

THE F-TWIST REALISM ECONOMIC POLICY ANALYSIS AND CLIMATE CHANGE



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Introduction

1.0 The F-Twist – Realism, Economic Policy Analysis and Climate Change

Existing political economic setup is predominantly based on neoclassical ideology in most countries. In that context, most economic theorizing is built on unrealistic assumptions. Below listed examples clearly demonstrate the neoclassical mythology.

Examples of Fake Assumptions:

1.1 Government Budget Must Be Balanced

A government which issues a sovereign currency is explained using a household analogy ignoring the fundamental differences between the two. In reality sovereign government is the currency issuer and the house hold are the currency users. Sovereign government can do deficit spending and the household cannot do the same.

Adhering to household analogy as prescribed by the mainstream economist in third world, countries like mine (Sri Lanka), only the government debt grabs all the headlines, despite private sector debt has grown disproportionately to private income levels due to the Easter attack in 2019 and subsequent covid-19 lockdowns. Government only postponed the interest payment of the households and businesses during the pandemic, creating an additional loan to unpaid interest and subsequently raising the interest over 30%. This allowed banks to extract massive amount of household and business earnings as interest payments leaving hardly anything to consume or invest. As a result, Sri Lankan GDP has started declining rapidly due to the lack of consumption and closure of businesses due to shortage in liquidity creating a massive product scarcity as well. Inflation has risen over 100% due to the supply side shock exacerbated by the balance of payment crisis, though, wrongly framed as increased money supply in the system. All these coordinated efforts by the central bank and policy makers increase indebtedness of masses of people pushing them further into debt paving a way to wealth transfer of the century, from mases of people to few wealthy bankers. Valuable assets of people will get extracted to banks at depressed prices leaving the balance liability on the shouldders of the borrowers.

1.2 Economies are always in Equilibrium

Economies are always believed to be in equilibrium. Neoclassical economics teaches a general economy has a self-stabilizing mechanism and it provides both economic participants a fair value.

Third world debt or economies like mine (Sri Lanka) are believed to be in equilibrium. Under general economic conditions, the economy is suffering from mass emigration, capital flight, product scarcity and public assets are being sold to pay off foreign debtors. General equilibrium theory is not only unreal but also ignores the adversities or shocks calling them externalities or exogenous, completely misrepresenting the truth or facts. Reality teaches us the economy is a complex system and it is far from equilibrium.

In fact, applying equilibrium theory to international trade for the last 40 years resulted in massive external debt, deterioration of local production capacity, massive amount of waste causing pollution and rapid depreciation of local currency sending the economy out of balance. During this stage, mainstream economists call it a crisis and palm it over to politicians to apply further austerity measures to the public, severely impacting the income and wealth distribution resulting in increasing inequality of the population.

1.3 Impact on climate change is negligible to the World Economy

Neoclassical economists claim that the climate could only have a trivial impact upon the economy. Mainstream economists assume that about 90% of the GDP is unaffected by climate change because economic activities are taken place in indoors or underground. They use a relationship between temperature and GDP today as a proxy for the impact of global warming over time. Economists ignore energy consumption in economic activities, undermining energy as a negligible part of economic output. But in reality, energy is an irreplaceable input in economic activities. Energy production has a direct relationship with nature. Further, neoclassical economists completely misrepresent the “Tipping elements in the Earth’s climate system” such as melting of Greenland ice layers which can be detrimental for the survival of species as per the findings of Natural Scientists. These findings are built up upon made up numbers (fake data) to support a pre-existing conclusion. Since the conclusion is already known, neoclassical models are more or less a reverse engineering process to make up data which supports the pre-existing belief.

1.4 The F-Twist

In a famous essay “On the methodology Of Positive Economics” published in 1953, Milton Friedman defended the apparently absurd view that ‘Unreal assumptions ‘are not vice but virtue:

‘Truly important and significant hypothesis will be found to have “assumptions” that are widely inaccurate descriptive representation of reality, and in general, more significant the theory, the more unrealistic the assumptions (Musgrave, 1981).

According to Nordhaus, mainstream economists does not consider climate today to be a major consideration in economic output as compared to labour or technology today. However, according to natural scientists, the climate of our planet changes drastically due to the rapid emission of greenhouse gases threatening the survival of humanity. Further, Nordhaus goes on to claim that the majority of economic activities are unaffected from climate change, since these activities are taken place in indoors. In other words, climate has been equaled to weather. They are under the over simplified assumption only the outdoor economic activities are affected by weather or climate. Mainstream economists estimated the impact on future GDP of increasing global temperature based on the same relationship they found today between the temperature and the economic output. This used what Tol called “the statistical “approach and Mendelsohn more accurately called “cross sectional” approach. In this approach economists are hypothetically altering the temperature of the planet. The possibility of that depends on assumptions like moving a region’s location of the planet which is impossible. This resulted in the ridiculous conclusion of increasing temperature through global warming will benefit the economy. These types of principals fall under the F-Twist Ideology.

The F-Twist is an ideology or the hypothesis built on fake assumptions, ignoring facts or evidence. Ultimately, Fake theories are accepted over the truth.

2.0 Debunking the Myths of Modern Money

Money is not a commodity, instead, money is a social relationship of debt and credit. Money is a creature and a credit issued by the state. A special kind of a credit which can be redeemed by taxation. By issuing money, the state becomes a debtor. The beneficiary of the state spending becomes the holder of the asset. In other words, issued money (state IOU) becomes a liability to the state. The state (issuer of debt) has to accept it back in payments. Money always involves two entries; debt of the issuer and asset of the creditor. Delivering an IOU back to the issuer results in its extinction; debt is stricken and so as the asset of the creditor. Promise to convert is not fundamental to issue of state IOUs (ex: convertibility to gold). Modern fiat currencies are accepted with no promise to convert. In other words, modern currencies often called as fiat currencies are not backed by any precious metal.

However, not all money being circulated presently is created by central banks. In modern economy, majority of the money supply is created by the banking system. When banks lend or extend loans, they simply credit the borrower's account. Bank holds the IOU of the borrower as its asset and issues the deposit as its liability. These bank credits (bank liabilities) function as money, simply because they are convertible to government money and the government accepts these bank credits as payment for the government taxes. Due to these reasons, the public would consider bank credits (bank IOU) as good as cash (state IOU). Most countries use bank IOUs which are recorded electronically as their primary form of money as oppose to physical cash created by the state. An electronic payment system then ensure that payments can be settled using bank liabilities. Reducing the balance of one account and increasing the balance of another, majority of the time without the need of physical transfer of cash.

In conclusion, sovereign money does not need taxes for revenue, but to create a demand for its currency. Government first creates a money of account (USD, Pound, Yen) and then imposes tax obligations in that money of account. Other than taxes, there are secondary government obligations which drive the currency, such as government fees, charges and fines. All these obligations are also payable from the national currency. Imposing tax liabilities payable in state currencies drives money and creates the acceptability. Subsequently, the government will be able to issue currencies denominated in the same money of account.

Based on the true description of the sovereign currency, the government can spend more than it redeems from taxation and government deficit becomes an income for the rest of the economy. Hence, government spending can lead the way for productive purposes such as eliminating poverty, eliminating environmental pollution and investing in sustainable development of ecology. It is evident a sovereign government has no financial constraints. However, it has resource constraints, especially limitation in natural resources and planetary boundaries.

2.1 True Impact of Global Warming

Currently, global warming is the crisis of our time. Millions of people around the world are thinking the same way, that is, global warming is caused by the greenhouse gas emission due to the economic activities such as fossil fuel burning for energy, deforestation for plantation, pollution caused by transport and production etc.

These activities cause the global temperature to rise rapidly, unbalancing the natural circle, creating disastrous outcomes impacting environment, societies and the economy. Namely, natural disasters such as storms, droughts, hurricanes, floods, earthquakes and rising sea levels.

Moreover, the entire humanity, animals and nature are the regular victims of the effects of global warming. Millions of people lose wealth due to natural disasters and displacement. Many more thousands of people lose their lives annually due to natural disasters. Similarly, animals lose their inhabitants and extinction of some animals is caused as a result. Furthermore, the human population is forced to suffer due to sicknesses such as difficulty in breathing and epidemics.

In my opinion, it is very clear, under the current political economic systems, global warming is rapidly rising due to pollution by large scale industries, fossil fuel industries and financiers who fund these extremely profitable ventures. Policy makers blinded by the free-market ideology are at the mercy of the greed of financial capitalists who are making profit at the expense of humanity and environment. This system delivers profit for less than 1% of world population, while delivering disaster for others.

Finally, there has to be a shift from fossil fuel usage to renewable energy. Governments around the world must take a committed step encouraging and incentivizing renewable energy production. Recycling and reusing must be encouraged through government policies. People around the world must put on pressure on respective governments to take actions to slowdown global warming. Organizations around the world must pressure global superpowers to help this cause taking commitment via its agencies such as the IMF, World Bank, UN and WTO.

3.0 Conclusion

3.1 Fiscal policy Space for the sustainable development of the Ecology.

Further, government policies can be redirected for sustainable development of ecology to rescue the planet from global warming and save the natural habitat for future generations. Financing can never be a problem since sovereign governments can never run out of money. It is also clear that the banking system also create money when they extend loans. In fact, in modern economy, over 90% of money being created is by the banking system. Hence, governments can guide the credit creation of banking systems via central bank regulations for productive purposes such as investing in solar energy and other green projects.

However, there can be certain limitations to some sovereign countries (third world countries) like mine, Sri Lanka, since they have issued debt in foreign currencies and piled up massive external debts. These countries generally have very low production capacity and dependent on imports even for basic needs, hence, their currencies are worthless. They are on a continuous foreign debt spiral since their currencies are not acceptable for import payments and continue to borrow foreign currencies for import settlements.

Just to summaries the importance of the role that the banking system plays in an economy, economies which are dependent on global trade inflows for primary needs are extremely vulnerable to exchange rate fluctuations leading to changes in domestic prices. These trade flows are not possible without the financial flows to initiate them. Hence, financial flows dominate the trade flows pressurizing the exchange rate, devaluing the domestic currency. Financial flows determine the outcome of the economy. Window guidance by the central bank, directing banking systems on creating financial flows on a sustainable path, both economically and environmentally, is an essential policy decision to make.

Even though sovereign governments do not need taxes for revenue, it is an important fiscal tool to use to fight against global warming and any other activity that can be harmful for the society such as income and wealth inequality.

Taxes can be imposed on activities which pollute the environment, since it can take away the entire wealth created through pollution, pushing people to give up environmentally harmful industries.

Further, tax concessions and tax credits can be used to encourage or redirect masses to green energy investment and green energy usage.

There are many other tools such as trade embargos and capital restrictions at the disposal of the policy makers to redirect the society, economy and the environment on a sustainable path.

A comprehensive coordinated effort using monetary tools, fiscal space and other mechanisms such as trade controls is essential to the battle against global warming and the setting the economy on an ecologically sustainable path.

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