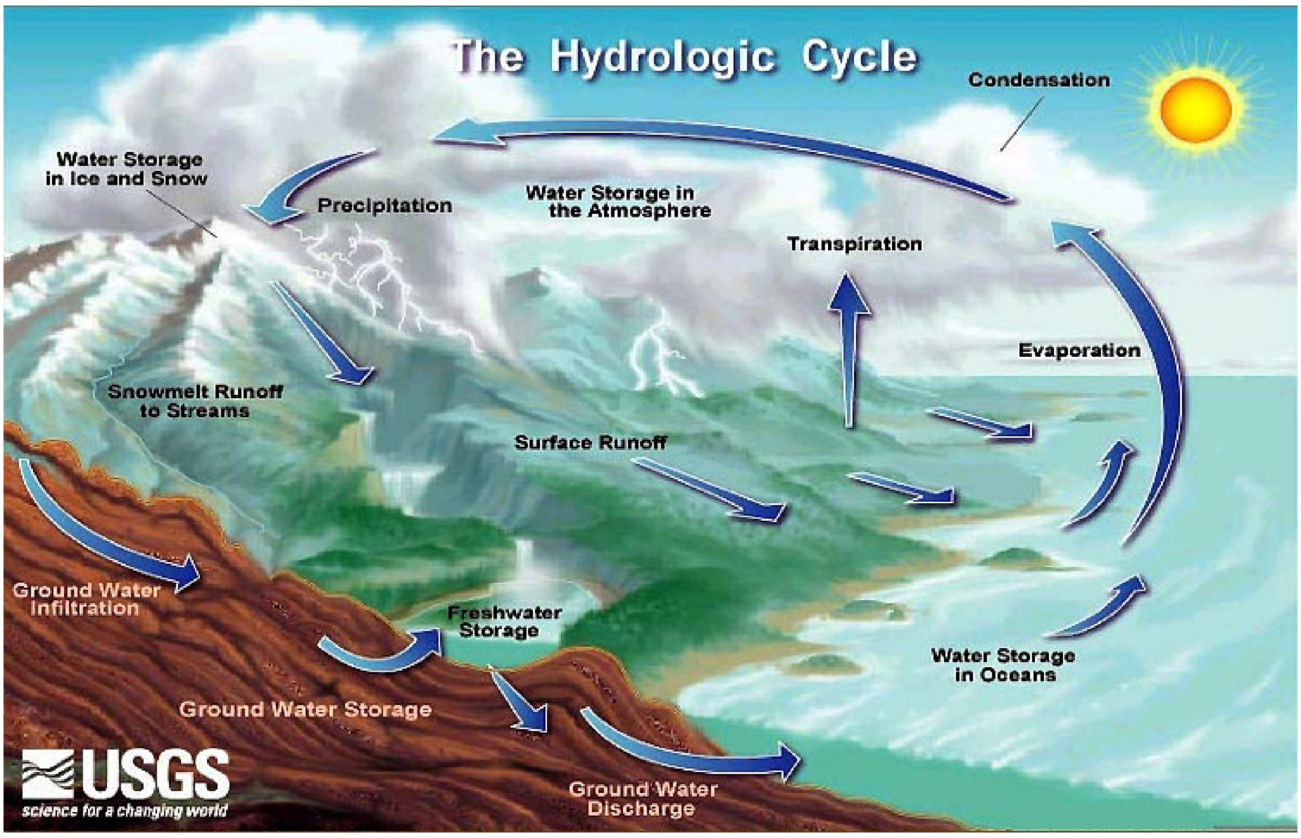
Should our economic system imitate the Nature?

linkedin.com/pulse/cycle-rain-should-our-economic-system-imitate-nature-foglietta



Published on May 24, 2016

Introduction

We all know that capital concentration is a serious system dysfunctionality. History taught us about the correlation between this KPI and the war and social conflicting trends. It is easy to understand because when e.g. 50% of the blood is concentrated in a few fingers the whole body suffers. However capital concentration has always been a matter of political ideologies and these shown to be not a solution rather than another harsh conflict source. Progressive taxation may redistribute resources away from the riches and reduce wealth concentration but it might also weaken entrepreneurial incentives and generate large efficiency costs. Moreover, it demonstrated to be ineffective to compensate capital concentration which is a different issue than wealthy distribution among citizens.

A systemic approach

Another way is to approach the problem is in term of system theory. We may imagine that such complex matter requires a complex theory and models but it is not always true. For example in Europe, in an extreme simplification, currency is created by the central bank (BCE) and is lent to national banks, then it is lent to national states and commercial banks, finally it is lent to individuals and companies. Due to this process the related debt is created. Such debt revealed to be unmanageable even if a ratio between national public debt and gross domestic product is respected. In particular, this drove the European area to a stagnation scenario.

Unione Europea - Tasso di Crescita annuale del PIL

Once some amount of currency is created the related debt, as well. On this debt is requested to pay an interest but the currency for paying that interest has never been created. Year by year the debt accumulation leads to a general unsolvable situation. In order to compensate this effect, some liquidity should be injected without more debt creation and wisely distributed in order to allow the economic system to be solvable again. It seems weird? Keep reading.

Paradigms challenge

Our economic system is tailored on infinite growth paradigm which has no any correspondence with a finite reality. Fortunately it is based on a fiat currency concept. So far, the economy could grow on the nominal value. Unfortunately our currency come with an implicit paradigm: money is not a perishing good. Because of this, the debt is produced and capital concentration takes place. In a long term both are unmanageable, especially when the growth is mainly nominal. Injecting liquidity without debt creation has the aiming of relaxing this paradigm which is not wrong by itself. It is wrong because the way in which combines with all the others. Injecting money in a controllable way in order to stimulate the economic system will create the liquidity necessary to pay back the debt interests.

Fiat currency has a nominal value which is not related with its own intrinsic value. It worth because individuals and national states use it. The difference between intrinsic value and the nominal value could be defined as an added value and it is almost the nominal value, because the gap is the cost of producing the paper and printing it. Individuals delegated national states to create currency. Then national states delegated up to the BCE to create currency. We delegated the rights of creating currency and lend it but we still have the ownership of that rights. Because of this, BCE should pay a percentage of all the circulating currency back to the natural owners for the rights of creating currency and lending it.

Under this circumstance it is perfectly reasonable to create a small amount of currency without creating the related debt in order to compensate the natural owners for the delegated rights over the fiat currency. It is similar to credit card cash back but it is not the same, obviously.

System correction

Even letting the economic system running as is, it is possible to apply a stabilising corrective mechanism. For example in Euro area BCE may create liquidity for e.g. 1% of circulating currency and may distribute it among EU states proportionally to their area (infrastructures) and to their population (end user market) during an entire solar year. Half of this money would go to the national states and the second half redistribute to individuals pro-capite. We may name this mechanism like “*money for free*” or some sort of “*helicopter money*” but we do not need words that stick but a corrective currency policy to drive economy system out of debt nightmare. We also need to remember that European countries joined the Euro with their public debts accumulated during a completely different economic and financial era.

We may argue that it would be better deliver this extra liquidity only to national states but it would be equivalent to cut their public debts which it is not the aim. We may argue that it would be better deliver it only on pro-capite basis and let the national states to tax this amount of money which it leads to be some sort of incoming which it is not the aim. This proposition is a not taxable currency refactoring operation which involves European citizens, states and BCE.

The aim is not to propose a temporarily medicament but to stabilise the economic system by the introduction of a mechanism to plan and control inflation. Controlled inflation is similar to a negative interest on liquidity because due to inflation the liquidity tends to lose buying value in time. When this happens, any productive investment became relatively more remunerative. Injecting liquidity versus raising the base interest rate on the main refinancing operations have the opposite effects: acceleration vs deceleration, capital redistribution vs concentration.

Increasing liquidity and controlling the inflation

Increasing liquidity will boost productive investments and the market capacity to buy more goods or more valuable goods but only under certain constrains. In a short time, it is reasonable that the extra liquidity will be used to pay private and public debts but on the longer term, it will be used to buy high quality goods and services. So the productive system will orient his production towards this kind of new demand. This is the main reason because temporary actions will not have a good chance to make such a difference while a stable system correction will succeed in a short and in a long terms.

The wild inflation could jeopardise the economic system stability as much as capital concentration. One advantage of the proposed compensating system is that could be applied progressively and in a planned manner in such a way wild effects will not happen at all. By operating wisely on two parameters: the base interest rate and the liquidity injection ratio, it would be possible to accelerate or decelerate the whole economic system. Why this compensating system is necessary? Today the central bank can release brakes decreasing the base interest rate but cannot acts on the acceleration because the money production increases the debt and the public debts is limited by the gross domestic product ratio. Eliminating or relaxing this GDP rule will drive public debts out of any control.

Dynamic equilibrium

If the injecting money ratio is greater than the base interest rate, the economic system will accelerate (inflation) by the difference of two. If it is smaller, the system will decelerate (deflation) by the difference of two. If it is equal, the system would be stable. Why negative base interest is not sufficient? Because it would operate within bank system and this shown to have not a straightforward nor an immediate effect on the economic system. In order to keep a system under control, it is necessary to drive it with a reasonable small latency and with a direct effect. Relatively small response time and direct reactions are the keys of any control and stabilisation mechanism. We may think that this mechanism would work like a basic salaries increase or a taxable social incoming but this is not true because these two arise political and social debates, include over-complicated ways to administer, depend on national reception and moreover they have not a fast response time nor a homogeneous direct effect.

System sustainability

Today, we need to sustain our economic system in order to avoid that it will collapse under the pressure of national public debts and we need to mitigate the capital concentration without increasing taxes in order to boost the market demand. For these reasons, the best approach is to injecting money exactly where they are needed to go: 1) national states by "*area to cover by infrastructures*" and "*population to assist*" weights; 2) pro-capite citizens which are consumers. This capital concentration mitigation approach aims to avoid a systemic dysfunctionality without introducing over-complicated and dishomogeneous mechanisms like welfare does. Taxes and welfare exist for others reasons and are not the right tools to control a system which has much faster dynamics today than the times taxes and welfare has been introduced.

Implementation

The primary key of a successful implementation is simplicity: keep it as simple as possible.

Central bank could decide a year plan and distribute liquidity on monthly transfers directly on the final bank accounts. It could increase or decrease the amount of the plan progressively. In the same way, it could increase the base interest rate when it is needed to decelerate. We do not need to boost economy in just one big shot but to sustain it continuously. A flood would be destructive while a light regular rain will be productive.

Injecting liquidity will increase inflation and this will decrease the buying value of the currency. By analogy: a small part of liquidity value will evaporate proportionally to the concentration in order to rains down where it will boost the economic system. This would be appropriate because nobody needs oceans of liquidity and wide desert lands but a living dynamic system.

This mechanism is self regulating because liquidity injection (e.g. 1% of GDP) allows to partially pay back debts which will reduce the circulating liquidity. The total effect would be multiplicative: in one hand the debt will be reduced while in the other hand the money circulation – then the gross domestic product – will be increased. The ratio of these two matters:

- PD / GDP = 133 / 100 = 133% → 1% injection→ (133-1) / (100+1) = 131%.

This because the same good effect over national public accounting will happen in the private sector, as well. Because the way in which liquidity is distributed back – even in a relatively small amount – it will lead to a bigger systemic stimulation. It is a matter of fact that oceans do not get dried due to evaporation because the rain get back to them in a closed loop.

Conclusion

The 2007 crisis demonstrated that inflating an economic system by creating debt at higher rate than its real growth rate will lead to a systemic failure. Because of this, private debt creation has been limited in order to contain the risk. This united to the European GDP limit of public debt creation brought us to a long lasting stagnation. Once the necessary liquidity drained away from the real productive economy, the market moved to cheap and lower quality goods and services. Cheap productions relocated in low incoming countries raising the unemployment domestic rate which is reducing the domestic attitude towards consuming. National states progressively increases taxation in order to keep paying their debts but causing a faster production relocation outside their borders which is worsening the negative loop.

Low or even negative base interest rate and welfare support failed to redistribute liquidity in such a way the economic system needs to change its trend. This because any self regulating mechanism necessarily should respect the controlling system theory: stabilisation feedback requires the regulating actions take place in a relatively fast and a direct way.

A proposal may consist in “*helicoptering money*” but this temporarily medicament lacks of a systemic approach because it moves debts around. We need to inject money without creating more debt and send them exactly where they need to go: national states and individual consumers which are the natural owners of the fiat currency rights and mainly contribute of its added value using it. A relatively small amount of liquidity created out of debt will stimulate multiplicative positive effects on the whole system as long as the distribution model will respect some constrains. Moreover, this new mechanism could be integrated progressively and seamlessly in the existing system and it would allow central bank to control the economic acceleration by acting on two key parameters.

The past interest rate on the lent currency was a bet that the today economy growth rate would be greater but that bet is lost. To revert the economic trend, some liquidity should be created without debt and wisely distributed. This mechanism would works like the cycle of the rain: evaporating a bit of value from capital concentration in order to let it rain down where it is more effective. Oceans of liquidity and wide desert lands are a scenario nobody wants. No any ocean dried because the rain always get back. It is a wise decision? Move the debts around will not solve any problem.

Our economic system should imitate the Nature for the simplest and most important reason: we want that it works!