Institutional ECONOMICS

Archive

Articles for the Month:

John Coffee
questions whether research can be made truly independent of those who subsidise it: *Ultimately, US regulators have recognised that securities research is not a profit centre. Forcing the separation of analysts from broker-dealer firms that underwrite stocks would lead to far fewer analysts being employed in the industry. Will the global settlement's prophylactic measures work? They may prevent the more egregious abuses but securities research does not support itself; instead, it depends upon a subsidy from other divisions. That subsidy may not be forthcoming unless analysts reciprocate and assist those other divisions. However strict the firewalls and informational partitions within the firm, the handwriting is still indelibly on the wall: if analysts wish to be subsidised, they have to create value for the provider of the subsidy. Hence, the most innovative and creative feature of the global settlement is its requirement that the defendant firms subsidise independent research by research boutiques...Will this work? Much depends on one's criteria for measuring success. Independent research firms may be no more accurate but they are likely to be less optimistic. At least the retail broking client will see a range of views and, it is hoped, come to understand the subjectivity of the process...Even the growth of independent research firms does not guarantee that conflicts of interest will at last be eliminated. After all, independent research firms will want to renew their contracts to provide research to the clients of underwriting firms, and this could cause them to pull their punches in the cases where they review the underwriters' clients.* In fact, there are some independent research firms that get by perfectly well without such subsidies. It's a tough business to be in, but there are enough people out there who recognise the value of independent analysis to make such businesses viable.

posted on 4/29/2003

Steven Levitt
has won the John Bates Clark Medal, awarded every two years to a leading economist under 40. A high percentage of Bates Medal winners have gone on to win the Nobel. A little more exclusive than the Australian Centenary Medal, that went to over 15,000 people. After Andrew Norton reported that every one of his previous employers had got one, I went and checked out my previous employers. Making allowance for the fact that I have spent most of the last six years working for Americans who would not be eligible, most of my former employers got one too.

posted on 4/28/2003

Andrew Norton is on a roll

taking down both Clive Hamilton and *The Australian Financial Review*: *The thinking person's anti-capitalist, Clive Hamilton of The Australia Institute, has been getting quite a bit of coverage for his new book, Growth Fetish. One of the book's arguments is that we are seeing a significant number of people giving up their addiction to high incomes and excessive consumption, and 'downshifting' to a more modest lifestyle. This Hamilton argument sits rather incongruously in the latest issue of The Australian Financial Review Magazine (pay per view, so downshifters will need to read it in their local library). On my count, the magazine's readers have to get through twenty-two pages of advertisements for such trademarks of the frugal life as Louis Vuitton watches, Armani suits, and a 12 cylinder 760Li BMW, plus a story about marketers turning buying luxury goods into an 'inspirational experience', before they get to Clive's lifestyle advice.*

posted on 4/25/2003

Andrew Norton

highlights the suffering of Michael Pusey: *It seems that when Pusey's family migrated to Australia, when he was 12, the plan had been to establish a franchise of a textile firm. Alas for the Puseys, on their way here the Menzies government imposed import restrictions, making the textile business impossible and forcing them into sudden downward mobility. This experience, the Sun-Herald says, left its mark on a young mind. On the evidence, however, that mark was not on his intellect. You'd think this personal experience would highlight the social cost of protectionism. But no, the adult Pusey is a protectionist. But it is nice to know that he has suffered for his ideas. His readers certainly have.* Some people are just beyond learning.

posted on 4/24/2003

More on inflation targeting

Bill Dudley and Paul McCulley have their own suggestion for an inflation target for the Fed: *the Fed should commit to keeping its federal funds rate at or below the current 1¼ per cent until core inflation climbs back to, say, 2 per cent or higher on a year-on-year basis. The current reading of about 1½ per cent (on Mr Greenspan's preferred measure, the core PCE deflator) is right in the middle of the 1-2 per cent range that Ben Bernanke, Fed governor, recently suggested as the working definition of price stability.* If this sounds strange coming from a bond fund manager, think of the trading opportunities they envisage: *Bond yields would rise even before the inflation target was reached, helping to slow the economy and keep inflation from rising. Conversely, if the economy slowed or inflation fell, investors would anticipate a much longer period of low short-term rates. This would pull down bond yields, helping to stimulate the economy. The bond market vigilantes would be enlisted as a posse to help the Fed stimulate or restrain the economy.* Still, their proposed conditional inflation target is more rigorous than that found in some inflation targeting countries. Australia's target is for 2-3% on average over the economic cycle, which leaves the RBA with an enormous amount of policy discretion. Meanwhile, the world leader in inflation targeting, the RBNZ, has just cut rates. The RBNZ often leads the global interest rate cycle, so much so that the RBNZ now seems to be an entire cycle ahead of the curve. The other central banks of the USD-bloc periphery, the RBA and BoC, arguably have more tightening to do.

posted on 4/24/2003

Ken Rogoff

suggests it's time for central banks to commit to long-term inflation targets over a five to ten year horizon: *I do not regard transparency of long-term inflation objectives as being more important than maintaining central bank independence, or than having conservative central bankers with strong anti-inflation credibility. Indeed, looking over the next 40 years, one has to be concerned about burgeoning fiscal deficits and ballooning old-age transfers in the biggest economies. Monetary institutions must remain strong or the irresistible force of fiscal profligacy will once again overwhelm all inflation resistance. A greater measure of inflation transparency can only help. It is time to end policies of destructive ambiguity.* Rogoff also considers some possible objections to his proposal. An important issue is what the appropriate inflation target should be. With productivity improvements and globalisation driving goods prices lower, it could well be that future inflation targets will need to be revised lower to take account of structural deflation.

posted on 4/23/2003

Martin Feldstein

on why the UK should not join the euro: *The German example shows that Britain's decision about adopting the euro is not a question of whether the time to do so is now right. Adopting the euro is a permanent commitment with permanent consequences. My judgment is that it would not be in Britain's long-term economic interest to accept the constraints of the single currency*. It is interesting that so many commentators blame Europe's current economic problems on the Stability and Growth Pact, rather than blaming the lack of flexibility inherent in the euro project itself. The arguments against the Stability and Growth Pact are in fact arguments against the euro project as a whole. In any event, it would seem unlikely that the UK will join the euro. The euro has a lousy track record when actually put to a popular vote.

posted on 4/22/2003

Joe Stiglitz is trying to be unconventional

telling a MoF seminar the Japanese government should issue its own currency separate from the BoJ, according to this report in the Nikkei: *Prefacing his statement by saying that as an economist it might be heresy, Stiglitz...claimed at a Ministry of Finance meeting that a deflationary economy is different from an inflationary economy, requiring a shift in thinking. He explained that if the government issued currency separately from the BOJ and used it to pay a portion of its expenditures, the government's finances would be funded without issuing government bonds and this would increase the supply of funds at the same time.* The proposal is in fact no different in substance from the BoJ buying government bonds. Former US Treasury Secretary Robert Rubin was arguing as early as 1999 that Japan should monetise government debt. Far from being heresy, Stiglitz's argument is little different from what was in fact an official US policy stance.

posted on 4/17/2003

Remember Woodside?

John Durie looks at the consequences of the Federal Treasurer's discretionary interventions in the market for the ownership and control of equity capital: *As usual with Costello, politics beat sound economic policy management by a considerable stretch in the foreign investment debate over Woodside. The Shell bid was certainly no certainty on economic grounds, but the tragedy was Woodside shareholders were denied a look to decide their own fate. Having set the precedent in knocking back Shell, Costello has yet to repeat the medicine, which shows how politics rather than national interest drove that decision. Woodside shareholders have since seen the company's stock price underperform the market by some 8 per cent and even fall below Santos by about 14 per cent. Over the past year, the price relativities have worsened, with that market "leader" Santos's stock price up close to 10 per cent against the 16.4 per cent fall in Woodside, as domestic fund managers have bailed out bewildered about the apparent lack of direction in the company. The board killed two attempts to expand offshore as the company's stock price continued falling amid confusion as to where the company was heading, against a known earnings gap in the next two years before new projects come on line in 2005.*

posted on 4/16/2003

Competition Commissioner Allan Fels

is doing something constructive in tackling the DVD regional coding issue, whereby the DVD industry attempts to price discriminate across different markets. Fels arguably made his name taking on the monopolistic practices of the publishing and music industries with respect to the parallel importation of books and CDs and helped to achieve some important legislative changes in Australia to facilitate parallel importation of copyright material. But Fels is now portraying this as some sort of war on ‘international cartels,’ when the issue here is one of defining the regime governing intellectual property rights in a more liberal direction. There are very few genuine instances of the global cartel-like behaviour Fels is railing against and he is wrong to suggest that "Free trade paradoxically has given rise to cartel behaviour which has required regulatory action. When you deregulate markets, people are very aware that the way to make money is to create some restriction." The DVD case is actually a good example of how technology is the main enemy of such attempted restrictions. Obtaining a multi-region coded DVD player is very easy, which has more to do with free trade and technology than the actions of regulators.

posted on 4/16/2003

Alan Kohler
has been nailing the local superannuation industry for some time now. Today's piece is no exception: *The investment industry has evolved into a complex, arcane and sophisticated system for relieving the public of a sizeable but generally unobserved portion of its wealth in return for providing security in retirement. This has become a desirable, indeed largely compulsory, service because governments have too little money left after buying the votes of young families to meet the cost of supporting old people.* In fact, by world standards, the Australian superannuation system isn't a bad one. All it needs is less compulsion, lower taxation and for investors to catch on to the efficient markets hypothesis and the value of indexing. Perhaps the biggest sin of active fund managers is to charge their clients for alpha and then turn around and invest in beta.

posted on 4/12/2003

Anna Schwartz
takes a critical look at the IMF's proposals for a universal bankruptcy law for sovereign creditors. Adam Lerrick has another take on the issue, providing a nice summary of how we got to where we are today: *In 1995 in Mexico, Lawrence Summers, then US Treasury undersecretary, stretched forth his hand and gave life to a financial anomaly: an asset with a high rate of return and with an unwritten AAA guarantee via IMF bailouts. The natural laws of the risk/return trade-off were contravened; the demand was explosive. Annual bond issuance by Latin American governments instantly quadrupled from $9bn to $37bn. Bailouts grew with borrowing. Official loans to save faltering economies and their creditors mounted to $250bn by 2001 and were still climbing. Taxpayers in the Group of Seven richest countries were staring at a long list of future payouts. When the IMF stood by and Argentina was allowed to default on a massive $100bn of bonds, the forgotten process of debt restructuring recaptured the international agenda.*

posted on 4/11/2003

Pessimism about the multilateral trade liberalisation process
would appear to be rife among the participants in the process, according to a survey from the University of Adelaide's Institute for International Business, Economics & Law: *The survey...polled 70 trade experts including ambassadors to the WTO in Geneva and government officials from Washington, Brussels, Canberra, Tokyo and other national capitals. It found that 83 per cent of these experts doubted that WTO member countries would break the current impasse on negotiations to free up agricultural trade before the end of the July summer break in Europe. The anonymous survey was carried out in the last week of March, as the WTO was on the brink of missing its March 31 deadline for reaching a framework agreement on reforming agricultural trade. But it found that the pessimism amongst key officials extended beyond agriculture to other important areas of the Doha round of negotiations. Two thirds of those responding to the survey said they doubted the WTO's 146 member countries would meet a May 31 deadline for finalising negotiations on changes to the trade organisation's dispute settlement provisions. And about half of the officials thought that two key new areas for the negotiations - dealing with the links between trade and investment and competition policy - would not be finalised in time for the next full WTO ministerial meeting in September this year.*

posted on 4/11/2003

Trans-Tasman competition regulators
have not surprisingly rejected the proposal by Qantas to take a 22.5% stake in Air NZ, on the grounds that it would be ‘anti-competitive.’ The *AFR* reports that ‘Qantas chief executive Geoff Dixon signalled on Wednesday that he was prepared to negotiate with the regulators if the deal was rejected.’ The danger here is that Qantas ends up giving undertakings that amount to the de facto re-regulation of trans-Tasman aviation by competition regulators. The protectionist attitude of the Australian and NZ governments to their respective carriers has been enormously damaging to the competitiveness of the aviation sector, effectively derailing what had been an attempt by Singapore Airlines to re-capitalise Ansett and Air NZ, including ramping up Ansett into an international carrier. The result has been bankruptcy for Ansett, re-nationalisation for Air NZ and with the competition regulators left trying to promote competition through ad hoc, discretionary interventions in the market for the ownership and control of equity capital.

posted on 4/10/2003

According to the Catallaxy Files blog roll
I'm a whig! Given Jason's typology, I guess that's the category I'm most comfortable with and I certainly can't complain about the company I'm keeping in Jason's Whig section.

posted on 4/10/2003

The *Arts & Letters Daily* of Political Theory
is how I would describe this site. The editor is a graduate student at the New School for Social Research. Well worth a look.

posted on 4/9/2003

There is an interview with Lawrence Lessig
over at Econlib on the subject of intellectual property.

posted on 4/8/2003

The 'rise' of the Greens in Australian politics
is the subject of an article in *The Economist*. The article refers to the Democrats as a party ‘whose star has now faded,’ but fails to make explicit the extent to which increased support for the Greens has come almost entirely at the expense of the Democrats. The article also suggests that ‘oddly, it was the demise of One Nation, a small party espousing bigoted nationalism…that left the ground open to [the Greens].’ The Greens in fact exhibit a strong nativist streak and have views on immigration and industry protection that are very similar to One Nation and the Democrats. The obvious conclusion to draw is that any increase in the Green vote simply represents shifting support among minor parties with essentially the same isolationist, anti-globalisation agenda. Perhaps the most meaningful way to look at these parties is to take the sum of their primary vote as representing the combined anti-globalisation vote, which remains reassuringly small and steady. There is also an important lesson in the demise of the Democrats and One Nation. Small parties are vulnerable to implosion, becoming victims of their own success.

posted on 4/7/2003

'Would you like some derivatives to go with that?'

The Japanese Ministry of Finance is looking to sell Japanese government bonds through convenience stores, according to the *Nikkei*: *"We are now considering steps so the general public can buy government bonds more easily, at places such as convenience stores," Shiokawa told a news conference...Currently, the bonds can be bought only at financial institutions, such as banks and brokerage houses, or at post offices...The government is under pressure to diversify marketing channels for its bonds as it is to issue more of them to finance the ballooning budget deficit.* Nothing like going down to the corner store and coming back with the government owing you money! You have to worry about a country in which government debt has become a convenience good.

posted on 4/7/2003

William Baumol and Burton Malkiel

put the case against the expensing of stock options.

posted on 4/5/2003

John Quiggin

responds to a recent post of mine on fiscal policy in the US. I have great difficulty in taking long-term fiscal projections seriously, given the parameter uncertainty to which they are subject. The projections of endless fiscal surpluses of just a few years ago illustrate this point, although I would agree that they also highlight the extent of the fiscal deterioration seen under the Bush Administration. Where Quiggin and I part company is in our respective approaches to fiscal consolidation. As I think my post makes clear, I favour a fairly radical curtailment of non-defence discretionary outlays, which have been one of the main drivers of the recent fiscal deterioration in the US. This would nicely complement the permanent nature of the tax cuts, ensuring positive wealth effects to offset what might otherwise be a contractionary fiscal impulse from fiscal consolidation. John might have also noticed that on 27 March, I linked to an *FT* op-ed, in which US Treasury Under-Secretary Peter Fisher makes the case for accrual accounting in the budget process and suggests that the US debt to GDP ratio probably rivals that of Japan (to the extent that we can make any sense at all of Japan’s public sector balance sheet). This does not sound like ‘banana republic populism’ to me. **UPDATE:** In my original post, I said "But one can’t help but think that deficits of similar magnitude incurred by a Democratic Administration in the wake of a major recession would not occasion similarly alarmist predictions from the likes of Quiggin." This is a little unfair on John, since it is obviously difficult for him to defend himself against a counter-factual. So I asked John to provide some examples where he has been critical of left-of-centre governments in relation to fiscal policy. John has refered me to pgs 63-64 of his *Work for All*, which includes criticism of the Whitlam government's fiscal policies. Since John has risen to the occasion, I think I should withdraw my imputation of selectivity, although still stand by the rest of my discussion about the policy alternatives in relation to US fiscal policy.

posted on 4/3/2003

Just when you thought exchange rate targeting and currency pegs had been completely discredited

Kumiharu Shigehara, former chief economist at the OECD, argues for targeted yen depreciation, with a peg if need be. The proposed USD-JPY target of 150-160 would make little difference to domestic inflation outcomes. An even higher target for USD-JPY would potentially introduce serious distortions in relative price signals between the traded and non-traded good sectors that are crucial in communicating the imperatives of structural reform. The yen depreciation prescription is also at odds with some of Shigehara's other policy prescriptions, such as encouraging foreign competition. Some of Shigehara's other proposals are not necessarily bad. But the idea that yen depreciation is some sort of panacea for Japan is not credible.

posted on 4/2/2003

Rupert Darwall

has produced an excellent overview of the politics of economic reform in New Zealand. I have only a few minor quibbles with his overall argument. Darwall says that 'since the election of the current Labour government in 1999, the country's talent drain has worsened.' In some categories, perhaps. But overall NZ is currently seeing strong net migration inflows. Inward and outward migration is an important part of what keeps the NZ economy flexible and helps to alleviate supply-side constraints in an economy with a very low unemployment rate. While there is much angst about the composition of these flows, to me they have the appearance of an entirely healthy global trade in human capital. NZ has always been fairly relaxed about migration, especially in contrast to Australia. Darwall also suggests that NZ's personal income tax rates are driving outward migration, including to Australia. Given Australia's very high marginal and average rates of personal income tax, I doubt too many NZers are migrating to Australia for a tax break. It is interesting that NZ's reform experience is still attracting international attention. It would be amusing to have an outsider conduct a similar analysis of the demise of the reform process in Australia, where the current government is relying heavily on the international security environment and a fearful electorate to make up for the fact that it has little by way of a substantive third term policy agenda.

posted on 4/1/2003