this country over the last fifty years. A unique combination of social and political forces has secured for this area unusually strong organizational and generous financial support. Official agricultural statistics are more complete, reliable, and systematic than those pertaining to any other major sector of our economy. Close collaboration with agronomists provides agricultural economists with direct access to information of a technological kind.

Leontief (1970) Theoretical Assumptions and Nonobserved Facts (pdf)

44

Economic Sectors

44.1 Housing

44.1.1 Land Tenure Finance

Ryan-Collins Abstract

This article examines the links between private property in land and the financial system. Private landed property (PLP) has played an important role in supporting the growth of modern banking and credit systems, industrialization, and economic democratization. However, since the 1980s, high-income economies have exhibited a strong preference for PLP as a form of tenure, in the form of home ownership in particular. This pattern has combined with financial liberalization and innovation to create a land-finance feedback cycle with negative social and economic outcomes. They include a housing affordability crisis for younger and poorer socioeconomic groups; rising wealth inequality as land rents have become more concentrated; economic stagnation due to capital misallocation; and increased financial fragility as household debt has exploded. We illustrate these historical processes in the Anglo-Saxon “home-owning democracies,” where they have been strongest, focusing in particular on the United Kingdom, Australia, and the United States. This article considers how alternative tenure arrangements and reforms to finance and taxation could help mediate these dynamics.

Ryan-Collins Memo

Residential Capitalism

The dominant model of land tenure in high-income economies is private ownership, whether the use is commercial or residential. This fact is rarely questioned, but it could be considered one of the great paradoxes of modern capitalist economies. For, unlike most commodities, land (considered as location) does not observe the basic rules of supply and demand upon which capital-

ist exchange and markets depend for their operation and efficiency. Land has special properties— inherent scarcity, fixity, and irreproducibility. As a result, increased demand yields higher economic rents, which tend to be capitalized into the market value of land. To say that land—which absorbs the growing wealth of the community and wider society in which it sits—should be privately owned and its value only lightly taxed (relative to income and profits) is perverse since the “owner” has done nothing to merit such gains. It was for this very reason that the founding fathers of modern economics—Adam Smith, David Ricardo, John Stuart Mill, and Karl Marx—viewed the landed class and land rents more generally as a threat to capitalist development.

An important reason private landed property (PLP) has become so entrenched as a mode of tenure is its intimate relationship with finance. Titled, privately owned land is arguably the most attractive form of collateral in existence for financial institutions, given the above- mentioned special properties. By supporting the development of modern banking, PLP encouraged economic development and industrialization in both settler colonies and feudal regimes. The perverse economic effects of PLP are then, to some extent, counter- balanced by its enabling of finance and capitalist development.

But the interaction between land and finance is a delicate one. As a result of financial liberalization and globalization in advanced economies, financial speculation has become the dominant motive for investment in land and its appurtenances (most notably residential housing) and the source of negative consequences for society and the economy.

Policy attention has focused almost exclusively on so-called supply- side solutions to the housing problem, whether it be deregulating planning or zoning systems or just building more affordable homes, with much less attention paid to the demand side of the equation or the underlying institutions that have created the land-finance cycle.

In academia, the term “financialization” (of housing/real estate) has become popularized since the 2008 global financial crisis (GFC). However, a number of urban scholars, including Anne Haila, noted the problem of land being exploited as a financial asset rather than a factor of production or consumption good well before the GFC.

In one of her final works, critiques classical economists, who underestimated the ongoing power of landowners in capitalist accumulation. She also notes more recent trends of both corporations and the public sector selling off land in order to release capital to their core business and public services, respectively. She calls for “a theory explaining landowners’ power and alliance with financiers, and the relationship between real estate and finance sectors”.

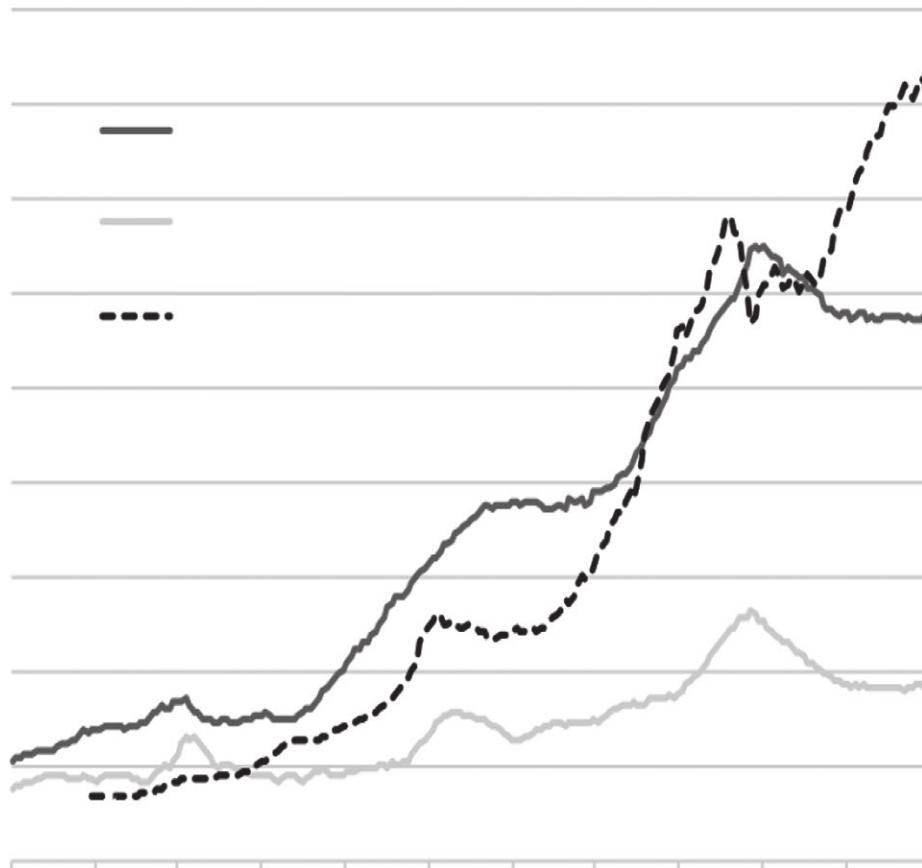
In this article, I focus on the relationship between PLP and the financial sector over time, with special attention to Anglo-Saxon liberal capitalist economies, in particular the United Kingdom, the United States, and Australia, where this

mode of tenure, along with financial liberalization, has been promoted most vigorously.

In the hierarchy of risk of property titles, land carries the least risk, being superior to real capital goods, tradable assets, and contracted income. The more secure the debtor's property title, the more easily he or she can secure credit and the lower the rate of interest. The rate of interest is then determined by the quality of collateral, and there is no "natural rate" that clears the goods market achieving equilibrium. This point has been noted by some economists critical of an equilibrium notion of perfect information.

Credit constraints, which are judged by the degree of liberalization of the mortgage credit markets, are the "elephant in the room," helping to explain significant differences in house prices and consumption between countries such as Germany, the United States, the United Kingdom, and Japan.

The deregulation of mortgage finance was initiated in the United States, the United Kingdom, and Australia following the collapse of the Bretton Woods agreement, which led to the freeing up of international credit flows and increasing competition between the New York and London financial sectors (Helleiner 1994; Krippner 2011). The election of conservative, free-market-oriented leaders (Reagan and Thatcher) in the United States and the United Kingdom led to the repeal of regulations that prevented banks from competing with building societies and other established housing finance institutions. Limits on interest rate charges and tax disadvantages were removed, along with other sectoral credit controls on mortgage credit—the so-called Big Bang. The removal of foreign exchange controls also made banks less dependent on domestic deposits for their funding, de-linking domestic incomes from mortgage credit growth.



From the mid-1970s, U.S. banks were able borrow from abroad to finance mortgages, in particular from the largely unregulated “Euro-dollar” market. Domestic financial innovations also enabled banks to attract deposit funding away from the thrifts.

By opening up housing finance to a vast global investment sector, it broke down previous national and local institutional barriers to the funding of home purchase.

A key development motivating these dynamics in high-income economies in the 1980s was the emergence of a new international regulatory framework—the “Basel Accords”—that introduced for all banks minimum capital requirements that are related to the type of assets they held. Loans secured by mortgages on residential properties only carried half the risk weight (50 percent) of loans to non-financial firms in the original Basel Accord. Securitized mortgages, which were viewed as more liquid and thus even less risky, only carried a 20 percent risk weight. The effect of these reforms was to allow banks to earn fees and net interest margins by holding 2.5 times more credit risk in real estate than they had before, without any increase in their capital requirements.

These regulatory strategies can be seen as a classic example of the fallacy of composition. Regulators and banks, encouraged by policy-makers keen to boost homeownership levels, were right to consider that at the level of any individual bank, a residential mortgage loan will be less risky than an unsecured loan to a firm. But from the perspective of macroeconomic and macro-financial stability, the synchronized expansion of mortgage credit well beyond the rate of growth of GDP and of incomes was clearly problematic. Until the 2007–2008 crisis, however, central banks were reluctant to act, continuing to strictly observe their mandated focus on consumer price stability.

Credit and finance are not neutral. Where they go determines their effect on the economy. Traditional lending to firms supports capital investment and helps pay wages, leading to increased GDP transactions, economic growth, and productivity. The increased growth in the economy enables firms to pay back both the principal and the interest, preventing the build-up of excessive debt overhangs. But credit creation for the purchase of existing property and land increases property prices without stimulating investment or wages. Households must either take on more debt or reduce their spending, leading firms to cut back on investment, leading to lower profits and stagnating wages. This, in turn, feeds into more demand for mortgage debt as house prices continue to rise relative to incomes, generating a positive feedback cycle where increasing mortgage credit effectively creates its own supply. A study of 46 economies over 1990–2011 found a negative relationship between the stock of bank lending to domestic real estate and economic growth but positive growth effects of credit flows to non-financial business.

In Anglo-Saxon economies, homeownership levels appear to have peaked in the early 2000s and have been falling since then, despite further increases in mortgage debt relative to GDP. In these countries, housing wealth and land rents have become more concentrated in older and richer cohorts, with significant growth in “petty landlordism” and second-home ownership.

Privatized Keynesianism

This model of economic development has been termed “privatized Keynesianism” or “house-price Keynesianism”. Encouraging the personal accumulation of assets, such as housing equity, as a means of meeting the cost of social care and retirement needs in an aging population also made political sense to neoliberal governments keen on reducing the role of the state. “Asset-based welfare” began to emerge as a new policy framework, with homeownership leading to less support for higher taxes to fund universal welfare provision and pensions.

The embrace of financial liberalization and homeownership by Anglo-Saxon capitalism may have also been driven, in part, by broader national economic strategies towards globalization. These countries saw their export industries, in particular manufacturing, facing fierce competition from China and other emerging markets and may have seen attracting foreign investment into real estate and other financial assets as a means to offset the resulting trade deficits.

Other Western economies, such as Germany and Sweden, were able to preserve their manufacturing sectors and generate current account surpluses that made asset inflation a less attractive macroeconomic strategy.

Post-2008 Developments

Post-crisis, central banks have taken a closer interest in monitoring house prices and introduced macro-prudential policies aimed at restricting real estate credit to address “systemic risks” across national economies (Cerutti et al. 2017). Regulators have imposed limits to loan-to-value and loan-to-income ratios for mortgages and also targeted buy-to-let and interest-only mortgages with some success in the United Kingdom, Australia, Switzerland, New Zealand, and Hong Kong.

However, countervailing this has been extraordinarily loose monetary policy. Short-term policy interest rates have been reduced to the zero lower bound, whilst quantitative easing (QE) programs have driven down medium- and longer-term rates via the vacuuming up of government bonds from capital markets. The hope was that this would lead investors to invest more in risky, real-economy investments such as debt and equity issued by companies. But the evidence suggests that, rather than stimulating real-economy growth, QE has pumped up asset prices, in particular house prices.

The “wall of liquidity” created by QE catalyzed a global search for higher yielding, but safe, assets). Landed property, particularly in rich global cities, proved to be one of the most attractive assets for investors with global reach, not least because they could easily source borrowing, backed by property assets, at ultra-low interest rates from a banking sector still with a preference for real estate. Property prices in global cities have “synchronized,” with price dynamics closer to each other than with cities and regions in domestic hinterlands (Duca 2020). Although speculative buyers from both home and abroad usually target “prime” (very expensive) properties, speculation raises prices across these cities and means they become unaffordable for those on middle incomes.

A financial sector that has become so dependent on high and rising collateral values.

Only a developer protected from the profit motive, such as the state itself, can ever have any incentive to produce houses at a rate that would lower the cost of housing overall in the area they are being built.

East Asian states, in particular Singapore and Hong Kong, adopted a strategy of public land value (or rent) capture, becoming “property states.” In Singapore, 90 percent of the land is owned by the state, which leases it out for development, enabling it to capture land value increases as leases come up for renewal; 82 percent of the resident population lives in high-quality public housing provided by the state. This creates a virtuous circle of socialized non-bank mortgage finance that has proven effective at providing affordable housing. The average house-price-to-income ratio in Singapore is one of the lowest in Asia and has

been falling since a housing bubble in the mid-1990s. Meanwhile, the system provides the Singapore government with a handsome source of public revenues.

More aggressive macro-prudential policy would seem the most obvious and easiest first step for central banks and financial regulators seeking to reduce the flow of mortgage credit into real estate.

The easiest way to introduce such a scheme might be to have some form of productive credit ratio, whereby a minimum ratio (such as 30 percent) of a bank's assets should support non-financial firms. Currently, that ratio is around 10 percent on average in the United Kingdom.

Regulations should support banks that are able to de-risk their loans via methods other than property-based collateral. "Stakeholder banks" are more focused on business lending, do not have such stringent collateral requirements, and devolve decision-making to branches. They de-risk their loans not by requiring property as collateral but by building up strong and long-lasting relationships with and understanding of the businesses they lend to.

A tax on the incremental increase in the unimproved market value of land that would fall upon the landowner is the obvious policy choice, following Henry George's ([1879] 1884) concept of a land value tax (LVT). By attaching a cost to owning land, LVT diminishes the incentive to buy land for speculative purposes—in hopes of realizing capital gains—rather than for productive purposes or simply to provide shelter.

By the 1980s, the interaction between titled land and finance morphed into a damaging feedback cycle whereby the financial sectors became addicted to property as the main source of profits, collateral, and dominant assets on the balance sheets of financial institutions. The more credit flows into land, the higher house prices and collateral prices go, and the more attractive property becomes as an asset against which to lend. Ultimately, this leads to land and house prices rising well above incomes, driving up land rents and creating financial fragility and widening wealth inequality.

Ryan-Collins (2021) Private Landed Property and Finance: A Checkered History (pdf)

44.2 Ocean ('Blue') Economy

Crona Abstract

Ocean activities are rapidly expanding as Blue Economy discussions gain traction, creating new potential synergies and conflicts between sectors. To better manage ocean sectors and their development, we need to understand how they interact and the respective outcomes of these interactions. To provide a first comprehensive picture of the situation, we review 3187 articles to map and an-

alyze interactions between economically important ocean sectors and find 93 unique direct and 61 indirect interactions, often mediated via the ocean ecosystem. Analysis of interaction outcomes reveals that some sectors coexist synergistically (e.g. renewable energy, tourism), but many interactions are antagonistic, and negative effects on other sectors are often incurred via degradation of marine ecosystems. The analysis also shows that ocean ecosystems are fundamental for supporting many ocean sectors, yet 13 out of 14 ocean sectors have interactions resulting in unidirectional negative ecosystem impact. Fishing, drilling, and shipping are hubs in the network of ocean sector interactions, and are involved in many of the antagonistic interactions. Antagonistic interactions signal trade-offs between sectors. Qualitative analysis of the literature shows that these tradeoffs relate to the cumulative nature of many ecosystem impacts incurred by some sectors, and the differential power of ocean sectors to exert their rights or demands in the development of the ocean domain. There are also often time lags in how impacts manifest. The ocean governance landscape is not currently well-equipped to deal with the full range of trade-offs, and opportunities, likely to arise in the pursuit of a Blue Economy in a rapidly changing ocean context. Based on our analysis, we therefore propose a set principles that can begin to guide strategic decision-making, by identifying both tradeoffs and opportunities for sustainable and equitable development of ocean sectors.

Crona (2021) Sharing the seas: a review and analysis of ocean sector interactions (pdf)

44.2.1 Financing the Ocean Economy

Sumaila Abstract

The ocean, which regulates climate and supports vital ecosystem services, is crucial to our Earth system and livelihoods. Yet, it is threatened by anthropogenic pressures and climate change. A healthy ocean that supports a sustainable ocean economy requires adequate financing vehicles that generate, invest, align, and account for financial capital to achieve sustained ocean health and governance. However, the current finance gap is large; we identify key barriers to financing a sustainable ocean economy and suggest how to mitigate them, to incentivize the kind of public and private investments needed for topnotch science and management in support of a sustainable ocean economy.

Sumaila (2021) Financing a sustainable ocean economy

44.3 Blue Hegemony

Schutter Abstract

The blue economy has become an influential concept in international and national marine governance discourse. Various contested interpretations exist, and different actors choose to emphasise different aspects of the triple goal

of environmental, economic, and social improvements. However, despite disagreement over its interpretations, the blue economy finds support in many different arenas. This paper explores the position of dominance that the blue economy has reached, and examines how supporters of the concept maintain and employ power to keep it relevant. The paper applies a mixed-methods approach: 29 semi-structured interviews with people in roles of formal decision-making across the fisheries sector, economic development and tourism sector, conservation and environment sector, and specific blue economy-institutions are supplemented by observations from the wider landscape during 4 months of fieldwork in Seychelles. Findings show that in international discourse, the blue economy obtains and maintains its influence through persuasion and through the construction of a ‘common sense’ and productive way forward, capable of achieving triple wins. Within this narrative, oceans are undergoing a reconfiguration as economic frontiers, and the blue economy places economic growth from oceans centrally within contemporary environmental governance. Maintaining the blue economy as a powerful concept on the ground is done through social power relations: the blue economy functions as a boundary object, contributing to depoliticisation of discussions about a shared vision. Depoliticisation allows Seychelles to continue using the concept despite simmering dissent among policy makers, practitioners, and resource users. Dominance of the blue economy on the international stage means that associating with it brings Seychelles visibility and influence. The usefulness of the concept in eliding tensions makes it difficult for counter-hegemony to arise, although alternatives are emerging elsewhere, such as blue justice. However, fundamental change is needed to re-politicise environmental decision-making and explicitly discuss values and images attached to the blue economy.

Schutter Memo

The blue economy has widely gained influence at the international stage, and ties in with the hegemonic regimes of contemporary global environmental governance. It has become influential through persuasion and consent, and the boundary object status is useful to facilitate communication but also to offer something to everyone. The triple bottom line promise creates an appealing sense of progressive change, benefiting the economic, environmental, and social dimension simultaneously. Interest in the blue economy is further fuelled by framings of the ocean as underdeveloped and underexplored [31,62], and in need of rational management. The blue modernisation narrative thus absorbs issues associated with the ocean economy (e.g. coral bleaching, pollution, industrial overfishing). It avoids “challeng[ing] the factors causing our ecological ills” [77], constituting a passive revolution of continued and even accelerated exploitation through closing off pathways to alternative trajectories [66]. The emerging conceptualisations and proposed ways of governing oceans also determine who is considered to be connected to the ocean, and consequently, which stakeholders have a voice in blue economy debates. The lack of a culture of local civil society engagement and the ambiguity in the concept means that local engagement in Seychelles has proven difficult. Instead, voices from the international

civil society have managed to gain positions of influence, strengthened by the increased reliance on NGOs in marine environmental governance following economic restructuring and cuts in government budgets.

Schutter (2021) The blue economy as a boundary object for hegemony across scales (pdf)

Part I

Appendices

Appendix A

About



Dyre Haugen and Dyrehaugen is Webian for *Jon Martin* - self-owned Globian, Webian, Norwegian and Canarian with a background from industrial research policy, urban planning and economic development consulting on global, regional and urban scales. I am deeply concerned about the (insane) way humanity (i.e. capitalism) interfere with nature. In an effort to gain insights in how and why this happens stuff is collected from around the web and put together in a linked set of web-sites. The sites are operated as personal notebooks. However, these days things can be easily published to the benefit of others concerned with the same issues. But be aware - this is not polished for presentation or peer-reviewed for exactness. I offer you just to have a look at my ‘work-desk’ as it appears in the moment. Any comment or suggestion can be mailed to dyrehaugen@gmail.com You can follow me on twitter as @dyrehaugen. Thanks for visiting!

Appendix B

Links

Current Dyrehaugen Sites:

- rcap - On Capitalism (loc)
- rclm - On Climate Change (loc)
- recs - On Economics (loc)
- rfin - On Finance (loc)
- rngy - On Energy (loc)
- renv - On Environment (loc)
- rsts - On Statistics (loc)
- rurb - On Urbanization (loc)
- rvar - On Varia (loc)
- rwsd - On Wisdom (loc)

Blogs:

- rde - Blog in English (loc)
- rdn - Blog in Norwegian (loc)

Discontinued:

- jdt - Collection (Jekyll) (loc)
- hdt - Collection (Hugo) (loc)

Not listed:

- (q:) dhe dhn jrw56
- (z:) rcsa rpad rstart

Appendix C

NEWS

Bibliography