**An**

**Economic Policy**

**for**

**Stable, Sustainable Recovery**

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**November2010**

Contents

 1 Introduction 3

 2 Measure #1: Restore the value of real estate 5

 3 Measure #2: Optimize the aggregate demand 6

 4 Measure #3: Make the consumption sustainable 7

 5 Measure #4: Balance the trade 8

# 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 public debt a common view is that the country is poor and therefore is obliged to reduce the 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 public debt and/or a trade debt cannot 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 the 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 public debt per capita being the largest in the whole world. The Japanese public debt is simply owed to the (rich) people in Japan.

7 An accumulated foreign debt, on the other hand, is a problem which may have a much greater impact on the country and especially on the next generation. A large foreign debt due to a long-term accumulation of trade deficits has 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 facing many countries can be handled the age-old, destructive and unfair way they usu­ally are handled and all the poor people with­out financial assets, losing their jobs and having the least guilt in bringing on the crisis, will be losers and suffer the most while the people with political power and/or with finan­cial assets will be winners and thrive amidst the crisis.

9 Is this antiquated, destructive and unfair way of handling the economy really what the majority 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 essence of the solution is to elicit the market to act construc­tively by creating a sound 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 market forces will auto­matically work to solve the problems.

13 There is no measure below explicitly mentioning the strength­ening of the budget. The simple reason is that this problem will be solved automati­cally if the other measures are taken, although there is always room for improved efficiency in the bureaucracy of the state.

# 2 Measure #1: Restore the value of real estate

1 The stock of real estate has a fundamental, important function in the economy and that is to serve as the 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. The buying sub­sidy can be made negative, when so is required, and then 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 tool 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.

# 3 Measure #2: Optimize the aggregate demand

1 A sufficiently large aggregate demand is absolutely essential in an economy to avoid harmful unemployment, large budget deficits and destruction of real capital and human capital.

2 There is an effective method to increase and then to stabilize and optimize the aggre­gate demand:

3 Introduce an adjustable percentage consumption subsidy.

4 The consumption subsidy can be financed in full by an adjustable, flat (equal percentage for all income levels), percentage income fee.

5 The psychological impact of a fully financed consumption subsidy is 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 effect 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 and optimize the aggregate demand so that 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 have to be reduced in the future when the economy is approaching optimal 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.

10 Fees on harmful emissions which are repaid in equal amounts to every individual in the economy may also become important and increase aggregate demand and stimulate the economy thanks to a societally beneficial redistribu­tion of the purcha­sing power.

# 4 Measure #3: 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 import, simplifying the measuring, veri­fica­tion and control problem greatly.

3 As a first major step in the right direction a general, 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 the 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.

# 5 Measure #4: 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 must be remedied - at a cost.

2 The sole purpose of the export is to pay for the import, and acting according this principle is the only long-term, responsible and sustain­able way of handling the trade between countries.

3 Viewing a large trade surplus as 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, on all imported goods and services.

5 It must 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 improve the balance of the trade both regionally and globally and make it long-term sustain­able and beneficial for all countries.

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. When 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 fee can be replaced with an import control subsidy and the export subsidy can be replaced with an export control fee following the same basic logical principles as the control of the, above mentioned, import control fee and export control subsidy.

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, so far, in the economic paradigm is a sufficient know­ledge about human psychology and basic feedback control theory.