

An Economic Policy For Robust Sustainable Recovery

This paper contains a condensed description of economic measures and mechanisms proposed to create a robust recovery of ailing economies. The principles of the proposed measures are based on the more comprehensive paper **"An Economic Paradigm for Robust Sustainable Progress" by Anders L. Hoglund**.

One of the simple, yet powerful, principles behind this proposal is that it is possible to create sufficiently strong, transparent and democratically viable economic signals and mechanisms. Robust and efficient economic signals and mechanisms rewarding economic behaviors, individually and collectively, that are genuinely good, not only for the faltering economies but for all economies.

The Swedish Sustainable Economy Foundation is ready to expound on the above mentioned principles to help any country take advantage of these 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 chemotherapy' 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 con-

sumption 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.

7. Over the years before the collapse of the real estate markets in the various

countries within the European Monetary Union the asset price inflation was far from uniform between countries and there developed more or less serious fundamental imbalances between the replacement cost and the market value of real estate. In the long term these imbalances can effectively be eliminated by an economic feedback mechanism ensuring that the total market value of real estate basically reflects the replacement cost (corrected for wear).

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 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 or on other words; a negative consumption tax.
4. The consumption subsidy can be financed, if full, by an adjustable, flat, percentage income fee or tax.
5. The psychological impact of a, sufficiently high and fully financed, consumption subsidy will be positive and powerful.
6. Even if 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, CO₂-fee can be applied.
4. To make the CO₂-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 CO₂-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 CO₂-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 fundamental purpose of the export is to pay for the import. Acknowledging and adapting to this principle is the only long-term sustainable and responsible 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 both trade deficit and trade surplus economies.
4. Every country with a Central Bank can relatively easily prevent a harmful accumulation of trade deficits. One way of doing this is through buying of other currencies to such an extent that trade debts towards other countries are secured in the form of a trade debt currency reserve.
5. Such a strategy has a fundamental influence on the exchange rates and reduces the risk for an accumulation of destructive, financial and structural, imbalances which otherwise will cause unnecessary costs in the form of job mismatching, unemployment and capital destruction when they, sooner or later, are corrected. The trade imbalances are worsened by countries which willfully or through ignorance counteract a natural appreciation of their currencies despite a trade surplus.
6. The idea that a trade surplus is something positive and desirable is an age-old fallacy which is still influencing the trade policy of most countries and whose negative consequences will afflict both surplus and deficit countries, due to the harmful warping of the production infrastructure. The worst damage, however, will befall those deficit countries whose productive capacity has been impaired the most. Due to an often relatively long time delay, market corrections can come about unexpectedly and with great strength which increases the risk and the damage caused by the non-existent, ignorant or adverse trade policy.

7. Countries whose currencies have attained a high status, and therefore are used as reserve currencies in many Central Banks, are especially prone to having their infrastructure warped due to the even stronger decoupling of the currency from the real economy and the foreign trade which may occur. The resulting accumulating trade imbalances can have severe consequences in the long-term and can affect the whole world economy in a destructive way when panic-driven exchange rate corrections suddenly begin and when the greed is replaced by fear.

8. An acceptance and application of the proposed trade debt currency reserve concept could result in a profound positive change in the behavior of the speculators on the currency market – where the analysis of and the respect for economic fundamentals need to be restored.

9. The absurdly high ratio of the financial turnover on the currency market to the real turnover in the world trade reveals that speculation has become the totally dominating activity on the currency market. This financial hyperactivity has a negative influence on the world economy since it is crowding out the fundamental relations between the real economies of the countries in the world.

10. 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.