

# **An Economic Policy for Robust Sustainable Recovery**

**“An Economic Policy for Robust Sustainable Recovery”** is a condensed description of economic measures proposed for a robust recovery of ailing European economies. The principles of the proposed measures are based on the more comprehensive paper **“An Economic Paradigm for Robust Sustainable Progress”**.

The following condensed document is aimed primarily at experts in the field of macroeconomics and is a guide to new and effective economic measures to make ailing economies recover and to prosper but the document may also be used to provide non-experts an opportunity to obtain a better understanding of basic economic realities.

One of the simple, yet powerful, principles behind the proposed measures is that sufficiently strong and transparent economic signals are needed. Economic signals rewarding economic behaviors, individually and collectively, that are genuinely good for the faltering economies.

The Swedish Sustainable Economy Foundation is willing to expound on **The Economic Policy for Robust Sustainable Recovery** to help anyone who wants to know more, to become more familiar with the new ideas, to get inspiration and to learn how to use the new powerful macroeconomic tools and instruments.

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## **1. Introduction**

1. In the wake of the first great financial crisis of this millennium many nations in the world are struggling with high unemployment, soaring budget deficits, huge trade deficits and crippling debt servicing costs.

2. Some of these countries are in an even worse situation due to the fact that their monetary free agency is restricted by a common currency in the European Monetary Union.

3. In country after country economic austerity measures and shock therapies are introduced which reduce the aggregate demand, reduce investment and production and increase the unemployment.

4. When a country is suffering from a large budget debt a common view is that the country is poor and therefore is obliged to reduce its spending and to save and to cut down on the costs in general. The idea is that this is like an 'economic chemo-therapy' to 'purge' the economy.

5. This view on the problems is usually based on a lack of understanding of the fundamental difference between macroeconomics and microeconomics. One insight often lacking is that a country which has accumulated a budget debt and/or a trade debt will not solve its problems effectively by cutting down on investment and production like an indebted firm firing its less productive workers to reduce the costs.

6. All domestic financial debts are, by definition, also domestic financial assets. So no matter how large the public debt it does not automatically mean that a country or that the population as a whole is poor. An extreme example; Japan is a rich country and the Japanese are a rich people (on the average) despite the Japanese budget debt per capita being the largest in the whole world. The Japanese budget debt is simply owed to the (rich) people in Japan.

7. A large foreign debt, on the other hand, is a problem which may have a much greater impact on a country as a whole and especially on

the next generation. A large foreign debt due to a long-term accumulation of trade deficits will have to be paid off by the next generation and force people to give up a considerable fraction of their income and reduce their standard of living to pay for the debt-financed consumption of the previous generation.

8. Of course the economic problems due to accumulated debts becoming unsustainable (unserviceable) can be handled the age-old, destructive and unfair way they usually are handled, and the poor people without financial assets, losing their jobs although having the least guilt in bringing on the crisis, will suffer the most while the people with political power and/or with financial assets will be winners and may in fact even thrive amidst the crisis.

9. One is tempted to ask the question; is this antiquated, destructive and unfair way of handling the economy really what the majority of people would choose if they knew that there is an alternative, constructive and fair way of handling the economy and solving the problems?

10. In the chapters below there are some specific measures recommended to the distressed countries in the European Union, although these measures may, to great advantage, also be applied in other countries struggling with similar age-old macroeconomic problems.

11. The psychological factors in an unbalanced and/or unstable economy often have a dominating influence. The essence of an efficient solution is to elicit a constructive behavior, both individually and collectively, by creating a sufficiently strong incentive structure in the economy – an incentive structure harmonizing private interest with long-term public interest and private good with long-term public good.

12. When the proper incentive structure is in place and the externalities are internalized in the economy then, by definition, the market forces will automatically work to create sustainable employment and growth which will greatly simplify the task of balancing the budget.

## **2. Measure #1: Explain the new economic policy**

1. Even the best efforts to make an economy recover may be in vain if the psychological part of the economic recovery message has not been accepted by the people.
2. However, if the proper incentive structure can be created then the rest of the task will be relatively simple.
3. Each of the measures proposed below should be explained logically and graphically in mass media. Preferably in pedagogically simple terms on national TV at prime time.
4. Make a reminder that the situation with the economic and financial imbalances and problems facing the world and especially the countries within the European Union has been building up gradually in full view of all parties involved and acknowledge that the prevailing economic paradigm has contributed to the collective acceptance of the accumulation of unsustainable imbalances on a worldwide scale.
5. Acknowledge that many people, in different countries, have been correct in sensing that the economic policy based on the prevailing economic paradigm is potentially dangerous and needs to be reformed.
6. Announce the introduction of a new economic policy, focused on sound investment, employment, production and the creation of real economic value and a balanced, fair and sustainable economy.
7. Acknowledge that some of the measures may, at first, sound new and unproven but emphasize and explain that they are firmly based on economic reality, natural laws and well proven human behaviors.
8. Explain that these measures are equally valid for all countries – rich or poor, successful or less successful. Both within the European Monetary Union as well as outside.
9. Emphasize that the whole population will benefit from the proposed measures in the long run and that a majority of the population will benefit immediately as soon as the measures are applied.

### **3. Measure #2: Restore the value of real estate**

1. The stock of real estate has an important fundamental function in the economy and that is to serve as the major underlying security in the financial system. It is a well known fact that the collapse of a major real estate bubble is often accompanied by serious and sometimes dangerous financial disturbances affecting the whole economy. There is an effective method to restore the pre-crisis value of the stock of real estate:
2. Introduce an adjustable percentage buying subsidy on the real estate market. When the subsidy is positive every buyer on the market will receive this percentage subsidy, from a real estate market control fund, when the property deed has been officially registered. The same fund will charge every seller on the real estate market a selling fee, of the same percentage, when the transfer of property has been officially registered. If the subsidy needs to become negative, once the value of the stock of real estate has been restored, then, by definition, the buyer will pay a buying fee to the fund and the seller receives a selling subsidy.
3. Publicly announce that the purpose of the control subsidy and the market control fund is to restore the value of the stock of real estate to the value it had before the collapse of the real estate market and then to secure its value to safeguard the securities in the financial system.
4. Adjust the subsidy sufficiently often for a control subsidy futures market to emerge spontaneously – as a means to reduce risk exposure.
5. The windfall profit potential of the rising prices on the real estate market could elicit strong speculative forces. However, no excessive turnover on the market is needed to bring about the desired result since the market prices will rise mainly due to strong psychological effects which do not depend directly on the rate of turnover.
6. If the basic principles of this controlled reflation of the market value of the stock of real estate is properly communicated to the real estate market the process will begin spontaneously without delay.

#### **4. Measure #3: Improve the income and tax structures**

1. The unemployment and the budget deficit can be reduced simultaneously by introducing a, sufficiently high, flat tax. That is; with the same percentage for all incomes to be equal and fair.
2. The secret how to secure democratic acceptance and popular support for such a measure is to repay a sufficient amount of the tax in equal amounts to all individuals.
3. It is important that the repayment includes the whole population, both rich and poor, since that will eliminate the risk for the repayment to be viewed as an unfair economic burden for the working majority of the population and as a subsidy for the poor and unemployed minority of the population.
4. Through the repayment of financial resources (money) according to this principle the purchasing power in the economy can be redistributed in a such a way that the result will be an increased consumption and aggregate demand. The reason for this is that if those who have money in abundance are unwilling to use their purchasing power, to a sufficient degree, then a simple remedy is to redistribute the purchasing power, to those willing to use it to a sufficient degree.
5. The principle of the flat tax guarantees fairness in the redistribution since exactly the same fraction of every income is paid in tax. Every income is treated the same irrespective of the individual earning the money. The principle of the repayment in equal amounts also guarantees fairness since every individual is treated the same.
7. The increased aggregate demand in the economy will start a virtuous circle by triggering investment in increased production capacity. The increased production capacity will require increased employment. The increased employment will result in increased income and increased tax revenues, reducing the budget deficit and further stimulating the economy.

## **5. Measure #4: Optimize the aggregate demand**

1. A sufficiently large aggregate demand is absolutely essential in an economy to avoid harmful unemployment resulting in misuse and destruction of human capital.
2. Without a beneficial incentive structure in the economy, eliciting a sufficiently large aggregate demand, a high rate of unemployment in the economy can persist for an indefinitely long time since there are no automatic economic forces guaranteeing full employment.
2. There is an effective method to increase, stabilize and optimize the aggregate demand:
3. Introduce an adjustable percentage consumption subsidy.
4. The consumption subsidy can be financed, if full, by an adjustable, flat, percentage income fee.
5. The psychological impact of a, sufficiently high and fully financed, consumption subsidy will be positive and powerful.
6. Even if the the consumption subsidy is not fully financed it will have a positive influence on the budget and reduce the budget deficit thanks to its consumption rewarding incentive effect resulting in a stimulating influence on the aggregate demand, on the employment, on investment, on production and on the budget revenues.
7. Publicly announce that the purpose of the subsidy is to increase and then to stabilize the aggregate demand so that the level of employment can be optimized in the economy.
8. Explain that the subsidy will be most profitable for the consumers during the first phase of increased demand since the subsidy will gradually be reduced, later when the economy is approaching full employment.
9. Monitor the average wage index and the consumer price index closely and adjust the subsidy regularly and sufficiently often for a consumption control subsidy futures market to emerge spontaneously.

## **6. Measure #5: Make the consumption sustainable**

1. To make an economy environmentally compliant and long-term sustainable, control fees can be charged on harmful emissions.
2. Many harmful substances, both man-made and naturally occurring, can be charged with an emission control fee upstream, preferably at production, at extraction or at importation, simplifying the measuring, verification and control problem greatly.
3. As a first major step in the right direction a general, all inclusive, technology-neutral, CO<sub>2</sub>-fee can be applied.
4. To make the CO<sub>2</sub>-fee, and other control fees, democratically viable a reimbursement account for every individual can be created.
5. If a sufficient fraction, of the total income from the control fees, is repaid regularly, in equal amounts to each individual account, the system can be made profitable for the majority of the population.
6. A sufficiently high CO<sub>2</sub>-fee, which is repaid according to the above described principle will also function as an effective and benign stimulus in the economy since there will be a societally beneficial redistribution of purchasing power.
7. The simple reason for this beneficial result is the fact that the principle will, in an objective, equal and fair manner, redistribute purchasing power from those who have more purchasing power than they desire to use to those who have less purchasing power than they desire to use.
8. Although it is recommended that the major part of the CO<sub>2</sub>-fee should be repaid to the population a considerable part could be used to strengthen a weak budget.
9. Control fees on resource depletion will become a more and more important measure in the future. In addition there are many other externalities in the economy which can be charged with fees to make the economy not only more sustainable but also more efficient and fair.

## **7. Measure #6: Balance the trade**

1. Trade imbalances which persist for long periods of time tend to warp the infrastructure of the economy and create imbalances which will harm the economy in the long run. Sooner or later these structural imbalances will have to be remedied at a cost.
2. It is important to realize that purpose of the export is to pay for the import. Adapting to this principle is the only long-term, responsible and sustainable way of handling the trade between countries.
3. Viewing a large trade surplus as a positive indicator in the economy and failing to take action or even worse; trying to increase the amount of exported goods and services by various means, above what is needed to pay for the import, is an age-old fallacy. The results of this fallacy are harmful side effects warping the structure of the economy both in countries with an export surplus and in countries with an import surplus.
4. There are some straightforward methods to eliminate an accumulated trade debt and to turn a trade deficit into a balanced trade. One of these methods can be utilized in a situation where the financial free agency of a country is restricted by a currency union. The method is to charge a, sector neutral, import control, fee, designed as a flat percentage of the value (price), on all imported goods and services.
5. It should be publicly and internationally announced that the sole purpose of the import control fee is to achieve a gradual and steady, controlled shift towards a sustainable, balanced trade.
6. It must also be made totally clear that the import control fee is not a trade-impeding measure but instead a measure to achieve a balanced trade and a balanced production structure both regionally and globally and to improve the sustainability of international trade.
7. The income from the import control fee can be used, in full, as a budget revenue. Another possibility is to use the income from the fee to

pay for an export control subsidy using the same percentage as the import percentage fee. As long as the value of the import is greater than the value of the export this will result in a certain net budget revenue.

8. The import and export markets should be continuously monitored and the percentage fee should be adjusted regularly and sufficiently often for a control fee futures market to emerge spontaneously.

9. For countries with a trade surplus the import control fee can be replaced with an import control subsidy and the export control subsidy can be replaced with an export control fee following the same basic logical principles mentioned above to achieve a balanced trade.

10. To minimize the total societal cost of creating a sustainable economic structure and balancing the trade, the trade control fees should be used with caution and the restructuring of the economy is best done over a period of several years. However the beneficial psychological effects on the market can be immediate as soon as the principle and the long-term effects of the trade control measures are understood.

11. The trade control fee should not be viewed as a permanent solution to the problem of trade imbalances. These problems need to be solved by proper control of the credit volume and the rate of credit expansion in the economy so that the average real wage, in the long term, can reflect the average real labor productivity and so that the rate of consumer price inflation and the rate of asset price inflation can be harmonized within the Euro Zone.

12. All principles proposed above regarding human psychology, incentive structures and stabilizing feedback control are based on an abundance of long-time proven knowledge freely available from fields outside economics. What seems to have been lacking in the prevailing economic paradigm, is a sufficient recognition of the importance of human psychology and basic feedback control to achieve an acceptable performance of the economic and financial systems.