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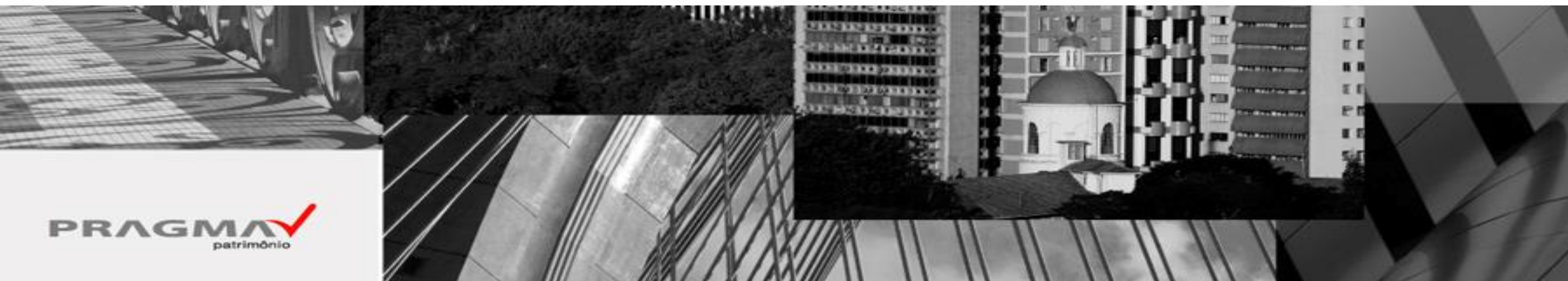

Taylor for Fed (John Cochrane – 20/10/2017)

John H. Cochrane is a senior fellow at the Hoover Institution. He is also a research associate of the National Bureau of Economic Research and an adjunct scholar of the CATO Institute.

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I might as well share with blog readers my favorite for the Fed: John Taylor.

A preface is in order though.

Monetary policy is not, right now, the flaming hot mess that characterizes so much of the Federal Government. And all the candidates are good.

The Fed's official mandate is low interest rates, low inflation, and maximum employment -- as large as monetary policy can make it. Interest, inflation, and unemployment are each lower than they have been in living memory. The stock market is high yet surprisingly quiet (low volatility).

One may question whether this is because or despite the Fed. (My view, largely despite.) One may quibble about low growth and labor force participation. One may worry about over-regulation, though Congress mandated most of it. But by the standards of the Fed's mandate, we must admit that the outcomes we see are fine. In any other branch of the Federal government, performance like this relative to mandates, together with a tradition of reappointment, would argue for Ms. Yellen's swift reappointment.

Ms. Yellen's critics, such as the Wall Street Journal editorial page, are forced to argue that she might fall short faced with future challenges. She might keep interest rates too low for too long, and let inflation pick up. (Inflation is still nowhere in sight.) She might raise interest rates too fast if the economy does start to grow more, in fear of inflation, and choke off supply side growth. (Yes, the two criticisms are inconsistent.) She might not handle the next crisis well.

Indeed. And taking the measure of people and trying to figure out how they will deal with future challenges is just what this process is supposed to be about. One can also complain that the process of monetary policy has too much discretion, too many speeches, and needs a more stable rules based approach. I have complained that the Fed is massively over-regulating finance, and this will cause a less competitive and efficient financial system in the future.

But recognize that all this is hypothetical, and there is little to complain right now about in the outcomes we tasked the Fed to achieve.

Still, let us suppose Mr. Trump decides he wants a new person at the Fed. Why John?

John is, quite simply, the top monetary economist of his generation. He understands the theory, he understands the empirical work, he deeply knows the history. He took the baton from Milton Friedman.

After it became clear that central banks could not operate by controlling the quantity of money in the 1980s, they went back to interest rate targets. But standard monetary doctrine said interest rate targets could not work. (Friedman 1968 is classic on that.) John's "rule" describes how interest rate targets can, and should work. John's work here is not high tech math, but very transparent and intuitive. And it has had enormous impact on the world of policy. Pretty much every central bank now frames its actions with reference to Taylor's rule, or its descendants such as an inflation target.

Now, usually being a great academic is not much of a recommendation for a top Washington job however. You can fill in your own list of Nobel Prize winners, justly lauded for their intellectual accomplishments, who would be disasters in any actual job.Still, John's stature as an academic means that he understands monetary policy, the limits of our knowledge about monetary policy, amazingly well. John knows what the equations in the staff papers mean, and can push back. Nobody will bamboozle him.More importantly, John would, in my view, be superb in the job. He also has served in Washington, has many deep connections there, and understands the practicalities of policy.

John's great contribution is the "Taylor rule." He is unfairly tarred with the ignorant calumny that he wants to tie Fed policy to a mechanical formula. If you just listen for a moment to what John says about that, you will understand why I use such harsh language to describe his critics.

John's description of how his rule would operate is that it is mostly like a "rule" you might announce to your spouse: I'll be home for dinner by 6. You both understand that if traffic is bad, if the boss has a sudden request, if there is trouble picking up the kids from school, you'll be late. But rules engender good incentives and coordinate expectations. The spouse who shops and cooks has a good idea when and what to expect, and the spouse coming home by 6 has a special reason to really work hard to fulfill the promise. He or she will be expected to provide an explanation for deviations, but reasonable deviations are part of the game.

So too monetary policy rules are largely about stabilizing expectations, and getting past this state that markets are hanging on every word uttered by the high priests. Also, given that fact, I would hardly expect John to charge in and do anything dramatic. The point of rules is not to surprise markets after all, and most implementation of Taylor rules put a big coefficient on past interest rates, meaning one moves slowly.

The process of picking a Fed chair is not about voting on the direction of interest rates. Most of the media paints it this way -- pick one or the other depending on whether you want rates up or down. The Fed chair runs a committee and a big organization. John will be good at this too.

What you don't want in a Fed chair, especially an academic, is someone who comes in with an agenda determined to push it. Milton Friedman might have made a bad Fed chair. I suspect he might have clung to monetary targets too long. Despite the rule, Taylor is not that guy.

Taylor listens. Actually, to a fault. We run a few things together at Hoover, and there are times when he should just come out and say to me "John, that's a lousy stupid idea." Instead he listens, offers a gentle thought in the other direction, and gradually guides me to figuring out for myself just what a stupid lousy idea it was.

I also experience disagreements with John. For example, he is currently in favor of a smaller base of reserves, that don't pay interest. I like lots of excess reserves. He handles disagreement like this very well. He listens, he tells me his view, we look for different assumptions underlying our different conclusions.

This flexibility will be important. One thing we know for sure is that the next crisis will challenge any intellectual framework. It will challenge even more someone who does not have an intellectual framework and can't get back to the assumptions and logic of opposing views.

As I have prognosticated many times before, monetary policy -- raising and lowering interest rates -- is likely to be a small part of what characterizes the Fed going forward. Regulation and supervision is going to be much more important. I was a bit disappointed that Ms. Yellen seems so comfortable with the current regulatory direction. John is no fan of regulation. He has worked deeply in the area, for example on reforming bankruptcy so that banks could actually be put through it. But John is no fan of the big bank's idea of deregulation either -- keep the rules in place as barriers to entry, but lower capital and liquidity standards so we can make lots of money again. The really big question is what will happen with supervision and regulation. John will be a great chair to come to a reasonable repair of the Dodd-Frank mess.

Well, that's my case for John. As I said before, it is not a case against Ms. Yellen, or any of the other people currently under consideration. They may share many of these traits. I just don't know them that well.

Disclaimer, in case it was not obvious: John's office is next to mine at Hoover, and he's a great guy. So I'm obviously horribly biased.John's office is next to mine at Hoover, and he's a great guy. So I'm obviously horribly biased.

Fonte: The Grumpy Economist

Resurrecting Creditor Adjustment (Robert Skidelsky – 24/10/2017)

Robert Skidelsky, Professor Emeritus of Political Economy at Warwick University and a fellow of the British Academy in history and economics, is a member of the British House of Lords. The author of a three-volume biography of John Maynard Keynes, he began his political career in the Labour party, became the Conservative Party's spokesman for Treasury affairs in the House of Lords, and was eventually forced out of the Conservative Party for his opposition to NATO's intervention in Kosovo in 1999.

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With all the protectionist talk coming from US President Donald Trump's administration, it is surprising that no one has mentioned, much less sought to invoke, an obvious tool for addressing persistent external imbalances: the 1944 Bretton Woods Agreement's "scarce-currency clause."

That clause, contained in Article 7 of the agreement, authorizes countries, "after consultation with the [International Monetary] Fund, temporarily to impose limitations on freedom of exchange operations in the scarce currency"; and it grants those countries "complete jurisdiction in determining the nature of such limitations." A country's currency is considered scarce in the foreign-exchange market if it imports more than it exports – which is to say, if it runs a current-account deficit.

The scarce-currency clause has an interesting history. In his original plan for an International Clearing Bank, the British economist John Maynard Keynes proposed an escalating range of sanctions against member states that maintained continuous credit balances (and less onerous sanctions on countries with persistent debt balances). The idea was to pressure countries to reduce their current-account surpluses. Surplus countries would not be prevented from spending their money freely, but they would not be permitted to hoard it.

The United States, which was by far the world's largest creditor, understandably refused to go along with Keynes's proposal. As a result, the IMF was left to provide short-term financial help for deficit countries, and otherwise to uphold the orthodox doctrine of debtor adjustment. But, to placate the British, Harry Dexter White, the US Treasury official now remembered as the architect of the Bretton Woods Agreement, inserted Article 7 to allow dollar-deprived member states to restrict their purchases of US goods.

The scarce-currency clause has remained a dead letter ever since. In the early postwar years, the US plugged up European countries' current-account gaps with Marshall Plan funds. By the early 1970s, the US itself was running trade deficits, and the dollar was in oversupply. The US Congress urged the IMF to invoke the scarce-currency clause against "recalcitrant" surplus countries, but its efforts were in vain. As the Princeton University historian Harold James has pointed out, the tables had turned: the US had taken up Keynes's arguments, but creditor European countries, along with Japan, successfully resisted them.

Fast-forward to today. Of the world's four largest economies, only the US suffers persistently weak competitiveness. China, Japan, and Germany, by contrast, are super-competitive. And because China has been willing, for its own reasons, to finance the US deficit, the dollar and the renminbi now seem to be locked into misaligned positions.

To redress this state of affairs, the economist Vladimir Masch suggests that the US should pursue a plan of "compensated free trade" (CFT), which essentially amounts to a unilateral activation of the scarce-currency clause. The Trump administration would set a ceiling on the US trade deficit each year, and then impose limits on major US trading partners' surpluses. This would largely affect China, Japan, Germany, and Mexico, which contributed $347 billion, $69 billion, $65 billion, and $64 billion, respectively, to the US's $737 billion trade deficit in 2016.

Under Masch's CFT arrangement, it would be up to each surplus country to limit its exports to the US. Countries could exceed their export quotas only if they paid a fine equal to the difference between the value of their actual and allowed exports. And if they tried to export more than allowed without paying the fine, their surplus exports would be blocked.

The problem with this plan is that it puts no pressure on Germany to reduce its surpluses with other eurozone countries. To be sure, after the 2008 global financial crisis, the European Union did establish a Macroeconomic Imbalance Procedure to fine eurozone countries with surpluses exceeding 6% of GDP or deficits exceeding 4% of GDP. But the MIP, even if it is in the spirit of Keynes's proposal for an International Clearing Union, lacks two essential mechanisms.

First, Keynes's plan would have automatically levied sanctions against persistent creditors, whereas the EU's framework has proved incapable of doing so. Germany has run a surplus exceeding 6% of GDP for over a decade with impunity. Although its surplus vis-à-vis the eurozone recently shrank to under 3% of GDP, that is largely a reflection of impoverished Mediterranean countries importing fewer German goods. If those countries' economies recover and return to anything near full employment, the German surplus will likely rebound.

The MIP's second flaw is that it lacks the omit protections for debtors that are afforded by the scarce-currency clause. Without the ability to devalue their currencies, the only recourse the eurozone's persistent debtors have is to threaten to leave the single currency. But, as the Greek crisis demonstrated, this is not a credible threat. The result is that imbalances between creditors and debtors have been locked into place.

One way to unlock current imbalances would be to adapt the Bretton Woods mechanism. Each eurozone member state would pay into a European Monetary Fund in proportion to its national income and level of trade. And the Fund would have its own scarce-currency clause, allowing for member states to discriminate against imports from creditor countries.

In his wide-ranging speech at the Sorbonne last month, French President Emmanuel Macron called for the creation of a European Monetary Fund, though he did not spell out the details of what he envisions. A mechanism that provides for trade discrimination could potentially violate the EU's free-trade principles. And yet economic integration has always depended on some degree of creditor adjustment. Without it, a free-trade system will eventually break down. Advocates of open borders can pay now, or they will certainly pay later.

Fonte: Project Syndicate

How Money Could Unblock the Brexit Talks (Anatole Kaletsky – 20/10/2017)

Anatole Kaletsky is Chief Economist and Co-Chairman of Gavekal Dragonomics. A former columnist at the Times of London, the International New York Times and the Financial Times, he is the author of Capitalism 4.0, The Birth of a New Economy, which anticipated many of the post-crisis transformations of the global economy. His 1985 book, Costs of Default, became an influential primer for Latin American and Asian governments negotiating debt defaults and restructurings with banks and the IMF.

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Like many divorce proceedings, Britain's negotiations with the European Union have reached an impasse that can be broken only by compromise. The solution is for both sides to admit that a permanent new relationship cannot be agreed in the short time remaining until the Brexit deadline in March 2019.

So, instead of letting the United Kingdom crash out of the EU then, the talks should now shift to the temporary "transition" that Prime Minister Theresa May officially requested last month – and which a strong consensus among Britain's business leaders and public now demands. Above all, the negotiators should focus immediately on the British budget contributions that will be required to make an orderly transition possible.

An agreement on a mutually beneficial transition would require some compromises from both sides. But neither Britain nor the EU would have to abandon any fundamental principles.

For Europe, shifting the focus of negotiations to a temporary agreement, probably modeled on the EU's relationship with Norway, would involve only a small loss of face: EU leaders would have to concede that the sequencing they originally proposed for the Brexit talks had to be rejigged. Instead of agreeing on a financial settlement first, and then moving on to trade relations, finance and trade would have to be acknowledged as interdependent – and thus be discussed simultaneously.

For Britain, a change of focus from permanent arrangements to the conditions for an orderly transition could transform the budgetary issues now preventing progress into a key that could unlock the talks. In a speech delivered in Florence last month, May offered to make EU budget contributions of roughly €10 billion ($11.8 billion) annually for a transition period of at least two years after the Brexit deadline, as well as to maintain free movement of labor and enforce all EU rules.

May hoped that her promise would win over European leaders – especially the biggest contributor, Germany, and the big net recipients, such as Poland and Portugal. But her offer failed to impress, probably because EU leaders are less worried about the financial hole created by Brexit in 2019 and 2020 than they are about the next budget cycle, from 2021 to 2026.

To suggest that Britain should pay budget contributions well into the next decade may seem completely unrealistic, given the vehement opposition to all EU payments from Euroskeptics in May's Conservative Party. But, on closer inspection, making a long-term budget offer could have two big advantages for May.

First, transitional budget contributions could be presented as commercial payments to support European programs from which Britain benefits, instead of the punitive-sounding "divorce settlement" of €50-60 billion currently demanded by the EU. If Britain's transitional payments continued near the current level of €10 billion for the five or six years realistically required to negotiate a permanent trading relationship, they would add up to the same amount.

Second, a British budget offer would be a powerful tool to create the "deep and special partnership" with Europe that May claims is her ultimate goal. Until last month, May avoided defining this phrase, for fear of antagonizing her party's hardline Europhobes. But in her Florence speech, May promised British businesses something close to the current level of access to EU markets. She also recognized that any privileged access to EU markets would require budget contributions, as in the case of Norway and Switzerland. The implication was clear: something close to the current level of access to EU markets would demand something close to the current level of budget contributions. And if May's "deep and special partnership" is to be a permanent feature of British-EU relations, the budgetary contributions will have to be permanent, too.

But what if May is not really serious about that "deep and special partnership"? What if her true objective is to satisfy Conservative hardliners by bringing about a "clean break" with the EU? Even then, Britain will need to continue paying budget contributions for many years, if it wants an orderly and non-disruptive Brexit.

Let's assume that Britain's ultimate aim is to create completely new global trading relationships, without any special EU trading privileges. These new trade deals will take many years to negotiate, and until their completion, British businesses are desperate to avoid two costly disruptions: one when EU membership ends in March 2019, and another at whatever future date the new global trade agreements are finalized and come into effect.

Avoiding such a double disruption is the whole point of May's proposal for a "standstill" transition period from 2019 to 2021. But achieving that objective will require the standstill in Britain's EU arrangements to continue until new global agreements are ready to implement. This implies that Britain's budget contributions must also continue until new global agreements are finalized.

The probability that complex negotiations with dozens of countries can be completed within just two years of Brexit is vanishingly small. So, even if British politicians and voters really want a hard Brexit involving total rupture with Europe, UK businesses will need to preserve their special EU trading arrangements, along with the associated budget contributions, for at least several years beyond 2021.

The upshot is that, regardless of what type of Brexit the UK wants, any orderly withdrawal will require continued post-Brexit budget payments to the EU. The only question is whether these payments turn out to be permanent, as they would if May really wants a "deep and special partnership," or continue only for the 5-7 years required to negotiate new trade agreements after a hard Brexit.

Either way, May should recognize that EU budget payments will be inevitable for many years after Brexit. More than that, she should turn this recognition into an impressive long-term financial offer to unblock the Brexit talks.

Fonte: Project Syndicate

China's New Emperor (Chris Patten – 25/10/2017)

Chris Patten, the last British governor of Hong Kong and a former EU commissioner for external affairs, is Chancellor of the University of Oxford.

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An anecdote about US President Richard Nixon's visit to China in 1972 has long been regarded as confirmation of the long view of history taken by Chinese leaders. Zhou Enlai, Mao's dutiful number two, is said to have responded to a question about the lessons of the French Revolution by saying that it was too soon to tell. In fact, according to diplomats who were there, Zhou was discussing not the revolution of 1789, but the 1968 student uprising in Paris, so it probably really was too soon to tell.

After this false start, lessons from the French Revolution have made a comeback in China. Shortly after the 18th National Congress of the Chinese Communist Party in 2012, it was reported that Alexis de Tocqueville's The Old Regime and the Revolution, written in 1856, had become a "must-read" for senior CCP cadres. The book's merits were most enthusiastically touted by Wang Qishan, the man at the helm of President Xi Jinping's anti-corruption campaign and perhaps Xi's closest ally.

Toqueville argued that growing prosperity in eighteenth-century France had actually made it more difficult to govern the country. As people became wealthier, they also became more aware of social and economic inequalities and thus increasingly resentful of the rich and powerful. Attempts to reform the system only highlighted its vulnerabilities. Revolution followed, sweeping away the monarchy and aristocracy. Their heads literally rolled.

The CCP's just-completed 19th National Congress showed the extent to which China's leaders have taken Toqueville's insights to heart. Xi asserted his undisputed authority over his party and country. Xi consolidated his position during his first term, by reversing much of Deng Xiaoping's legacy, including the opening of China's economy, the separation of the CCP from government, and a low-key approach to foreign and security policy.

Xi has also swept aside potential rivals, relying primarily on his far-reaching anti-corruption campaign to target officials previously thought to be untouchable. He has just overseen the largest-ever purge of the CCP Central Committee. He has cracked down on even the most restrained criticism or signs of dissent, and has even banned Internet jokes, including memes comparing him to Winnie the Pooh.

In another country, such measures might trigger harsh reproach, with critics accusing Xi of turning his country into an old-school Leninist dictatorship. In China, however, they have drawn praise from observers who believe that Xi is leading the way to the fulfillment of the "Chinese dream" to rejuvenate the country.

But, for some, the dream is on the verge of becoming a nightmare. Demographic trends are threatening to turn the labor surplus that helped drive China's rapid growth over the last few decades into a labor shortage at an unprecedented pace. Water contamination and scarcity, alongside carbon dioxide emissions and lethal levels of air pollution, are imperiling people's health and jeopardizing the sustainability of China's economic performance.

Moreover, Chinese GDP growth, while welcome, is being fueled largely by a combination of fast-rising debt and widespread property bubbles. Even Chinese researchers admit that their country has one of the highest levels of income inequality in the world. As the poor get poorer and the rich get richer, many are asking if this is what "socialism with Chinese characteristics" really means.

Of course, there is always an optimist around to offer a positive spin. China owes most of its debt to itself, because political priorities guide lending as much as commercial considerations do. China supports international efforts to address environmental degradation and climate change. Most people are becoming better off, if unevenly. And Xi's administration is at least doing something to stamp out the endemic corruption in the CCP.

We should all hope that at least some of what China's cheerleaders say is true; if Chinese growth collapses, the entire global economy will suffer. But, even if the optimists are partly vindicated, Xi's claim that China has found a better way to run a modern society and economy seems far wide of the mark.

To be sure, from the stupefying antics of US President Donald Trump to the damaging rise of populist nationalism in Europe, democratic countries are experiencing their share of trials. But democratic systems have built-in stabilizing mechanisms that enable them to right themselves without resorting to violence or repression.

That is not the case in Xi's China. For years, there was a serious debate in China about the state's proper role in economic affairs. One camp maintained that if the CCP relaxed its grip on the economy, it would inevitably lose control of the state. Others argued just the opposite: unless the Party ceded more economic control, it would lose political power, as the economy's contradictions multiplied and development became less sustainable. Xi clearly falls into the statist camp.

But it is not just the Party that Xi is empowering; he is also empowering himself. In fact, it is hard to know who is ascending the CCP's commanding heights and who will be struck down for disagreeing with the paramount leader. This hasn't deterred outsiders from speculating, but there is not much point in playing that guessing game. Xi, like any other emperor, will continue to appoint courtiers who follow him wherever he leads.

But with great power comes great responsibility – and, at this point, Xi's power is virtually absolute. That is a heavy burden for one man. Xi may be much smarter than Trump (not a high hurdle to clear), but that is not enough to guarantee a stable and prosperous future for China. And, if things go wrong, everyone will know whom to blame. There is a reason why dictatorial dynasties tend to end up the same way. You don't have to read Toqueville to know that.

Fonte: Project Syndicate

China's Contradictions (Stephen S. Roach – 23/10/2017)

Stephen S. Roach, former Chairman of Morgan Stanley Asia and the firm's chief economist, is a senior fellow at Yale University's Jackson Institute of Global Affairs and a senior lecturer at Yale's School of Management. He is the author of Unbalanced: The Codependency of America and China.

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China's quinquennial Communist Party congresses are that rare event where ritual and dogma combine with introspection and strategy. The 19th National Congress, which began on October 18, is no exception.

Notwithstanding the suspense over potential changes in Party leadership, which typically occur at the end of the meeting, President Xi Jinping's political report, delivered on the opening day, was a high-impact event. Significantly, it says as much about the Party as it does about Xi. As Alice Miller, a leading Sinologist at Stanford's Hoover Institution, emphasizes, the report was carefully crafted over a one-year period to convey the consensus of the Party's highest organ, the 205-member Central Committee.

Three conclusions from Xi's address are particularly important. For starters, the ideological underpinnings of "Xi Jinping Thought" have been raised to the same lofty level as those of "Mao Zedong Thought," effectively elevating Xi over his three predecessors – Hu Jintao, Jiang Zemin, and even the revered Deng Xiaoping. Much has been written about Xi's consolidation of power since he was appointed General Secretary in November 2012. But this elevation makes it official. After only five years in office, the Party leadership has anointed Xi as one of modern China's two greatest historic figures.

Second, the political report speaks with great confidence about a China that has now entered a "New Era." But by underscoring the Chinese adage that the "…last leg of a journey just marks the halfway point," Xi sketched an even more ambitious future.

China's sights are now set on two goals – completing the task of building the so-called moderately prosperous society by 2035, and then establishing its position as a Great Power by 2050. Unlike China's goal-setting exercises in the past, there are no quantitative targets attached to these "twin centenary goals" (which roughly align with the Party's founding in 1921 and the establishment of the People's Republic of China in 1949). They celebrate the long-awaited national rejuvenation that Xi has dubbed the China Dream.

The third point is perhaps the most intriguing. This is couched in the form of China's "principal contradiction" – a Marxist concept that serves as an admission of a fundamental problem requiring resolution. The principal contradiction, while typically elliptical and ambiguous, frames a rich discussion of risks and opportunities, strategy and tactics, reforms and governance – all of which will shape China's prospects for the foreseeable future.

The big news is that, under Xi's leadership, the Party has revised its principal contradiction for the first time since 1981. Whereas the contradiction had previously been framed as a tradeoff between the needs of the people and China's "backward social production," it is now viewed as a tension between "unbalanced and inadequate development" and the "people's ever-growing needs for a better life."

This restatement of the principal contradiction has not emerged from thin air. It clearly signals a far-reaching change in national perspective – from that of a poor developing country to that of an increasingly prosperous society focused on becoming a Great Power. It is also consistent with the critique of former Premier Wen Jiabao, who in March 2007 famously warned of a Chinese economy that was becoming increasingly "unstable, unbalanced, uncoordinated, and [ultimately] unsustainable."

Over the past ten years, two five-year plans – the 12th, enacted in 2011, and the 13th, enacted in 2016 – plus a major set of reforms adopted at the so-called Third Plenum in 2013, have aimed to resolve China's persistent and worrisome imbalances. Xi's political report doesn't alter the main thrust of those efforts. The real significance is that rebalancing is now enshrined within the Party's ideological underpinnings. It is a foundational pillar of Xi Jinping Thought.

The political report's focus on China's principal contradiction also raises important questions about what still may be missing from the Party's long-term strategy. Three "secondary contradictions" are especially striking on the economic front.

First, there is ongoing tension between the role of the state and that of markets in guiding resource allocation. This was a glaring contradiction of the 2013 Third Plenum reforms, which focused on the seemingly inconsistent combination of a "decisive role" for markets and steadfast support for state ownership.

The Party has long believed that these two features of economic life are compatible – the so-called blended economy with Chinese characteristics. Xi's political report praises the mixed ownership model and also aspires to an economy led by great firms with unmatched global competitive prowess. But it glosses over the thorny issue of state-owned enterprise reform that may be required to resolve this contradiction and avoid the Japanese "zombie" problem of a chronic debt overhang.

Second, there is the tension between supply and demand. Consistent with other recent pronouncements of senior Chinese officials, the political report leaves little doubt that supply-side structural reforms are now the highest priority of economic policymakers. The related emphasis on productivity, innovation, pruning excess capacity, and moving up the value chain in manufacturing and services are underscored as key building blocks of this effort.

At the same time, the report de-emphasizes consumer spending and services – now buried deep in the list of priorities for a modernized economy. Yet focusing on supply without paying equal attention to the foundations of aggregate demand is a puzzling and potentially worrisome disconnect.

A final secondary tension can be found in the contrast between the path and the destination. Notwithstanding all the self-congratulatory flourishes in Xi's political report, there is good reason to believe that the Chinese economy is only in the early stages of its long-heralded structural transformation. Its services sector is growing rapidly, but is still embryonic, accounting for just 52% of GDP. And household consumption, which is also growing rapidly, is still less than 40% of GDP.

China may well be on a path to a New Normal or a New Era. But the final destination remains far down the road, with many contradictions to be resolved during the journey.

Fonte: Project Syndicate

Central Banks Alone Cannot Deliver Stable Finance (Martin Wolf – 24/10/2017)

Martin Wolf is chief economics commentator at the Financial Times, London. He was awarded the CBE (Commander of the British Empire) in 2000 for services to financial journalism.

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Favourable global economic prospects, particularly strong momentum in the euro area and in emerging markets led by China and India, continue to serve as a strong foundation for global financial stability." This statement opened the International Monetary Fund's April 2007 Global Financial Stability Report. Since this benign view was published on the eve of the most devastating financial crisis in nearly eight decades, it has to be viewed, in hindsight, as a spectacular misjudgment. The fund is determined not to be caught out again. The question is whether the concerns it pours forth in its latest Global Financial Stability Report are well judged or whether it is crying wolf. As important, what might be the implications, especially for policy, of its worries? The underlying argument of the report is that "near-term risks to financial stability continue to decline", but "medium-term vulnerabilities are rising". The return of global economic growth, combined with comfortable monetary and financial conditions, together with sluggish inflation, strengthens investors' reach for yield and appetite for risk. With market and credit risk premiums at decade-low levels, asset valuations are vulnerable to a "decompression" of risk premiums — in blunter words, a crash.

As the report notes, shocks to credit and financial markets well within the historical range could have large negative impacts on the world economy: "A sudden uncoiling of compressed risk premiums, declines in asset prices, and rises in volatility would lead to a global financial downturn." Many hold the room for monetary policy manoeuvre to be limited. The result might then be a less deep, but still more intractable, global recession than that of 2009.

One element in these risks is yield compression. Yields on investment-grade fixed income instruments have collapsed since 2007, with almost none now yielding over 4 per cent. This has also encouraged greater capital flows to — and so more borrowing by — emerging countries. Non-resident capital inflows of portfolio capital reached an estimated $205bn in the year through August 2017 and are on track to reach $300bn in 2017, more than twice the total in 2015-16. In addition, argues the fund, low yields, compressed risk spreads and abundant financing are encouraging a build-up of debt on corporate balance sheets. Reversals in these spreads could cause a jolt: to reach the average levels for 2000-04, market risk and term premiums would have to rise by about 200 basis points for investment-grade bonds. Market volatility is also highly compressed.

Possibly most important, leverage continues to rise across the world, notably in China. In the high-income countries, the net asset position of the private sector has improved somewhat since the crisis, but the governments' has worsened. Moreover, assets are currently valued at high, quite possibly unsustainable, levels. Debt service burdens are generally low, at current interest rates. But this would change if those rates rose sharply. Moreover, in several economies debt service burdens in the private non-financial sectors are greater than average — notably in China, but also in Australia and Canada.

Such analyses bring worries into the open. This is helpful: the more worried people are, the safer the system. Yet it is also essential to tease out the implications of the fragility the fund describes so clearly. I would identify four.

First, investors must be very wary.

Second, it has to be possible for the financial system to cope with changes in asset prices without blowing up the world economy. This should not need saying. An essential part of achieving this is deleveraging and in other ways strengthening intermediaries, notably banks. That has indeed happened, but not, in my view, nearly enough.

Third, the generation of demand sufficient to absorb potential supply has become far too dependent on unsustainable growth in credit and debt and also on consumption (especially in high-income countries) or wasteful investment (as in China). We might break this linkage in several ways. One is to redistribute income, via the tax system, from savers to spenders. Another is to increase incentives for investment, especially by profitable businesses. Another is to remove the tax-favoured position of debt and rely more on equity financing throughout the economy. A final one is to rely more on government spending and borrowing, especially spending on public investment.

Finally, we should not conclude that central banks have to abandon the priority of stabilising the economy in favour of the possibly conflicting goal of stabilising the financial system. One reason is that monetary policy is a blunt instrument for achieving the latter. A more fundamental objection is that we cannot tell people they must remain stuck in a deflationary economy because it is the only way to stop the financial system from exploding. They will rightly respond that these priorities are wrong. Similarly, ensuring creditors get the returns they think they deserve is not the job of the central banks. If governments think creditors are so deserving, they should change taxes accordingly. Again, if they think the financial sector remains excessively unstable, they should regulate it.

Criticising the success of our central banks in reflating our crisis-hit economies, because this created today's financial risks, is not a valid reaction to their actions. It is, however, an extremely valid criticism of finance. It is also a valid criticism of the failure of governments to address the many frailties that still lead to financial excess. The central banks did their job. Unfortunately, almost nobody else has done theirs.

Fonte: Financial Times

A Turnabout on Corporate Taxes (Casey B. Mulligan & Tomas J. Philipson - 24/10/2017)

Casey B. Mulligan is a professor at the University of Chicago and author of "The Redistribution Recession: How Labor Market Distortions Contracted the Economy" (Oxford, 2012).

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Suddenly, an idea that has been accepted by economists and by policy makers on both sides of the political aisle—that high taxes on business hurt investment, workers and the economy—is considered "absurd."

In 2012, President Obama and his advisers proposed lowering the corporate tax rate because it "creates good jobs with good wages for the middle-class folks who work at those businesses." In 2013, Lawrence Summers, President Clinton's Treasury secretary and chairman of Mr. Obama's Economic Council, argued that the tax on corporate profits creates a burden without commensurate revenues for the government, and that changing it "is as close to a free lunch as tax reformers will ever get."

In 2015, Democrat Chuck Schumer and Republican Rob Portman co-sponsored a Senate bill to reduce the top corporate tax rate, which is the highest of any of the 35 countries in the Organization for Economic Cooperation and Development. "Our international tax system," Mr. Schumer argued back then, "creates incentives to send jobs and stash profits overseas, rather than creating jobs and economic growth here in the United States." Bill Clinton in 2016 said he regretted raising the corporate rate to its current level.

Yet President Trump's Council of Economic Advisers (of which one of us is a member) is now being accused of partisanship and unscientific analysis. Last week the council released a report using standard and widely accepted methods of the economics profession to find that cutting the corporate tax rate from 35% to 20% would raise the wage income of an American household by an average of $4,000 within a 10-year time-frame.

The critics include Mr. Summers and Jason Furman, who served as chairman of the CEA under Mr. Obama—both of whom backed cutting the corporate tax rate during Mr. Obama's presidency. Their main methods of criticism include qualitative introspection—the world works this way because I think so—without reference to a supporting scientific base. Other arguments use economywide times-series correlations—taxes are not as bad because both taxes and America grew in the 1990s—omitting other variables driving them, such as the explosion of the internet. Neither method is accepted by the economics profession.

One of the few substantive quantitative points they raise is that they believe the government will receive $200 billion less in corporate tax revenue if the corporate rate drops from 35% to 20%. They write: "We see from the CEA estimates that they predict American households will receive two to three times this amount in the form of higher incomes! That's impossible!" That's a fundamental misunderstanding of the CEA paper—and, more important, of how the economy works. Not only is it possible, it happens every single time.

This argument also contradicts several decades of standard tax analysis. To illustrate, consider a $1 million tax on airline tickets. People wouldn't fly, so no government revenue would be collected—and thus the harm of the tax would be infinitely as large as the revenue. Likewise, a tax cut in which the expansion of the base exactly offset the reduction in the rate would have no revenue effect, so society's gain from the cut would be infinitely larger than the revenue loss.

In the standard economic framework, including Mr. Summers's own work, the long-run loss in revenue to the government is always less than the addition to workers' wages, because resources are freed up to engage in more productive activities.

The gains to factors from a tax cut is always more than 100% of the loss in Treasury revenues, but how much larger? Standard economic models of capital investment predict it's 200% to 300% of revenue losses—as a $4,000 wage increase implies. That is supported by many different strands of the literature and why economists Edward Lazear (a CEA chairman under George W. Bush) and Laurence Kotlikoff, a father of many organizations' tax models, among others, find worker wage effects similar to those found by CEA. Nevertheless, according to Mr. Summers, anyone using these standard models—which includes Mr. Summers in his own work—is "dishonest, incompetent, and absurd."

Messrs. Summers and Furman now belatedly acknowledge that standard economc analysis vividly contradicts their initial proclamations. So they have tried to backtrack by saying that basic economics omits "complex issues" and so must now be irrelevant. But these so-called complex issues are not new. Nor are they complex. Nor do they change our analysis and conclusions. Economists Robert Hall and Dale Jorgensen first analyzed these issues in 1967, and improvements of that literature have been used by CEA in both past and recent analysis.

Among these issues, the economists profession is fully aware that the corporate tax favors—among other things—investments that are debt financed, have quicker depreciation, or can be assigned to foreign jurisdictions. All these distortions by the corporate tax code suggest larger, not smaller, output expansions per dollar of revenue by the proposed tax reform.

The Obama economists go on to favor the current corporate tax rate because, although most corporations are not monopolies, the corporate tax is absorbed by those that are. Widely accepted facts contradict that argument. In particular, economists have mountains of evidence that monopolies are a problem as they withhold production to raise prices. This means that too little capital and labor get used in their industries compared with the rest of the economy, and that too little is used in the economy overall. Thus, keeping the corporate tax only exacerbates this labor underutilization.

CEA of course welcomes debate on the merits, or the existing science, of the case. But these types of argument are neither.

Fonte: The Wall Street Journal

Economic Growth Is No Longer Enough (Manuel Muñiz – 25/10/2017)

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Macroeconomic data from the world's advanced economies can be mystifying when viewed in isolation. But when analyzed collectively, the data reveal a troubling truth: without changes to how wealth is generated and distributed, the political convulsions that have swept the world in recent years will only intensify.

Consider, for example, wages and employment. In the United States and many European countries, average salaries have stagnated, despite most economies having recovered from the 2008 financial crisis in terms of GDP and job growth.

Moreover, increases in employment have not led to a slowdown or a reversal of the decline in the wage share of total national income. On the contrary, most of the wealth created since the 2008 crisis has gone to the rich. This might explain the low levels of consumption that characterize most advanced economies, and the failure of extremely lax monetary policy to produce an uptick in inflation.

Employment, too, seems to be performing in anomalous ways. Job creation, where it has taken place, has followed a different path than history suggests it should. For example, most employment growth has been in high-skill or low-skill occupations, hollowing out the middle. Many of the people who once comprised the Western middle class are now part of the middle-lower and lower classes, and live more economically precarious lives than ever before.

Productivity growth has also become polarized. According to the OECD, in the last decade, productivity within “frontier firms” – defined as the top 5% of firms in terms of productivity growth – increased by more than a third, whereas the rest of the private sector experienced almost no productivity growth at all. In other words, a smaller number of companies have made greater efficiency gains, but there has been relatively no diffusion of these benefits into the broader economy.

It is unclear why these trends are occurring, although the impact of new technologies and related network effects is certainly part of the reason.

At the macro level, aggregate US productivity has increased by more than 250% since the early 1970s, while hourly wages have remained stagnant. This means that productivity growth has not only been concentrated within a narrow set of firms, but also that productivity and market labor income have decoupled. The fundamental consequence of this is that wages are no longer performing the central redistributive role they have played for decades. Simply put, gains in capital productivity are not being translated into higher median incomes, a breach of the social contract on which liberal economies rest.

It should be evident by now that many of the world’s economies are undergoing some form of structural change, and in the wake of that change, the “jobs-productivity-income” distribution triangle has gone askew. This paradigm shift has led to the erosion of the Western middle class and the rise of the precariat, a new socioeconomic class comprising not just those who cannot find a job, but also those who are informally, casually, or otherwise insecurely employed.

We now have abundant evidence linking the perception of economic insecurity in the West with anti-elite sentiment, political radicalization, and attacks on minorities. It is impossible to explain the recent rise of populist politics without considering the effects of these economic pathologies on average workers in the US and Europe.

To understand why the deviations from expected economic trajectories have occurred, one need look no further than the impact of technology on jobs. Advanced technologies, particularly advanced computing and robotics, have enabled productivity gains to occur without a corresponding increase in wages. The greater wealth generated by higher productivity goes instead to the owners of these technologies.

Automation of fairly sophisticated routine jobs is driving the polarization of the labor market. What remains are either hard-to-automate tasks that require little or no skill, or hard-to-automate tasks that require very high skills. The latter jobs are much smaller in number than the former, and they happen to be in frontier firms that are leveraging the effects of technology to outperform direct competitors, and to expand into new markets.

This brings us to the central question of our era: How can leaders address the externalities produced by rapid technological change, and thereby ensure economic and political sustainability? Put another way, how can we construct a new social contract for the digital wage?

Remedies are harder to come by than diagnoses. It is unclear, for example, if applying old economic treatments would reverse current trends. Pushing “structural reforms” and designing narrow macroeconomic policies aimed exclusively at increasing productivity might force Western workers to compete with technology to an even greater extent, exacerbating precariousness. Perhaps our current economic arrangements can produce growth only at the aggregate level, while driving down most people's living standards.

The debate about solutions has only just begun. Reducing economic inequality will require reforms of education and taxation, with the tax burden shifting decisively from labor to capital. Western countries will also need to create new redistributive mechanisms to supplement the declining role of wages in their economies.

The data make an overwhelming case for such reforms. If Western leaders are to contain, and ultimately quell, the political convulsions that their countries are now experiencing, they have no choice but to respond by crafting new, inclusive growth models.

Fonte: Project Syndicate