Institutional ECONOMICS

Archive

Articles for the Month:

Carlton vs Glebe.
Andrew Norton has a new take on Sydney-Melbourne rivalry, suggesting a book sales methodology for determining which city is the 'chattering class' capital of Australia. On this methodology, Sydney is a clear winner. Andrew is perplexed by the differences in the bestseller lists between the two cities. These results could be influenced by the display practices of the bookstores in question. But the results are sill surprising, given that Sydney's intellectual and cultural life is rather impoverished relative to Melbourne. Yet perhaps this explains the difference. If there is anything to the stereotype of the superficial Sydneysider, perhaps we should expect this to be reflected in their reading habits. Sydneysiders are simply more prone to becoming intellectual fashion victims. The 'chattering class' books in question might play a stronger role as positional goods in Sydney than they do in Melbourne.

posted on 12/31/2003

Institutional Economics collects another gong,
featuring in the 'Best of Australia' year-end issue of *The Reader* (like Arts & Letters Daily, except that it is weekly, in hard-copy and not free). Here is how they describe themselves: *We find the most interesting media content from everywhere and send it to our subscribers (and sometimes offer our views about the issues we cover). As well, we try to explain why the existing media acts the way it does. The bias of the Canberra media pack, the various proprietors, how PR infects media coverage: these are the kinds of subjects we hope will give readers some corrective lenses for the spin in the media.* *The Reader* seems to be part of a trend toward independent media filters that define themselves in opposition to mainstream media.

posted on 12/30/2003

Australian Competition and Consumer Commission
chairman Graeme Samuel is continuing his campaign of opposition to the Dawson review recommendations in relation to a more formalised merger review process, according to the *AFR*. There is very little that is new in the story, except that the AFR has obtained some comment from Samuel confirming that he is talking to the Treasurer on this issue. Samuel continues to appeal to administrative convenience, but the ACCC's main interest is protecting its bureaucratic discretion and lack of accountability in these matters (see the post from 13 November below). The ACCC has only recently undertaken to provide reasons for its merger decisions, which was probably an attempt to fend off the introduction of a more formalised review process.

posted on 12/30/2003

Universities' Lost Golden Age and Geezer Talk.
The *SMH* op-ed page today features not one, but two, laments from essentially the same genre: one on the demise of the mythical golden age when students were free of financial pressures by conservative writer Paul Sheehan; the other on the supposed demise of the university bar by Dominic Knight. In Sheehan's case, this is what Robert Fulford calls 'geezer talk, the dreamy fantasies of the old and nearly old who want desperately to convince themselves that they once did everything better than young folks do it now.' But Dominic Knight seems to be suffering from premature geezerism, harking all the way back to the *1990s*: 'students used to love Manning Bar [at Sydney University] back in 1990s.' This is what Knight thinks today's students are missing out on: *while the bar was a firetrap that stank of stale beer, and every step on the faded carpet squelched, the place undeniably had atmosphere.* Yep, that undeniably sums up the atmosphere. My recollections of the ANU Union Bar in the 1980s are much the same. It will take more than 20 years to turn the grim reality of that place into anything approaching nostalgia. Knight goes on to make the telling observation that the privately-run Clare Hotel opposite the University of Technology, Sydney 'has become wildly popular with its students.' Maybe it's the atmosphere.

posted on 12/29/2003

Ross Gittins
accuses the Productivity Commission of producing a report that is 'intellectually dishonest and cowardly' because of its failure to conform to his own prejudices on the role of capital gains tax relief in promoting house price inflation. Some of Gittins' observations on the politics behind the report are fair enough. In particular, he correctly identifies the reasons for the RBA fingering negative gearing in its submission on the issue: to deflect attention from monetary policy should the house price boom end badly. A certain amount of institutional shirking and bureaucratic arse-covering is to be expected in this context. But Gittins' view that capital gains tax relief and negative gearing are largely to blame for the recent house price boom in Australia will not hold water. House price inflation has been a widespread development throughout the industrialised world in recent years, suggesting a common price shock to this asset class that cannot be explained in country-specific terms. For all the inevitable politics behind the report, the Commission had the correct focus. Ross was down on capital gains tax relief well before the current house price inflation came along and is just as guilty of using the housing affordability issue to press his pet causes as the other players in the debate. Gittins also quotes some economists from the investment banking/funds management community on this issue. It should go without saying that these are not exactly disinterested players in the debate, given that they are in the business of promoting investments in asset classes that compete with residential property among retail investors and that also happen to benefit from capital gains tax relief. Ross and friends are throwing stones in the glasshouse. **UPDATE:** For those interested in the issue of capital gains tax, I would highly recommend this report by Alan Reynolds commissioned by the Australian Stock Exchange. It changed the way I think about some of these issues.

posted on 12/22/2003

Remember how an Australia-US Free Trade Agreement
was meant to compromise Australia's economic engagement with Asia? According to Rowan Callick, the Australia-US negotiations have been critical in China's decision to pursue an FTA with Australia: *[China] has selected Australia as its first partner for major bilateral FTA talks. Why? Partly, Canberra believes, because of Australia's reputation for clean, high-quality FTAs - with New Zealand, Singapore and Thailand,* ***and most importantly with the US, which strongly reinforced the seriousness with which Australia is taken by China as an economic player****...Canberra views the start of talks in January as a defining moment in Australia's history, one that must be seized.* (emphasis added)

posted on 12/22/2003

Samuel Brittan
on the politics of the Nobel prize in economics.

posted on 12/20/2003

Some interesting poll results out of the UK,
from *The Economist's* 'Bagehot:' *By a large majority, people think they are paying too much tax and there is little faith that increased spending is improving public services. In two polls, around 80% reckoned that a large part of the money was being wasted. A Populus poll for the Times and an ICM poll for Reform, a think-tank, found, respectively, that 59% and 76% thought the government's tax-and-spend policies were damaging the economy's competitiveness. The government must hope that this is nothing more than a snapshot of opinion before the extra spending bears fruit. And it is true that, according to both ICM and a YouGov poll in the Daily Telegraph, almost half the respondents (50% and 44% respectively) still think that taxes should go up to fund better services. Unfortunately for the government, the long-run data offer no such comfort. Hostility to overtly redistributive policies has been growing precisely since the time when the spending gusher was opened. The figure of 44% compares with 68% at the time of the last election in 2001 and 74% when Labour was returned to power in 1997. It is the lowest number in favour of extra spending since 1979, when Margaret Thatcher took office. The Social Attitudes survey underlines the trend. A study by two academics, John Curtice and Stephen Fisher, demonstrates that while Mrs Thatcher never succeeded in converting public opinion to her way of thinking, Tony Blair seems to have done the job for her. People who identify with the Labour Party are now much less likely to hold left-of-centre views than they were during Thatcherism's heyday (58% in 2001 compared with 84% in 1987). At the same time, there has been a general drift rightwards in terms of declining support for policies intended to help the poor, especially among the young and the hard-pressed lower middle classes.* I tend to discount polls like these, because the results are notoriously sensitive to the way in which the question or choices are framed. But what is interesting is that growing dissatisfaction with the provision of public services is translating into less support for higher taxes in the UK. The Australian data are arguably more mixed. But there are good reasons for thinking that 'health and education' are not 'positives' for the federal opposition in Australia, as is commonly assumed. If people come to associate new government spending initiatives in these areas with higher taxes and further reductions in consumer sovereignty (ie, limiting their ability to opt out of public provision through reductions in their after-tax income),

then such promises could turn out to be political negatives. One would hope that the horror stories coming out of the public hospital system in the state of New South Wales are more likely to lead to people wanting to opt out of the public system altogether than to support increased public spending on health. But in NSW, few people are making the obvious point that these problems are inherent in the public provision of private goods.

posted on 12/19/2003

Mark Steyn

on the horror of the Bike-Path Left: *David Brooks, visiting Burlington in 1997 in search of what eventually became his thesis Bobos in Paradise, concluded that the quintessential latté burg was "relatively apolitical." He's a smart guy but he was wrong. All the stuff he took as evidence of the lack of politics--pedestrianization, independent bookstores--is the politics. Because all the big ideas failed, culminating in 1989 in Eastern Europe with the comprehensive failure of the biggest idea of all, the left retreated to all the small ideas: in a phrase, bike paths. That's what Bill Clinton meant when he said the era of big government was over; instead, he'd be ushering in the era of lots and lots of itsy bits of small government that, when you tote 'em up, works out even more expensive than the era of big government. That's what Howard Dean represents--the passion of the Bike-Path Left.*

posted on 12/19/2003

Surveys of consumer and business sentiment

attract a lot of media attention and are sometimes credited with moving markets. As with labour market reports, this is partly because people feel more confident in their ability to interpret what these surveys mean for the economy. This in turn reflects the persistence of the Keynesian notion that sentiment or ‘animal spirits’ are important drivers of activity. There is considerable evidence arguing that these surveys in fact contain little information that is not already available in contemporaneous and lagged activity data. In other words, it is activity that drives sentiment, not the other way around. Sentiment surveys may still be useful in providing more timely and cost effective information about current and future activity, since they are quick and relatively cheap to implement. But their usefulness is otherwise very limited. Here are abstracts for two papers by economists from the Richmond Fed and the RBA respectively on the subject of sentiment surveys: *Consumer sentiment may predict future household spending, either because sentiment is an independent causal force or because it foreshadows current economic conditions. The empirical evidence we present favors the second interpretation. The evidence in previous research that favors the first interpretation is not robust because the analysis failed to control for the possible influences of expected changes in income and interest rates on consumer spending. Consumer sentiment foreshadows current expectations about the economy as well as about interest rates, suggesting that it is useful as a barometer of the near-term outlook for spending. *** Indices of business and consumer sentiment receive widespread media coverage and are closely watched by market economists despite their limited success as leading indicators. In this paper we ask what explains ‘sentiment’ and find that lagged economic indicators (such as changes in GDP, job vacancies and the cash rate) can explain a substantial proportion of the variation in a number of backward and forward-looking sentiment indices. This does not rule out the* *possibility that they may be useful for forecasting. We find, however, that when currently available economic information is appropriately 'filtered' from the sentiment indices, in most cases they fail even rudimentary Granger-causality tests of predictive ability. On a more positive note, we find that the Roy Morgan consumer confidence rating, NAB actual business conditions, NAB expected employment outlook over the next three months and the second question in the Roy Morgan and Westpac/MI consumer surveys all provide some, albeit small, contribution to forecasting employment growth. The second question of both consumer confidence surveys (which asks about anticipated personal financial conditions over the coming year) also appears to have some ability to predict recessions. Outside of these results there is little evidence that the surveys tell us anything we didn't already know. Thus, there is reason to suspect that surveyed respondents' forecasts offer little more information about the future path of the economy than a weighted average of lagged economic variables.*

posted on 12/17/2003

Fresh from debunking the great deflation scare of 2003

Alan Reynolds turns his sights on inflation angst: *As with the deflation scare earlier this year, the inflation stories in the popular press don't hold up too well on close examination. The Wall Street Journal's version mainly relies on veiled theories about inflation. A table of statistics includes only the lowest measure of inflation, the core Consumer Price Index. And any figure about past inflation tells us little about the future. Inflation is always lower before it moves higher. Other numbers in the table would be informative only if some theory could link them to inflation. One theory relies on a syllogism: "If the Federal Reserve shares that view [about a strong economy being inflationary], it will push up the federal funds rate, which... could slow or stop the recent economic rebound." The first premise is that strong economic growth boosts interest rates. The secondary premise is that higher interest rates weaken economic growth. Accept both premises, and your conclusion must be that strong economic growth causes weak economic growth. To avoid that paradox, scrap the second premise. Real interest rates always move higher when real gross domestic product speeds up, and rates decline in recessions. Real interest rates are what is left after subtracting inflation, so it is wrong to treat every interest rate rise as evidence of inflation.*

posted on 12/15/2003

Robert Heinlein's unpublished first novel

For Us, The Living: A Comedy of Customs is reviewed at CBC News. According to the review: *In the new novel, his first draft of future history includes a take-over of the United States by what he calls "Neo-Puritans" led by the televangelist Nehemiah Scudder, a character who is also prominent in his 1941 novella If This Goes On. The novella is the story of the second American revolution, when libertarians finally overthrow a dictatorship of the religious right. For Us, the Living also includes one chilling incident, a surprise attack on the island of Manhattan by two giant helicopters that flood the island with poison gas, killing 80 per cent of the population. The helicopters are based on aircraft carriers and the attack comes when the United States is at war with Argentina, Brazil and Chile in December 2003.* Having read the rest of Heinlein's work at an earlier age, I will have to read this one too for the sake of completeness. According to CBC story, a Heinlein biography is also in the works.

posted on 12/13/2003

A useful resource.

EconPhD.net is a useful resource for current and prospective PhD students in economics.

posted on 12/13/2003

The Australian Competition and Consumer Commission

has lost another 'market power' case in the High Court: *In this latest decision the High Court argued that Rural Press's retaliatory threat was not an abuse of its monopoly power but a use of its "material and organisational assets", which would no doubt intensify small business's plea for help. "What they're saying is that what Rural Press was trying to do was nothing more than trying to preserve the market it had for itself," said Ray Steinwall, visiting fellow at the University of NSW law faculty and general counsel at the NSW Independent Pricing Tribunal.*

posted on 12/12/2003

Alan Mitchell

is one of the few commentators to have consistently invoked the classical case for free trade in the debate over an Australia-US FTA. As Mitchell has long argued, the best approach to the negotiations would be to give the Americans everything they want. Unfortunately, it is not likely to play out that way: *A few weeks ago an economics professor rang to say excitedly that he'd heard that the Americans were suddenly demanding free access to the Australian university market. Could this be true? Could an old economic rationalist's Christmases all be coming at once? Alas, even if the Americans were interested in such a reform, it would be so good for Australian students that our negotiators would be bound to resist it to their last breath. But, as it happens, America's politicians are as determined as the Australian government to maintain the status quo. Australian universities can relax. The government's subsidies for tertiary students will continue to discriminate in favour of the established, publicly owned universities, and against new private and foreign universities. There will be no economic rationalist nonsense such as fully transferable vouchers that university students could use to help finance the cost of tuition in any university of their choosing, in Australia or elsewhere. Any uppity students with ideas of studying at the feet of a US Nobel Prize winner can think again. Any Australian university that feared it might have to lift its game to compete with American universities can relax. And any enterprising university that thought it might attract adventurous US students to do their degrees in Australia can just put their enterprising ideas away.* Mitchell is unduly pessimistic about the prospects for increased competition from US universities. One of the consequences of the greatly expanded student exchange programs between Australia and the US is that Australian students are getting to see what a well-funded, consumer-driven university system looks like.

posted on 12/10/2003

The Federal Government's Mid-Year Economic & Fiscal Outlook
has seen yet another upward revision to estimates for the budget surplus, giving further encouragement to those labouring under the mistaken assumption that fiscal policy initiatives must be framed entirely within the confines of the surplus. This effectively rules out a significant reduction in the overall tax burden, since tax cuts are seen as something that can only come out of the surplus. A meaningful reduction in the tax burden can only be realised through a reduction in the Federal government's own-purpose discretionary spending. But fiscal policy has now been reduced to a false choice between new spending or tax cuts out of the surplus, rather than meaningful reform of both revenues and outlays. One argument that is being used against further tax cuts is that they would be stimulatory at a time when monetary policy is aiming to be contractionary, implying that tax cuts would put upward pressure on interest rates. This would not be a serious concern if the tax cuts were also accompanied by reductions in expenditure. But this argument is being used in support of an entirely different agenda, neatly summarised by Laura Tingle: *But if ever there was a year to spend a surplus on infrastructure and less immediately stimulatory projects, rather than a tax cut that will boost consumer spending, surely it must be the one now approaching.* A simplistic Keynesian multiplier analysis would suggest that infrastructure spending would be considerably more stimulatory than tax cuts, although the small numbers involved suggest that neither would be a serious concern for monetary policy. But note the disregard for economic efficiency in this argument. Infrastructure spending can, of course, promote productivity, but one has to be doubtful whether this is the case with those projects favoured by the infrastructure lobby in Australia and the pet schemes of politicians. There is little consideration given to the distortionary implications of high marginal tax rates as a competing concern.

posted on 12/9/2003

RBA Governor Macfarlane's
testimony to the House Economics Committee once again makes explicit that the RBA is not in the business of targeting house price inflation: *It is clear that, despite our best endeavours to explain ourselves, a number of people think that the Bank tightened to cool down the property market. In fact, I have more than once received unsolicited advice that it would be better for us to explain our action in this way because people could more easily identify with it. The overheated property market is something that people can see around them; it is much more concrete than such concepts as inflation-targeting or returning interest rates to normal. However, such an approach would not be consistent with the truth. For a start, signs of overheating in the housing market were clearly evident through the second half of 2002 and all through 2003, yet the Bank did not change monetary policy. It was only when it became clear that good economic growth had returned both globally and domestically that rates were raised. I have often stressed that monetary policy has to be set taking into account the average of all the parts of the economy, not to what is happening in one sector. Of course, if a sector is overheated, it may push up the average for the economy, and in that way exert a disproportionate influence. It is also true that, historically, borrowing for housing purposes has been one of the more interest-sensitive sectors, and so it may have been more affected than other sectors by the previous low level of interest rates and it may respond more than other sectors to the recent*

increases. But that does not mean we singled it out. Unfortunately, Macfarlane's testimony also suggests that the RBA has lost none of its enthusiasm for its role as a regulator of the payments system, with BPay now in the RBA's sights over interchange fees: *We're talking to the banks about BPay and we'll do a thorough study of the economics to see whether the interchange fee is reasonable or if indeed there should be an interchange fee at all.* Macfarlane also indicated he would like to discourage credit card use with transaction fees. Unfortunately, the RBA's 'economics' in all this has been seriously flawed. The RBA is a frustrated regulator, having lost its battle to retain its regulatory role in relation to the financial system, and so all its paternalistic instincts are now being focussed on the payments system.

posted on 12/9/2003

What I am reading.

Steven Pinker's *The Blank Slate: The Modern Denial of Human Nature* came to me highly recommended and is one of the few books I have read recently that has changed my mind on some important issues. Following Bryan Caplan's article on the role of economic education in the political economy of Bastiat and Mises, I was struck by this passage in Pinker: *The obvious cure for the tragic shortcomings of human intuition in a high-tech world is education. And this offers priorities for educational policy: to provide students with the cognitive tools that are most important for grasping the modern world and that are most unlike the cognitive tools they are born with. The perilous fallacies we have seen in this chapter, for example, would give high priority to economics, evolutionary biology, and probability and statistics in any high school or college curriculum. Unfortunately, most curricula have barely changed since medieval times, and are barely changeable, because no wants to be the philistine who seems to be saying that it is unimportant to learn a foreign language, or English literature, or trigonometry, or the classics. But no matter how valuable a subject may be, there are only twenty-four hours in a day, and a decision to teach one subject is also a decision not to teach another one. The question is not whether trigonometry is important, but whether it is more important than statistics; not whether an educated person should know the classics, but whether it is more important for an educated person to know the classics than to know elementary economics. In a world whose complexities are constantly challenging our intuitions, these tradeoffs cannot be responsibly avoided.*

posted on 12/8/2003

That Krugman cover yet again.

Symptomatic of Bush Derangement Syndrome (BDS), according to Charles Krauthammer: *It is true that BDS has struck some pretty smart guys -- Bill Moyers ranting about a "right-wing wrecking crew" engaged in "a deliberate, intentional destruction of the United States way of governing" and New York Times columnist Paul Krugman, whose recent book attacks the president so virulently that Krugman's British publisher saw fit to adorn the cover with images of Vice President Cheney in a Hitler-like mustache and Bush stitched up like Frankenstein. Nonetheless, some observers took that to be satire; others wrote off Moyers and Krugman as simple aberrations, the victims of too many years of neurologically hazardous punditry.* Not to be confused with the more localised outbreaks of Howard Derangement Syndrome (HDS).

posted on 12/6/2003

The European Union's Growth and Stability Pact

is now widely regarded as a dead-letter following the failure of European Finance Ministers to throw the book at Germany and France over their continued failure to bring their budget deficits below 3% of GDP. As usual, the demise of the Pact is being viewed as a problem with the fiscal rules rather than the euro project itself. For example, *The Economist* observes that: *An optimistic interpretation would be that the stability pact will now evolve from a rigid rules-based system that is both unrealistic and undesirable into a more flexible instrument that relies more on moral pressure and political understandings.* At the outset of the euro project, I wagered that at least one country would be forced out of the euro within five years because of an inability to meet the requirements of the Growth and Stability Pact. I did not allow for the possibility that the fiscal rules themselves would be dumped and that the principal offender would be Germany. The fiscal rules of the Growth and Stability Pact are indeed 'unrealistic and undesirable,' but this is an argument against the euro project that necessitates them. The demise of the Pact has removed one of the major underpinnings of monetary stability in the eurozone.

posted on 12/5/2003

The Reserve Bank of Australia's

latest increase in official interest rates seems to have drawn out more than the usual special interest criticism, principally, that higher interest rates are putting upward pressure on the Australian dollar. While the motivation behind these criticisms is obvious, the equally obvious response is to ask whether or not these people have heard of hedging. With both interest rates and the exchange rate having touched multi-decade lows only two years ago, there is little excuse for not having taken advantage of these opportunities to hedge the relevant exposures. The critics of the RBA were on more solid ground in questioning the emphasis that the most recent Statement on Monetary Policy put on growth in household debt as a 'separate, but no less important issue' than the inflation target. Despite Governor Macfarlane's subsequent explicit disavowal that the RBA is targeting house price inflation, the emphasis the RBA has given to credit growth is bound to create the impression that it is straying from its inflation targeting mandate. This is unfortunate, because the RBA could easily rationalise the current tightening episode with reference to the strength of the recovery in the world economy. The RBA's own research points to the existence of a cointegrating relationship between Australian and US GDP, for example. The latest criticisms of the RBA point to the dangers of an everything-but-the-kitchen-sink or check-list approach to rationalising monetary policy actions. The emphasis the RBA has placed on credit growth raises suspicions that the RBA is more interested in paternalistic interference with capitalist acts between consenting adults than inflation. Governor Macfarlane has indeed performed a valuable community service in sounding the alarm on these issues in recent years. But Macfarlane's community service announcements on these issues should be kept distinct from the rationalisation for monetary policy actions. The great danger now is that any correction in house prices will be blamed on overly aggressive monetary policy, undermining support for the inflation targeting framework.

posted on 12/4/2003

Richard Rahn

asks whether the US budget deficit is *too small*: *What we do need to be concerned about is not the deficit, but the very rapid growth in real, nondefense, discretionary federal government spending, which is up an average of 7.2 percent yearly for the last three years. A continuation of this trend could indeed cause real economic damage. Finally, the analysis of the historical data clearly indicates that if we had properly structured tax cuts (like the first Reagan and the most recent Bush tax cuts) in 1969, 1973, 1979, 1989 and 2000 we may have avoided the recessions, with all their human misery and unemployment, that occurred the year following each of the above dates. Unfortunately, policymakers in all of those years were more preoccupied with reducing the deficits rather than keeping the economy growing. The lesson is clear, economic prosperity can continue, even if the federal government never balances its budget, provided it keeps government spending from growing as a percentage of GDP, and has an ongoing program of removing tax and regulatory impediments to growth.*

posted on 12/2/2003

Bryan Caplan

has completed his two-part essay on political economy in Bastiat and Mises. Caplan argues that Bastiat and Mises have a very different view to the one suggested by conventional public choice theory. Basitiat and Mises suggest that the problem is not that people vote their own interest. The electorate is simply labouring under bad economic ideas: *The Bastiat-Mises view of democracy is often accused of being "pessimistic." This is not only irrelevant; it is false. If special interests are in the driver's seat of democracy, then economic education is in vain. Even if every voter understood economics perfectly, inefficient policy would endure. The Bastiat-Mises view, in contrast, makes economic education the key to a better world.*

posted on 12/2/2003