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## Archive

Articles for the Month:

### Yet more on that Krugman cover.

[Don Luskin](#) points to possibly the most bizarre '[correction](#)' ever run in the *NYT*. As Luskin notes, as a 'correction,' it simply makes no sense. Corrections are for errors of fact, not interpretation. Luskin suggests it is just more defensive spin on Krugman's behalf, but even on that score, it's a failure. The criticism that has been made of the cover doesn't depend on some misinterpretation of one of its constituent images. [Krugman himself](#) has effectively conceded that the cover art is inappropriate and made the most damning ironic connection in relation to its actual context. Attempting to spin it otherwise just digs the hole deeper.

posted on 11/30/2003

### The end of deflation in Japan.

[Japan's core CPI](#) turned marginally positive in October, with a 0.1% change over the previous year. As always, it is possible to point to one off factors influencing this result, in particular, the unseasonably cold weather that has put upward pressure on the price of rice and tax changes. But the annual rate of change in the CPI has been on an upward trend for sometime now. Measured by the GDP deflator, deflation remains more pronounced, reflecting declining capital goods prices that are included in the non-residential investment deflator, but not the CPI. Given the massive overcapitalisation of the Japanese economy, it is appropriate for capital goods prices to fall. The extent of this fall is in any event overstated by the current methodology for calculating the GDP deflators. When Japan moves to a chain-weighted methodology sometime in 2005, Japan's measured deflationary experience will probably look less severe. In the meantime, it is remarkable that the return to a positive rate of inflation in Japan as measured by the CPI has not attracted more attention.

posted on 11/29/2003

### Get Shorty.

[James Surowiecki](#) discusses the SEC's proposed trial to remove restrictions on short selling large cap stocks in the US: *The result should be a better functioning market, which is in the interest of investors as a whole. Let corporations denounce short sellers all they want. The case against these bears is a lot of bull.* Milton Friedman's (1969) 'In Defense of Destabilizing Speculation' in [The Optimum Quantity of Money](#), Chicago: Aldine is, as is so often the case with Friedman, the classic reference on this issue.

posted on 11/28/2003

## European Market Watch

▶ [Good News...Where's the Bad News?](#)

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Fallen and I Can't Get Up: Is the U.S. Dollar About to Crash ... Again? [Learn More.](#)

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### The Economist's 'Lexington' column

on how [Bush hatred](#) is helping the President, including this observation: *Bush-hating is a fast-growing business, with Michael Moore and Al Franken as its robber barons and every leftist author in the land trying to break into the market.* No doubt this is the market the British publishers of Krugman's book had in mind when they decided to adorn it with imagery supplied by the anti-globalisation left, to [Krugman's subsequent embarrassment](#). Lexington's broader argument about Bush hatred helping the President has remarkable parallels to the pathological attitudes to Prime Minister John Howard among the commentariat in Australia. Much of the commentary directed against him only serves to reinforce his electoral position, since it demonstrates that Howard is closer to the electorate on key issues than those who criticise him. Indeed, the parliamentary press gallery almost single-handedly re-elected him at the last general election by giving saturation coverage in the final days of the campaign to an issue they thought was a negative for the government that was in fact a positive in the minds of the broader electorate.

posted on 11/27/2003

### Amid the positive signs of reform in Japan,

METI remains as confident as ever that it can [centrally plan](#) the future of the Japanese economy: *The Ministry of Economy, Trade and Industry will designate six fields as key industries in which Japan can take a leading role and help drive the nation's economy, the Nihon Keizai Shimbun learned Monday. METI will apply the designation to biotechnology, fuel cells, Internet-enabled home appliances, content such as computer software, environmental equipment and services, and robotics. Industries that supply these areas would also be considered key to economic growth. METI hopes to have top corporate leaders and academics participate, and spur restructuring within the industries as well as have the government come up with support measures. The ministry plans to have a report ready by May, which will include market projections for these industries.* This is the same bureaucracy that famously told Sony not to bother with consumer electronics and suggested that Honda avoid light passenger vehicles. One of the classic studies of industry policy in Japan is "Market access and competition: A simulation study of 16K random access memories," in *Empirical Methods in International Trade*, Cambridge, MA: MIT Press, 1988, which showed how strategic industry policy could impose net costs on an economy. The co-author was one Paul Krugman.

posted on 11/26/2003

### More on that Krugman cover.

The [NYT](#) has taken up the story and has some reaction from Krugman. Krugman essentially concedes that the cover on the Commonwealth edition is inappropriate, saying: *"I should have taken a look at that and said, 'What are you doing marketing me as if I am Michael Moore? This is silly.'"* Krugman deserves some credit for conceding this, except that he also tries to suggest that the cover was 'intended to be ironic.' The story notes that he was in fact a participant at the New York meeting of the World Economic Forum in 2002. It was the protestors outside the same meeting who then unwittingly provided the images for the cover art. This is indeed ironic, but Krugman's claim that the irony was intentional beggars belief. In any event, it is pleasing to me that the publishers are being held to account for this and that Krugman appears suitably embarrassed. Not so much because I have a major axe to grind

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against Krugman. I actually have quite a bit of respect for his scholarly output and even some of his earlier popular writing. My main concern in all this has been the way British publishers take for granted the political views of their prospective readers. The use of anti-American political iconography to market Krugman's book tells us more about the publishing industry than it does about the author. This episode has also served as a nice illustration of the way in which the blogosphere can promote accountability. It only takes one blog-equipped graduate student browsing in a Sydney bookstore to hold a major newspaper and publishing house to account. **UPDATE:** [Mickey Kaus](#) thinks Krugman should not get off so lightly: *Why is this a legitimate story? For the same reason it's often legitimate to hold reporters responsible for the headlines on their pieces even though they don't write the headlines. The headline writer is typically a copy editor who reads the piece quickly and tries to distill its essence--thus replicating what a average reader will do. If the headline gives a tendentious or slanted impression, often that's because the piece itself gives a tendentious or slanted impression to the average reader. Similarly, a presumably intelligent British publisher has read Krugman's book and distilled its essence as something like 'More Typical Militant Left-Wing Bush Hatred.'* Maybe the publisher did that because Krugman doesn't write much these days that typical militant left-wing Bush haters would be bothered by--even when that requires concealing his actual, more nuanced views. ... Someone judged his book by the cover, and it's a judgment that should embarrass him.

posted on 11/24/2003

**Samuel Brittan**

calls for an end to [immigration controls](#) for an 'experimental period' with a view to showing that this would yield net benefits. Unfortunately, with apparently so few convinced of the merits of freedom of movement in relation to goods, services and capital, Brittan's proposal is probably a non-starter and not just in the UK. By way of illustration, Australia's arts community is currently engaged in a brazenly self-interested lobbying effort in the context of negotiations for an Australia-US free trade agreement to continue sheltering its mediocre product behind government subsidies and local content rules. [Guy Rundle](#) is effectively calling for the nationalisation of the film industry, saying 'what we really need is a sort of government film studio,' something we might more reasonably expect to find in North Korea. [Jean-Francois Revel](#) has written eloquently on the consequences of cultural protectionism: *The idea that a culture can preserve its originality by barricading itself against foreign influences is an old illusion that has always produced the opposite of the desired result. Isolation breeds sterility. It is the free circulation of cultural products and talents that allows each society to perpetuate and renew itself.*

posted on 11/22/2003

### More on the Krugman cover

[Josh Gerstein](#) of the *New York Sun* has got some official reaction from the publishers and makes some very good points about the irony of Krugman's book being marketed through images of the anti-globalisation left: *W.W. Norton & Co.*, the American publisher of Mr. Krugman's book, indicated that it was made aware of the British company's marketing plan. "They would absolutely keep us informed," Norton's president and chairman, Drake McFeely, told *The New York Sun*. Asked if it was fair to say that his company and Penguin had taken dramatically different tacks in hawking the book, Mr. McFeely laughed heartily and replied, "I agree about that." He said that his firm had deliberately shied away from the dramatic imagery being used to promote the British edition. "We did not need to make this kind of splash," he said. Mr. McFeely called Mr. Krugman a "household name" in America, but said he does not enjoy that status overseas. "They have a much trickier publishing proposition in the U.K.," the publishing executive said. Mr. McFeely acknowledged that the British jacket would not have been appropriate for an American audience, but he said that he doubted that he or Mr. Krugman had any legal right to reject the cover art used in other countries. "Would I have used that jacket? No," Mr. McFeely said. "Am I going to censor what a very good publisher over in the U.K. might think is a good way to handle this book? I'm not going to do that either."... Perennial World Trade Organization protesters, like those depicted on the cover, might not care for Mr. Krugman's use of the word *bogus* to describe their arguments against the global trade body. "Every successful example of economic development this past century" is attributable to globalization, he writes in one piece. In another column, he faults America's labor movement for "working against the interests of most of the world's poor." While a writer for the online magazine *Slate* Mr. Krugman once filed a column entitled "In Praise of Cheap Labor." He has even argued that free trade is a net plus for the global environment.

posted on 11/21/2003

### Australian Business Economists

are holding their [annual forecasting conference](#) today, including keynote speaker SF Fed President Robert Parry. I am assuming ABE will put the papers up shortly. Keep an eye out for Ross Gittins' paper on the local monetary policy and political outlook. Previous presentations by Gittins at this forum have been quite insightful. Once again, it is telling that some of the most insightful commentary on Australian federal politics comes from someone who is not a member of the federal parliamentary press gallery. I would go so far as to say that Gittins has missed his true calling, except that had he been a member of the gallery, he would probably have also succumbed to its incredibly insular perspective.

posted on 11/21/2003

### **My previous post on the cover art for Krugman's book**

has generated something of a stir in the blogosphere. I should point out that it is quite common for books to have different covers in the US compared to the same titles published in the UK and other Commonwealth countries and is partly just a reflection of the territorial division of copyright. In Australia, we generally get the UK not the US editions of any given title. When I first saw the book in a Sydney bookstore, I was surprised that no one had previously commented on the cover. It then occurred to me that the US cover might be different and a quick check on the UK and US Amazon sites confirmed this. I am surprised that the publishers thought that such an overtly partisan cover would help sales. In their defence, it could be said that the Commonwealth version at least gives the potential buyer a clear indication that the contents is probably not going to be overly impartial or dispassionate about the Bush Administration! **UPDATE:** There has been much speculation about the origin, source and meaning of the cover design. Here is the cover art credit from the back of the paperback edition: *Cover: protestors with puppet placards demonstrate against the World Economic Forum, NY, 2002, copyright Alex Webb / Magnum Photos and copyright Susan Meiselas / Magnum Photos. Cover design: BonzoJones.* So now you know!

posted on 11/20/2003

### ***The Economist's 'Face Value'***

column profiles [Paul Krugman](#) and pretty well sums up my own view of him: *But, increasingly, people are asking whether Mr Krugman's success as a journalist is now coming at the expense of, rather than as the result of, his economics...perhaps the most striking thing about his writing these days is not its economic rigour but its political partisanship.* I saw a copy of Krugman's latest book in one of the local bookstores yesterday and was struck by its cover art. The cover art for the non-US or Commonwealth version of the book is very different from the unremarkable text that adorns the US version. [Click here](#) to see the version that retails at Amazon in the UK and compare it to the [cover from Amazon's US site](#). The cover art work for the non-US edition is more characteristic of the shopfront trashing anti-globalisation left than what we might expect from a mainstream commentator and publishing house. If I'm right about there being two sets of cover art for the US and non-US version, then the publishers seem to be engaging in a little more than just the usual territorial price discrimination. They seem to be discriminating across markets in relation to the cover art as well. I doubt they would get away with a cover like the Commonwealth version in the US. It says a lot that they think this sort of thing will work in other markets.

posted on 11/18/2003



### Opposition Treasury Spokesman Mark Latham

has told the [AFR](#) that a future Labor government would legislate to make the RBA independent and remove the Treasury Secretary from the RBA Board. He also wants to see the composition of the RBA Board changed to reflect a greater focus on monetary policy expertise. These are very welcome policy proposals that tie in well with the ALP's new-found interest in fiscal policy rules (see my post from 3 November). The current government failed to properly address the issue of central bank reform when it came to office in 1996, leaving Australia with a framework for monetary policy governance that significantly lags world's best practice. At least part of the motivation behind Latham's proposal is mistaken, however. Like all oppositions, he is concerned about political pressure being placed on the central bank. But government questioning or even criticism of monetary policy decisions is perfectly legitimate in my view, so long as the RBA has the institutional capacity to resist political pressures on its decision-making. Indeed, such open signalling of policy disagreements can be taken as a welcome sign that politicians do not have access to effective back channels of influence. Robust debate over monetary policy is essential to good policy outcomes. Reinforcing the legislative basis for the RBA's independence should make for more such debate, not less.

posted on 11/18/2003

### Cato on US Fiscal Policy:

'[money-sucking vampires that just won't die.](#)' Meanwhile, in Australia, [Ross Gittins](#) is down on Treasurer Costello for contemplating tax cuts that risk being pro-cyclical. But isn't Ross all in favour of extra spending on health, education and infrastructure? A simplistic Keynesian multiplier analysis would suggest that such spending would be even more pro-cyclical, assuming that's what Ross is really worried about.

posted on 11/17/2003

### RBA Governor Macfarlane's

[address](#) to the Melbourne Institute conference is worth reading, in particular, his concluding comments: *The potential for intergenerational conflict exists in all countries, and their future economic success depends in some sense on how they handle it. The countries that will do worst are those where the population is aging the fastest, and those where their governments have given the most generous promises. Again, we are looking mainly at Europe to find this combination of problems. But even in Australia, the conflict could become a problem and lead to all sorts of behavioural changes. At the very least, we should question the assumption that age and poverty are positively related and that concessions to alleviate the latter should be directed at the former. In fact, I think we will have to go further and be pre-emptive in conditioning the public, particularly the grey-headed part, to accept that policy must be forward looking and directed to ensuring a vigorous Australian economy and society 20 years hence. This will mean giving priority to tomorrow's working-age population, rather than satisfying the demands of yesterday's.* What Macfarlane is saying is actually quite provocative, but said with his characteristic understatement. Macfarlane goes on to say that he was surprised at the 'favourable public reaction' to his comments on higher education made previously at the same forum. But then he ducks for cover behind the following motherhood statement: *I can think of no better way of*

*ending this speech than again stating my view that an improvement in the quality of tertiary education is probably the best investment we can make in our future.* Macfarlane deserves a lot of credit for kick-starting the debate on higher education, but is obviously unwilling to push the issue, no doubt because we are in the middle of a politically sensitive debate on the subject. But having done so much to initiate the debate, surely he is obliged to say more and not hide behind a 'lack of expertise.' More generally, there is a good case for the RBA to become more outspoken on structural issues that have implications for productivity growth and inflation performance. FRB Chair Greenspan and former RBNZ Governor Brash have been quite outspoken on broader structural issues. Macfarlane should try being a little more adventurous, especially now that he is not seeking another term as Governor.

posted on 11/14/2003

### **Big Spending Conservatives.**

[Federal discretionary spending in the US](#) is out of control, while Australia's highest taxing government in history is now pondering how to deploy its budget surpluses to maximise its re-election prospects. There is a big difference in the politics of fiscal policy in the two countries, with deficit spending seen as electorally damaging in Australia, but apparently not in the US. This has seen unfunded tax cuts in the US, while in Australia, tax cuts and new spending initiatives are seen as something that can only come out of the budget surplus. What both countries have in common is a complete inability to reduce discretionary spending. The really interesting question is whether this is despite or because of the notionally conservative politics of the two governments.

posted on 11/13/2003

### **The Australian Competition and Consumer Commission**

has agreed to publish the reasons for its merger decisions, in line with the recommendations of the Dawson Review. This is a welcome improvement to a process that had been serious lacking in transparency. However, reading the [Commissioner's speech to the National Press Club](#) announcing the decision gives little confidence that the ACCC has turned over a new leaf under the new Commissioner. Much of the speech is devoted to defending the ACCC's informal approach to the merger approval process that was the subject of reform recommendations by the Dawson Review. In particular, the new Commissioner argues: *For these reasons I am concerned that the introduction of more formalised merger assessment processes will lead to more mergers being rejected than is currently the case. In recent years the Commission has, on average, only had problems with about five percent of the mergers it considers and about half of these are able to proceed after discussion and, in some cases, the offering of appropriate enforceable undertakings. Without wishing to put a figure on it I can see that this rejection rate is likely to increase with the introduction of more formalised merger assessment processes.* The ACCC's preference for a more informal process has more to do with enhancing its bureaucratic discretion and inhibiting accountability. The Commissioner's explicit threat in relation to the rejection rate gives the game away. He is effectively saying that business would be better off if they kept the law out of it. Yeah, right! The ACCC has a lousy track record in the courts and has been the subject of scathing criticism from the judiciary in relation to issues such as respect for due process. The business community is partly to blame for acquiescing in this process, hence the Commissioner's appeal to

administrative convenience rather than the law. The Commissioner also makes this rather telling observation: *There is an overwhelming focus on the Chairman. This is significantly the result of a practice, on the part of many sections of the media to personalise institutions by reference to the Chairman or Chief Executive. I began to understand this process almost 35 years ago when Robert Gottliebsen confided in me his journalistic style to refer to the head of an organisation instead of the organisation itself – a journalistic style that has been liberally adopted by his colleagues in the business media...I will continue to reinforce to anyone who is prepared to listen that while the Chairman is seen as the face of the Commission, all decisions are made by all of the Commissioners acting collectively.* The preoccupation with personalities at the expense of processes is not just the fault of the media. When the rule of law is replaced by bureaucratic discretion, there is an understandable focus on the bureaucrats exercising that discretion. The former Commissioner, Alan Fels, managed to get himself into the top ten of the AFR's 'power list' and his biographer subtitled his book 'A Portrait of Power.' Not bad for a bureaucrat who is meant to be administering the Trade Practices Act. But as the current Commissioner rather ominously puts it: *There is virtually no transaction entered into between business and business, or between business and consumers, that is not in some way impacted by the Act and as a consequence potentially subject to scrutiny by the Commission.*

posted on 11/13/2003

### **The Melbourne Institute**

is holding a conference on [Pursuing Opportunity and Prosperity](#). [Paul Kelly](#) gives an overview of the proceedings and main issues, including the following observation: *the Howard Government's record is equivocal. Howard is a cautious reformer alert to interest group pacification. He has never been the economic neo-liberal so bizarrely depicted by many of his critics. The reform momentum has been undermined by a complex set of forces that include complacency, breakdown of political agreement, the Senate as guardian of special interests, the demise of institutional support for a common "change" agenda, alarm about the fate of losers and the de-legitimising idea that economic reform spells the death of Australian egalitarianism.*

posted on 11/12/2003

### **From philanthropy to misanthropy.**

[George Soros](#) has really lost the plot. And [Andrew Sullivan](#) questions whether he is now appeasing anti-Semitic sentiment. Soros' philanthropy did much good in Eastern Europe in the 1990s, so it is a shame to see him now wasting his funds on narrowly partisan causes.

posted on 11/12/2003



### The Japanese Ministry of Finance

continues its almost [daily interventions](#) in the foreign exchange market to prevent yen appreciation against the USD. Horst Kohler, call your office! The money market also has its problems. Years of zero interest rates have hollowed out the money market's human capital, raising concerns at the BoJ about whether the market infrastructure exists to implement a termination in the Bank's current quantitative easing policy, according to the [Nikkei](#). These concerns are probably exaggerated. Financial institutions would not waste time reconstituting their money market desks if market conditions changed.

posted on 11/12/2003

### The Reserve Bank of Australia's

[Statement on Monetary Policy](#) does little to elaborate on the rationale for last week's tightening in monetary policy. Immediately following the Bank's discussion of the inflation outlook, the statement contains this paragraph: *A separate, but no less important issue, flagged repeatedly in previous Statements, is the rapid run-up in household debt. While this has been associated with a boost to domestic spending which was welcome in a weak international environment, such trends carry increasing risk if they persist over long periods. Those risks, discussed at length on other occasions and so not repeated here, appear to be growing. Monetary policy should, as far as possible, avoid adding to them.* While it is true that the RBA has discussed these issues previously, it has certainly not given a clear explanation of the relationship between these risks and its inflation target. The statement that these risks 'appear to be growing' is far from being self-evidently true. These are complex issues, so it is not surprising the RBA should fudge them, but it does raise questions about the RBA's overly broad mandate and weak accountability framework. Despite the increased prominence given to inflation targeting since 1993, and more formally since 1996, the RBA still gives the impression of running a check-list approach to policy, with a wide range of discretionary policy objectives potentially entering into its conduct of policy. It is interesting to compare the RBA's commentary with the [statement accompanying the BoE's most recent tightening in policy](#): *Underlying inflationary pressures are therefore likely to build gradually as demand strengthens and sterling's depreciation earlier this year feeds through. Against that background, the Committee judged that a modest increase of 0.25 percentage points in official interest rates was required to keep prospective RPIX inflation in line with the target of 2.5%.* The BoE's statement is more narrowly focused and makes explicit that long-run inflation outcomes are not exogenous variables under an inflation targeting regime.

posted on 11/10/2003

### The Japanese Cabinet Office

is planning on moving to a chain-weighted approach to calculating its GDP deflators, but not until the end of 2005, according to the [Nikkei](#). This should result in a better measure of economy-wide price movements and is likely to show that deflation is not as pronounced as the existing methodology implies. The deflators currently use a 1995 base year. Japan has been slow in adopting IMF data dissemination standards and its official statistical data suffers from being compiled by multiple agencies, rather than a single statistical authority. It falls upon the Cabinet Office to pull all the data together to constitute the national accounts.

posted on 11/10/2003

### Krugman You Can Profit From.

[Mickey Kaus](#) is running a Krugman Gotcha Contest: 'The prize is for a statement that now looks highly embarrassing in light of recent economic news.' My entry for this would have to be Krugman's June 20, 2003 effort, '[Still Blowing Bubbles](#)' (Late Edition - Final , Section A , Page 23 , Column 1). To see what makes this column embarrassing, look at a chart of the S&P 500 around 20 June and since. Krugman was expressing his doubts about the sustainability of recent gains in equity markets. Of course, subsequent gains do not necessarily make Krugman wrong. He would probably still run similar arguments. But your portfolio would certainly be underperforming if you used the *NYT's* columnist as anything other than a contrarian indicator. **UPDATE:** The [results](#) are in at Kausfiles. Our entry was runner-up.

posted on 11/8/2003

### USD-Bloc Labour Market Developments

Australia's unemployment rate makes new 14 year lows at 5.6%, validating the RBA's decision to raise interest rates earlier this week. Unfortunately, this will probably only encourage further complacency among Australian policymakers, something [Alex Robson](#) is warning against. The fact that it took a decade long expansion in Australia and a major contraction in the US to bring Australia's unemployment rate below that in the US remains a damning indictment of Australia's labour market institutions. NZ's unemployment rate is still nearly a full percentage point below that in Australia. There are also signs of life in the US labour market. [Ben Bernanke](#) has been addressing the relative merits of the household and non-farm payrolls surveys as measures of the US labour market and not surprisingly comes out in favour of the payrolls survey. [Allan Meltzer's](#) somewhat different view is now the subject of a more lengthy treatment from the AEI.

posted on 11/7/2003

### A MoF-BoJ Accord

to leave foreign exchange intervention operations unsterilised? The [Nikkei](#) thinks so: *Suspicion is growing in financial circles that the Bank of Japan probably reached some kind of a policy accord over foreign exchange market interventions with the Ministry of Finance in spring this year, when Toshihiko Fukui succeeded Masaru Hayami as new BOJ governor... Fueling the suspicion is the target amount of commercial banks' current-account deposits at BOJ, which the central bank has apparently raised in accordance with increased amounts of yen-selling market interventions since Fukui took the helm in spring. The amount of market interventions ballooned to an annual record 14 trillion yen in the April-October period, and the target amount of the current-account deposits has been jacked up by 12 trillion yen since March this year. The two figures appear to have increased almost in tandem... The MOF's enthusiasm about market interventions does not appear set to abate in the months to come, given the possibility of further yen appreciation. However, whether the BOJ will be able to continue raising the target amount of current-account deposits in accordance with a further expansion of market interventions remains to be seen. It will be interesting to see how the BOJ moves relative to the interventions.*

posted on 11/7/2003

### A T Kearney's Global Business Policy Council

has finally released its [FDI Confidence Index for 2003](#) in full. As mentioned in a previous post, Australia's rank as a desirable destination for FDI has fallen from 10th to 19th this year. Australia has ranked between 7th and 10th in previous years. Obviously, these rankings are relative to other countries, so this does not necessarily tell us much about Australia. However, Australia also ranks in the top five on the [OECD's measure of FDI restrictiveness](#). Not surprisingly, the A T Kearney survey has 72% of respondents citing 'government regulation' as among 'the most critical risks to corporations,' while 34% cite the 'absence of the rule of law.'

posted on 11/6/2003

### The Reserve Bank of Australia

has raised its official cash rate 25 bps to 5.0%. The USD-bloc peripheral central banks often lead the global interest rate cycle. Indeed, the RBA commenced a tightening cycle in May last year, but has left rates unchanged since June 2002, largely due to what had been a struggling US economy. The [statement accompanying](#) the tightening in policy presents the usual everything-but-the-kitchen-sink check-list of factors behind the RBA's decision. But it is significant that the RBA is hard pressed to talk-up inflation risks. The best it can come up with is this: *In the short term, these developments are unlikely to make for significant problems on CPI inflation. Indeed, it will most likely decline for a time, as the effects of the appreciation of the exchange rate show up in retail prices. Over a longer horizon, inflation is currently expected to be consistent with the target, but the risks to that forecast are beginning to tilt upwards.* 'Over a longer horizon,' of course, inflation outcomes should be endogenous, since to forecast inflation outside the target range would be to imply a failure in the conduct of monetary policy. It has long been a mystery to me why an inflation targeting central bank such as the RBA should talk about long-run inflation outcomes as though they were an exogenous variable. This can only be confusing to the public. In any event,

the household sector is now much more highly leveraged than in the past and monetary policy in Australia benefits from the widespread use of variable rate consumer debt instruments. In the absence of more serious upside inflation risks, the renewal of the tightening cycle commenced in the middle of last year can probably avoid testing previous cyclical highs in the official cash rate. But we are still 25-50 bps below a neutral setting. **UPDATE:** [John Edwards](#) is also less than happy with the RBA's rationalisation of its actions: *the increase does not require the prior rationalisation we had expected in next Monday's Statement on Monetary Policy, though no doubt the motives will be more fully described there. Some fuller rationalisation is certainly required because, as the RBA readily concedes, the retail-price inflation target, which is the basis of its declaratory policy, is not in jeopardy, and the risks of higher retail-price inflation are surely so distant they do not justify a tightening today. The RBA is moving because of house prices and credit growth, and needs not only to say so, but to say why, and how it will judge progress towards its objective. The monetary policy rules have changed, but the new rules have not yet been described.*

posted on 11/5/2003

### **Academic Economists You Should Be Reading**

[Bryan Caplan](#) is a GMU economist who is doing very interesting work applying classical liberal ideas to questions in political economy. Some of his publications can be found [here](#). Lynne Kiesling's blog, [The Knowledge Problem](#), has moved to a new location. If you are not already reading her blog, you should be.

posted on 11/4/2003

### **The Chifley Research Centre,**

the Australian Labor Party's think-tank, has produced a report on [Fiscal Policy Rules in Australia](#). [Ross Gittins](#) discusses the report, but does not do justice to its scope and intentions. Some might find it surprising that the Labor Party should have an interest in promoting fiscal policy rules. But it is characteristic for opposition parties to argue for fiscal and monetary rules, since they usually end-up on the wrong end of discretionary macro policy initiatives. The current government was a strong advocate of fiscal and monetary rules when in opposition. But in government, its Charter of Budget Honesty has been honoured more in the breach, while its joint Statement on the Conduct of Monetary Policy falls well short of world's best practice in monetary policy governance. It remains to be seen whether a future Labor government would be willing to tie its hands and forgo the short-run benefits of discretionary fiscal policy in favour of a more rule-bound fiscal policy regime.

posted on 11/3/2003

**Samuel Brittan**

[invokes](#) neo-classical growth theory to argue: *The controversial proposition I want to start from is that most of this growth takes place automatically without special policies, ministerial exhortation and all the other phenomena about which commentators and journalists become so excited.* One of the dangers of neo-classical growth theory is that it encourages us to view growth as exogenous and to downplay the role of institutions and policies in contributing to growth outcomes. Brittan is right in suggesting that much public policy is probably irrelevant to broad growth outcomes. But we also know that there are very significant cross-country differences in growth outcomes that are only approximately explained by exogenous growth theory. Although the institutional determinants of growth are notoriously difficult to pin down empirically, we should not neglect them as Brittan seems to be suggesting.

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**40 Million Aussies?**

Max Corden makes the case for (while considering the arguments against) in his [inaugural Richard Snape Memorial Lecture](#).

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**Alan Reynolds**

[reviews](#) the sorry history of US attempts to define a dollar policy. Reynolds suggests a more sensible approach: *the dollar's current level is no more problematic today than it was in March 2000. Nor would it matter much if the dollar went up or down a bit, so long as it wasn't being driven by the wind from Washington. Two lessons of postwar history are that (1) most of us should rarely worry much about the dollar and that (2) treasury secretaries and presidents should never talk too much about the dollar.* Meanwhile, the Japanese Ministry of Finance remains determined to run a [de facto fixed exchange rate regime](#), in defiance of the most recent G7 communique and the IMF's Articles of Association.

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