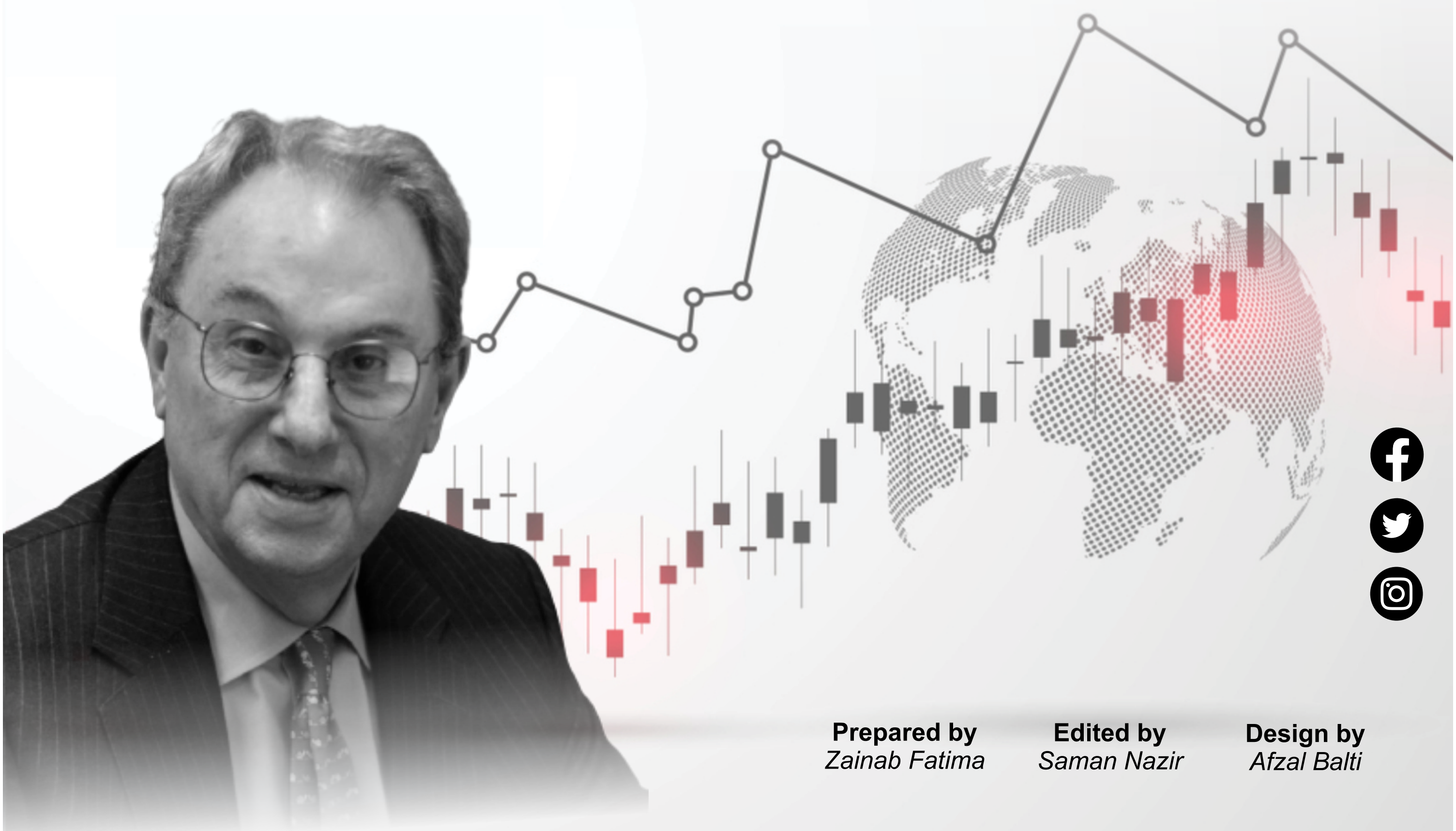
Pakistan Institute of Development Economics

Webinar Brief 122: 2023

ECONOMIC MANAGEMENT IN A MULTIPLE EQUILIBRIA ECONOMY



Prepared by
Zainab Fatima

Edited by
Saman Nazir

Design by
Afzal Balti

Introduction

This webinar addresses the critical failures in economic management within economically developed countries in recent years. The webinar speaker is **Mr. Andrew R. W. Smithers**, a respected figure in finance, widely recognized for his insightful commentary, columns, and literary contributions. In 1989, he established Smithers & Co., following a successful tenure as the head of S G Warburg's asset management business. Notable among his publications are **"Valuing Wall Street," "Wall Street Revalued," "The Road to Recovery," "Productivity and the Bonus Culture,"** and **"The Economics of the Stock Market."** Andrew critically examines prevailing economic theories and advocates for timely reforms to prevent recurring financial crises. In this webinar, he sheds light on the key causes behind these failures and emphasizes the importance of improving both economic policies and theories.

The speakers in this webinar discussed the role of tax policy as a third policy instrument alongside fiscal and voluntary policies. They investigated how tax policy could be used to alleviate the structural net savings problem while also increasing economic investment and demand. The speakers questioned the inadequacies of traditional consensus models and advocated for more realistic, economic-reality-based alternatives. They also discussed how tax policy could aid in overcoming structural stagnation and promoting economic growth.

Using graphs and data, Andrew supports his claims about the long-term stability of equity returns, the connection between corporate tax and returns on equity, and the possible effects of tax policy on boosting investment and demand. Speakers deviate from the fundamental assumptions and conclusions of the present economic mainstream paradigm by expressing concerns about it. The speaker thinks that resolving the structural savings surplus and problems of low growth in the twenty-first-century economy can be accomplished through tax policy. To bring about change, they end by promoting their beliefs through discussions, debates, and lectures.

Main Points

- The speaker, Mr. Smith, discusses **the key failures of economically developed countries in the 21st century**. He identifies three possible causes: bad luck, bad management, and policy based on bad theory. He concludes that the fault lies with policies based on bad economic theory rather than the incompetence of central bankers.

- Mr. Smith then **presents examples of economic failures**, including slow economic growth, deep recessions, and financial crises. He highlights the conditions ripe for another financial crisis and emphasizes the need for policy improvement and better economic theory.

- He introduces **the concept of multiple equilibria in an economy and presents two opposing views**: one that suggests a single equilibrium can keep the economy balanced and another that argues for the existence of several equilibria. He aligns with economists who support the idea of a single equilibrium but acknowledges the skepticism surrounding it.

- The speaker **criticizes the consensus model (CM) of economics**, stating that it has fallen on the wrong side of the demarcation between science and nonsense because its assumptions have been untestable and falsified by data. He argues that the assumptions of economic models should be testable and robust.

- Mr. Smith provides evidence that contradicts several important claims made by the consensus model, such as the denial of any link between the prices of different assets, the tendency of stock returns to revert to the mean, and the impossibility of drawing conclusive conclusions about the relationship between debt and other factors. Additionally, he argues that considerable increases in the money supply could lead to abrupt inflation.

- He highlighted the need for tax policy as a third tool for implementing policy as well as the shortcomings of monetary and fiscal policy in tackling liquidity traps. They argue that conventional monetary and fiscal policies are ineffective in releasing people from liquidity traps, especially when such traps are structural rather than cyclical. The speaker underlines that it is unsustainable to rely on a rising debt-to-GDP ratio to stimulate the economy because it may lead to extra problems like rising inflation and interest rates. They cite Japan as an example of a country with a high debt-to-GDP ratio during a period of low-interest rates, but they warn that this cannot be depended upon indefinitely.
- He introduces **tax policy as an alternative solution to stimulate demand without increasing the fiscal deficit**. They propose changing the taxation on investment and consumption to boost demand without relying solely on monetary or fiscal measures. They argue that corporation tax does not directly impact the return on equity or the return on assets, and changing the tax rate does not change the overall return. They contend that tax policy can be utilized to reduce consumption-related taxes and encourage investment, which will boost demand and promote growth. They stress the significance of a comprehensive strategy to address structural liquidity constraints and support economic growth and stability.
- They contend that tax policy can be utilized to reduce consumption-related taxes and encourage investment, which will boost demand and promote growth. They stress the significance of a comprehensive strategy to address structural liquidity constraints and support economic growth and stability.
- Mr. Smithers investigates who is to blame for these financial calamities. If the consensus model (CM) is correct, he thinks policymakers, particularly central bankers, should take responsibility. If the CM is invalid, then the foundational assumptions of economics as a whole are wrong.
- He speaks about the idea of a single economic equilibrium, which holds that in order for an economy to be stable, demand must also be stable. He did point out that economists like George Akerlof and Ricardo Caballero disagree with this claim and that the system may have more than one equilibrium.
- The consensus model's assumptions are then the focus of Mr. Smithers, who emphasizes the importance of testability and robustness. He claims that despite the paradigm's protracted history of being untestable, recent financial market data has shown it to be so. He holds that the model is incorrect and unscientific because experiments have shown it to be wrong.

Conclusion

Mr. Smith's final three identifications concerning the causes of economic imbalance include

- the failure of the consensus model,
- excessive expansion of the money supply, and
- asset bubbles.

He emphasizes how crucial it is to keep these factors under control in order to maintain economic equilibrium. He made the case that the problems with economic management in the twenty-first century were caused by bad policies, not by incompetence. The consensus model, which assumes a single equilibrium, has become unstable, according to his argument, and needs to be reevaluated in light of the facts.