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Articles for the Month:

Asia's Boy Bomb.
A review of *Bare Branches: Security Implications of Asia's Surplus Male Population* by Hudson and den Boer. I'm not sure that I buy their argument, but it is an interesting thesis that deserves further study. The review canvasses some of the methodological objections. My own view is that the spread of democracy and increased regional economic integration are potentially powerful offsetting considerations in assessing the risk of regional conflict.

posted on 4/29/2004

I make the case for a near-term RBA and RBNZ tightening
over at Action Economics. Extract: *The February Statement on Monetary Policy argued that 'the stance of policy remained mildly accommodative.' RBA Governor Macfarlane's speech on 14 April noted the highly stimulatory policy settings in the US and the G7, which has important implications for domestic activity, and his view that the growth rate in the stock of domestic housing credit was 'unsustainably high,' suggesting that the RBA is still unimpressed by the recent moderation in these indicators. The most recent domestic activity data also argue for moving policy from an accommodative to a more neutral setting. Gross national expenditure is currently running at stunning annual trend growth rate of 6.7%. Not surprisingly, the unemployment rate has fallen to multi-decade lows at 5.6%. The RBA remains concerned about the implications of growing capacity constraints for the medium-term inflation outlook, despite the fact that on most measures, inflation remains squarely within the target range. This partly reflects previous exchange rate gains, but as the RBA noted in its February SOMP, 'this effect will eventually wear off.' The recent downward correction in AUD and the risk of a broad-based USD upswing suggests that the exchange rate will no longer serve as a moderating factor for the inflation outlook.*

posted on 4/28/2004

Institutional Economics and Action Economics Collaboration.
Institutional Economics has entered into an arrangement to provide the clients of Action Economics, LLC with regular commentary on Japanese, Australian and New Zealand monetary and exchange rate policy. This will complement their in-depth coverage of the US economy, Fed policy, US Treasuries and other markets and is available exclusively through Action Economics. Institutional Economics readers can sign-up for a free trial here (enter free trial code 'Institutional Economics').

posted on 4/24/2004

Can public choice theory explain an entire continent? You bet.

posted on 4/23/2004

Desmond Lachman of the American Enterprise Institute is offering Australian policymakers macroeconomic advice: *As many countries' sorry experience attests, macro-economic policy, especially in the budget area, is often painfully slow to react to the bursting of a bubble. For that reason alone, it would seem none too early for Australian policymakers to start seriously examining their policy options for dealing with any eventual bursting of the past decade's spectacular run up in housing prices.* This reflects a growing consensus that policymakers should respond more aggressively to both prevent the emergence of asset price inflation and to address the consequences of any asset price bust. Lachman suggests we should be more concerned with the latter than the former, but Lachman's comparisons with the US and Japan are a stretch and his reference to IMF research neglects to mention the last Article IV consultation, which argued that Australia's recent house price inflation can be largely explained by fundamentals. One of the major causes of volatility in the Australian housing sector in recent years has been activist fiscal policy, not the lack of it. Recent changes to stamp duty in the state of New South Wales might well accelerate the downturn in house prices that Lachman views as inevitable. Even with the best of intentions, fiscal policy often ends up being pro-cyclical. The capitalisation of state taxes into house prices, along with other regulatory burdens on the sector, suggests the need for a more structural approach to the role of fiscal policy if we are concerned about house price inflation and its consequences. The volatility in dwelling investment in recent years has shown that the broader Australian economy is robust to large swings in housing construction and will probably prove robust to any sharp downturn in house prices as well. Australian GNE is currently running at an annual trend growth rate of 6.7%, with business investment running at 13.6%, while the unemployment rate is at multi-decade lows. Far from being symptomatic of a 'bubble,' this suggests a sound set of fundamentals. Rather than trying to second-guess the course of asset prices, policymakers should be responding to developments in the real economy. Failing to do so, or rushing to ease at the first signs of stress in the housing sector, has the potential to be far more destabilising. In any event, it is sad to see AEI scholars falling victim to the preoccupation with 'bubbles' and related arguments for more activist macroeconomic policy. The AEI is beginning to sound like the Institute for International Economics!

posted on 4/23/2004

Federal Opposition leader Mark Latham demonstrates his independent foreign policy stance,
by plagiarising a speech by former US President Bill Clinton. Latham denies the charge. Even if Latham is innocent, the ideas themselves have little by way of substantive content. Latham has been dining out on feel-good statements about the value of education for too long. He might now care to outline how he is going to pay for a post-secondary education for every 18 year old. **UPDATE:** How to get your ideas adopted by Mark Latham: send him a copy of your latest book. Not that you will get any free publicity! The problem is not so much plagiarism, but Latham's seemingly random approach to ideas.

posted on 4/22/2004

Michael Lind
reviews Australian philosopher Peter Singer's *The President of Good and Evil: Taking George W Bush Seriously* and asks 'could Karl Rove invent a critic of Bush less likely to inflict damage?' Given that Lind considers Bush 'the worst president of my lifetime,' Singer's effort must have really fallen flat. Lind is at least conscious of the dangers of Bush Derangement Syndrome. He is also no fan of bloggers, maintaining that Singer draws on blogs in terms of both content and style.

posted on 4/21/2004

Alan Wood is offering the Federal Coalition government political advice
suggesting they need to go to this year's Federal election on a platform of 'serious tax reform:' *Howard and Costello need a tax package big enough to capture voters' attention by offering significant structural reform of the income-tax system. A radical reform would be to align the top marginal tax rate and capital gains tax with the corporate tax rate of 30 per cent, which would remove significant problems and economic disincentives in the current system.* It was the 1998 Federal election that was supposed to be about 'serious tax reform.' What we got was a massive change in the tax mix that has yielded the Commonwealth the highest ever revenue take as a share of GDP. The government's long-standing commitment to hold the Commonwealth revenue share of GDP at 1996-97 levels has only been met through some convenient accounting practices. A meaningful reduction in the overall tax burden cannot take place in the absence of serious expenditure reform, but the government shows few signs of going into the election campaign on a platform of massive tax and expenditure cuts. Wood claims that 'Howard and Costello know that it was the GST, sold as "the tax plan for Australia's future", that got them over the line in 1998.' In fact, the GST nearly sent the government 'over the line' in the other direction. Only the Coalition's huge electoral majority from the 1996 election allowed it to contest the 1998 election proposing the introduction of a consumption tax. The compliance burden associated with the introduction of the new tax nearly sunk the Coalition again in 2001, but for the decision of a certain Norwegian ship's captain to steer the MV Tampa in the direction of the Australian coast. Andrew Norton also casts doubt on Wood's interpretation of the politics of tax reform. I doubt the government's tax and expenditure policies in the lead-up to this year's election will do much for the government other than to neutralise a similar set of proposals from the Opposition. More important will be the Federal opposition's abandonment of bipartisanship on foreign affairs and

defence, the same policy stance that sent the former opposition leader's approval rating to 100 year lows and could well sink Latham too.

posted on 4/20/2004

A new Austrian School-inspired group blog

called Taking Hayek Seriously has assembled a collection of Hayek scholars and those with an interest in Austrian economics. Steven Horwitz, who has done some impressive work in developing Austrian school perspectives on monetary economics, is also in residence.

posted on 4/15/2004

Mike Steketee's

painless solution to the problems of publicly-funded schools and hospitals: deficit spending! There is some truth to his argument that Australian governments have been overly preoccupied with debt reduction (Steketee quotes my former colleague Brendan Flynn to this effect), but it does not follow that throwing more money at public schools and hospitals will deliver better outcomes. There is actually a much bigger and far more interesting story here. Australian governments have focussed on debt reduction because it reinforces their credentials as economic managers with the electorate. In other words, debt reduction is politically popular. This suggests that the Australian electorate has sound Ricardian instincts and recognises that there is no such thing as a fiscal free lunch. This runs somewhat counter to the standard public choice argument that unrestrained democratic politics necessarily leads to fiscal Hobbesianism and deficit spending. By rewarding governments that practice fiscal restraint, the public appear to have induced a change in the politics of fiscal policy in Australia. The public's preference for a balanced budget might not always be optimal fiscal policy, but as a fiscal rule of thumb for a public seeking to economise on political monitoring costs, it is not necessarily a bad one. **UPDATE:** Charles Murray suggests taxpayers would generously fund public goods given the opportunity to allocate their own tax dollars.

posted on 4/14/2004

Robert Hahn

of the AEI-Brookings Joint Centre on Regulation on the consequences of the European Commission's ruling against Microsoft: *But the Commission did more than level the playing field; it chose a remedy that advances the interests of Microsoft's rivals at the expense of consumers as well as Microsoft. To see just how, consider the way the U.S. courts dealt with a parallel issue in Washington's own antitrust case against the giant software company. Microsoft was required to give computer makers the right (and technical ability) to remove user access to a variety of Windows features so that the vendors could feature substitute software from Microsoft's rivals. By contrast, the European Commission is demanding that Microsoft literally remove the software code, a fix that has the seeming advantage of putting a stake through the Window Media Player's metaphoric heart. That is deeply problematic, however, because Windows Media Player isn't a component to be snapped off Windows like the chopping blade of a Cuisinart chopping blade, but an intricate collection of software commands that makes use of myriad parts of the operating system. At best, then, meeting the Commission's orders will require an expensive overhaul of Windows that will strand many existing software programs that depend on help from Windows Media Player code. At* *worst, it will make Windows far less reliable as a platform for applications software, and force independent software makers to write programs for Windows that are inherently slower and more complex. That's why U.S. District Court Judge Kollar-Kotelly rejected the code-removal approach, ruling that it would "disrupt the industry, harming ISVs [Internet Service Vendors] and consumers."*

posted on 4/13/2004

Laissez-Faire Books
has a 15% off everything sale ending 30 April, including Johan Norberg's *In Defence of Global Capitalism* for a mere $8.80.

posted on 4/12/2004

In an otherwise worthy article putting recent USD developments in perspective,
Allan Meltzer supports Japan's recent interventions in foreign exchange markets: *Japan's policy has at last allowed monetary expansion to support economic expansion and reduce deflation.* As we have been arguing recently, this view is mistaken. Japan's foreign exchange market intervention operations have been largely irrelevant to monetary expansion. Indeed, they are at best a substitute for it. The annual rate of base money growth is now moderating. Unless the target for current account balances at the BoJ is raised fairly soon, base money growth will quickly slip back into single digits. But even if base money growth did accelerate again, whether due to an increase in the BoJ's target for current account balances or through unsterilised foreign exchange market intervention, this will not by itself translate into meaningful 'monetary expansion.' As Meltzer noted on another occasion in discussing Japanese monetary policy, 'exchanging base money for zero interest rate securities achieves nothing.' Fellow monetarist Robert Hetzel has argued rather persuasively that the BoJ's current quantitative easing regime serves only to accommodate reserve demand rather than forcing liquidity on to the public. It is sad to see AEI scholars like Meltzer and Makin offering monetarist rationales for Japan's intervention operations, which are motivated by mercantilist considerations, not domestic monetary policy. Their arguments are also seriously at odds with what the data are telling us about the operation of Japanese monetary policy.

posted on 4/7/2004

More strange bubble-talk from Morgan Stanley,
with Andy Xie making this extraordinary claim: *The risk of a global hard landing is rising rapidly, I believe. The trigger could be a policy action by China, a credit incident in the commodity market, or just the weight of the debt bubble in Australia…Australia's property market appears to be teetering on the brink, and could break soon. The resulting confidence shock could prick the Anglo-Saxon bubble.* This would be the first time since the 19th century gold rush that an asset price shock was transmitted from Australia to the rest of the world. The Australian economy does in fact serve as a good leading indicator of the global interest rate cycle and the Australian dollar is also a very good leading indicator of the world economy. But this is still consistent with Australia's role as a price-taker in global markets. The idea that an asset price shock in the Australian residential property market would transmit to the rest of the world is rather implausible. This is not to say that Xie's scenario for a 'global hard landing' or a correction in Australian residential property prices

is completely out of the question. But the idea that the latter would 'trigger' the former is a flight of fancy and Xie's overall argument that a 'global debt bubble,' especially in the Anglo-American economies, underpins the world economy is not a great deal more plausible.

posted on 4/7/2004

Liberty Fund
has launched a new web site for its Online Library of Liberty.

posted on 4/6/2004

Another Nikkei story suggesting a change in Japanese intervention policy,
but the only evidence the story can muster for such a change is the failure of the authorities to intervene massively to prevent the most recent episode of yen appreciation. As suggested in previous posts, it would not be surprising to see a shift to a less aggressive approach, allowing the yen to move into a new trading range. But this would still be consistent with a de facto 'managed' exchange rate regime, rather than a substantive change in intervention policy on the part of the MoF. Those who have praised BoJ Governor Fukui for his supposed commitment to easier monetary policy have the rather embarrassing task of explaining why these measures have not been more effective in curbing yen appreciation. This exposes the dubious link the Japanese authorities have made between their intervention operations and the BoJ's quantitative easing policies. Rather than augmenting quantitative easing, massive foreign exchange market intervention has been undertaken partly because quantitative easing has been largely ineffective in substantively easing monetary conditions.

posted on 4/5/2004

There have been a string of 'BoJ sources' stories,
most notably this week in the *FT*, suggesting that Japan's massive yen-selling interventions in foreign exchange markets might be coming to an end. It is no secret that the extent of Japan's intervention in the market bothers the BoJ, but also irrelevant, since the BoJ is not the responsible decision-maker. The MoF was quick to deny any change to intervention policy, although market developments do seem to suggest a change in the level of the exchange rate the MoF is willing to tolerate. It is quite possible that the MoF is now looking to 'smooth' rather than effectively fix the yen, having already given exporters plenty of opportunity to lock-in lower exchange rates (although there is a moral hazard problem with this strategy). What is perhaps more surprising is the relatively uncritical response Japan's intervention operations have received in the financial press, particularly outside Japan (for its part, the *Nikkei* has been refreshingly critical). This partly reflects the dubious link the Japanese authorities have drawn between their quantitative easing policies and intervention operations. This link does not exist in practice, even if the interventions were left unsterilised, but since any pseudo-easing measure draws a favourable reflex response outside Japan, the Japanese authorities are comfortable in promoting this fiction. As we have pointed out previously, *The Economist* has bought heavily into this view, this week paraphrasing Andrew Smithers: *In an ideal world, he says, the ministry would go on selling until the currency was thoroughly debauched and the economy decisively reflated.* In the real world, once the positive impetus to inflation from the currency depreciation was lost, there would be an immediate disinflation/

deflation, which would have a high output cost. Japan's intervention strategy serves only to introduce distortions into relative price signals between the traded and non-traded goods sectors and delay adjustment to global macroeconomic imbalances.

posted on 4/1/2004