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Economic Illusions

Statistics, Models and the Symmetry of Theory & Practice

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Economic theory evolved over the 19th century as a genuine attempt to replicate reality. By the early 20th century, agents of the rent-seeking culture had to neutralise this social science, which had identified the optimum financial policies for an efficient free market. Outcome: a mish-mash of “schools of thought” – ideologies – rather than a science of economics.

A. On Appearances and Reality

The emergence of the neo-classical school of economics at the beginning of the 20th century is attributed to a new analytical approach to understanding how firms make decisions (the "marginalist revolution"). In reality, a *coup* was launched by leading professors in the US to divert classical economics from one of its key findings: that, to secure optimum results for a fair and efficient economy, the public's finances had to be based on the rents generated by nature and by society. The economic professors who engaged in this revisionism were working under the patronage of the rent-appropriating Robber Barons who funded the leading universities in America (see Mason Gaffney's forensic examination of this episode in the history of social thought, in Gaffney and Harrison 1994).

Today, the world is governed with the aid of the neo-classical (more accurately: post-classical) economic paradigm. This has fatal consequences. The problems that governments seek to solve are not correctly analysed. This explains why politicians confine themselves to palliatives (relieving pain without dealing with the cause). This is ideologically safe. But it means that their decisions are distanced from reality. They seek safety in a fantasy future (see Box 1).

One consequence is the widening gap between rich and poor, and the reduction in the living standard of the middle class. In Britain, for example, since 2008, the average British worker has become poorer by £3,500 a year. But isn't this due to "market failure" rather than the failure of governments? That is what politicians would like you to believe.

Box 1

Forecasting & the Future

In his role as chief economist at the Organisation for Economic Cooperation and Development, Pier Carlo Padoan presided over the modelling of the global economy on behalf of over 30 member countries. The OECD had failed to predict the financial crisis of 2008. There was a good reason for this failure (as he was to confess [Padoan 2014]): *their models excluded data on the financial sector*!

In his confession, Padoan explained that "Prediction is very difficult, especially if it is about the future". Economists do not think it is odd to distinguish between (a) their fantasies about the future, which they "prove" with statistical models, and (b) the harsh realities as they actually unfold.

Today, Padoan is Italy's finance minister.

B. On Boom/Bust Cycles

The boom/bust economy operates on a regular timetable. The 18-year periodicity is inscribed in the historical record. And yet, economists refuse to come to terms with this pattern. Why? Because those patterns lead to conclusions with political implications. The data recorded in the history books disclose

(1) **the explanation** for *why* the capitalist economy is inefficient; and

(2) **the solution**: *how* to reform finance so that the economy is fair to everyone.

The empirical evidence for the 18-year cycle was gathered by an American (Homer Hoyt) in the 1930s. His theory was retrieved and tested against 20th century evidence by Harrison (1983, 2005). In essence, the pursuit of capital gains from land (the one resource that is fixed in supply) leads to asset price cycles that last for about 14 years, causing a bubble that eventually busts. Recessions last, on average, about 4 years (as Keynes explained in his *General Theory*).

B. The Counter-cyclical Remedy

The boom/bust cycle can be erased. Stability can be achieved by transforming economic incentives: this is delivered by reforming the public's pricing mechanism (taxation).

Under current tax policies, land speculation is rewarded because of the failure of government to collect the rents that are generated by public services. Lawfully, therefore, shrewd individuals engage in what is called "arbitrage". They work out how to profit from the flaws in public policies. They buy and sell rent-yielding assets. Thus, systemic failures, which manifest themselves in mass unemployment of labour and the waste of capital, are *not* due to "market failure" (the explanation favoured by economists). They are due to political failure.

C. So Why Does Australia Boom & Bust?

Why, then, has the Australian economy suffered from the boom/bust cycle over the course of nearly 200 years?

Land taxation was introduced into Australia in the 19th century by European settlers to fund the provision of infrastructure which they needed to support the growth of the economy and the new urban centres. But at no point in that history did state and federal governments collect all of the rents generated by public investments. Thus, there was scope for "capitalising" the stream of annual rents income into selling prices.

This history, and the virtues of rent-as-public-revenue, is explored in a new book by Philip Soos, from Deakin University, Australia, and his co-author, Paul D. Egan. *Bubble Economics: Australian Land Speculation 1830–2013*, is available as a free download at http://www.worldeconomicsassociation.org/books

The important lesson is this: *economic distortions caused by rent privatisation can only be erased by collecting all of the rents generated by society.* This, in turn, would make it possible to abolish all the taxes levied on wages and the profits of enterprise.

Modest charges on rent do *not* neutralise rent-seeking behaviour, whose toxic effects are also to be observed in the corrosion of people's personalities, their cultures and communities. Thus, if the objective of public policy is a healthy population, and a community grounded in the principles of morality, it is not possible to compromise on the need for an ethics-based system for financing public services.

References

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