

Contact data

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The Kiel Institute for the World Economy



Markets – the habitat of entrepreneurs

Understanding the rules of the game.

Intellectual backbone

Austrian Economics

Point of departure

Man acts.

Implications of “human action” (1/2)

- Purposeful conduct: Aiming at reducing uneasiness
 - » The human actor “wants to substitute a state of affairs that suits him better for one that suits him less”. (Mises)
 - » Human beings as universal entrepreneurs (explorers, not decision automata)
 - » Action: decision making + search for means
- Individuals act ...
 - » ... but not in isolation (society formed by voluntary interaction)
 - » ... groups/aggregates do not (non-collectivist approach)
- Preferences as ranks only
 - » Chosen ends are strictly subjective
 - » Making choices on means (no discussion of ends)
 - » No room for interpersonal comparison of utility (no social planner)

Implications of “human action” (2/2)

- Diminishing marginal utility
 - » Follows from praxeological approach (outcome, not an assumption)
 - » Not a psychological/physiological phenomenon
- Action in time
 - » Dynamic disequilibrium approach
 - » Evenly rotating economy as a state of non-action (thought experiment only)
- Uncertainty: Limited and distributed knowledge
 - » Action as speculation based on subjective judgments
 - » Knowledge: Local, fragmentary, non-centralizable
 - » Prices as universal information carriers
(The Use of Knowledge in Society, Hayek 1945)

Key differences

Neoclassics/mainstream	vs.	Austrian School
Homo oeconomicus	⇒	Homo agens
„Perfect“ competition	⇒	Competition as a discovery procedure
General (dynamic) equilibrium	⇒	Markets as feedback mechanisms (permanent adjustment process rather than sequence of equilibria)
Positivist social planning (constructivist rationalism)	⇒	Evolutionary institutionalism (civilization as a process)
Natural sciences as benchmark („Scientism“)	⇒	Economics as a social science

Example

Macro management and financial crises

The world economy on the search for growth

■ Structural Reforms

- » Even more important as economies are aging ...
- » ... but remain unpopular

**Structural
reforms**

■ Monetary policy

- » Did (more than) enough
- » Increasing negative side-effects

**Monetary
policy**

■ Fiscal policy

- » Back on stage? „Keynes put“?
- » Sustainability issues

**Fiscal
policy**

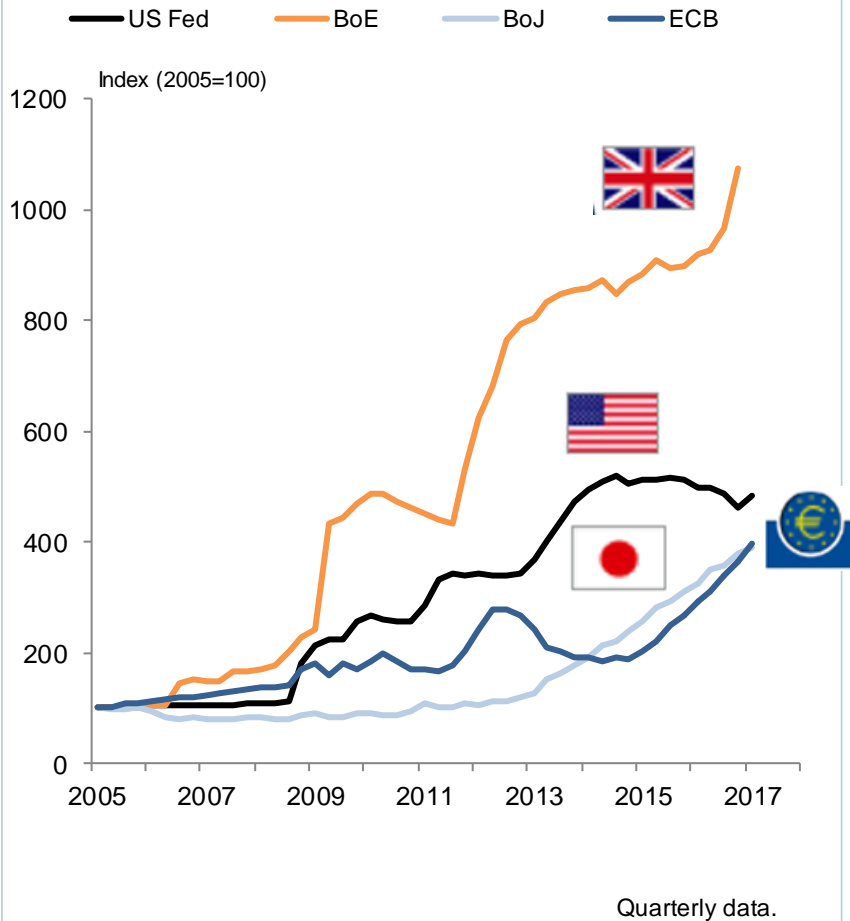
■ Neo-protectionism

- » Beggar-thy-neighbor gains momentum
- » Popular, but destructive

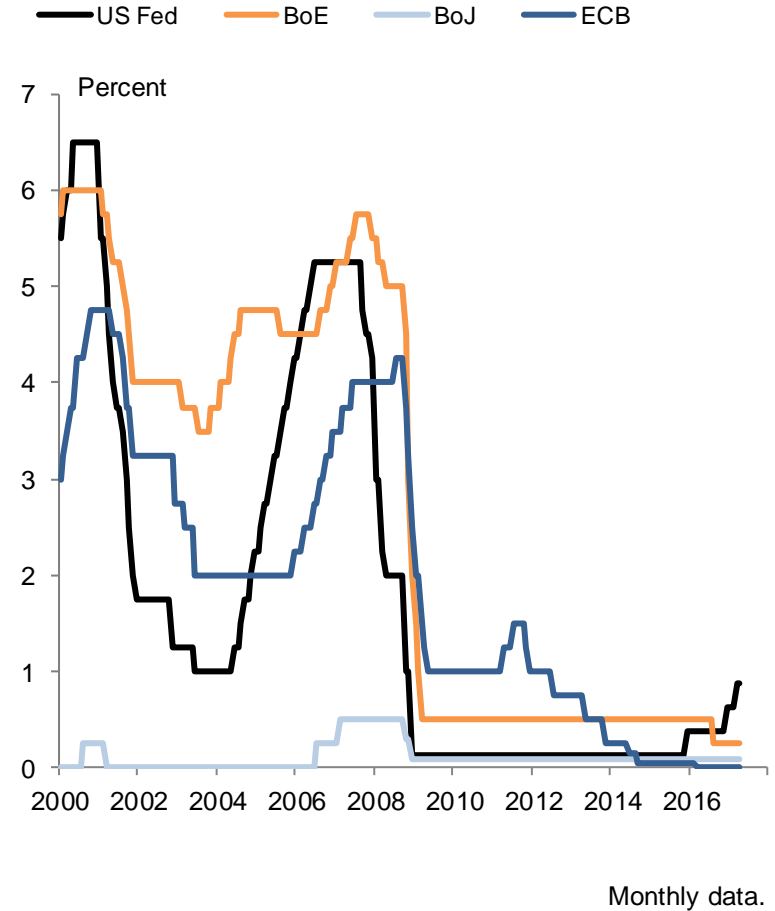
**Neo-
protectionism**

Monetary policy hits limits ...

Monetary Base



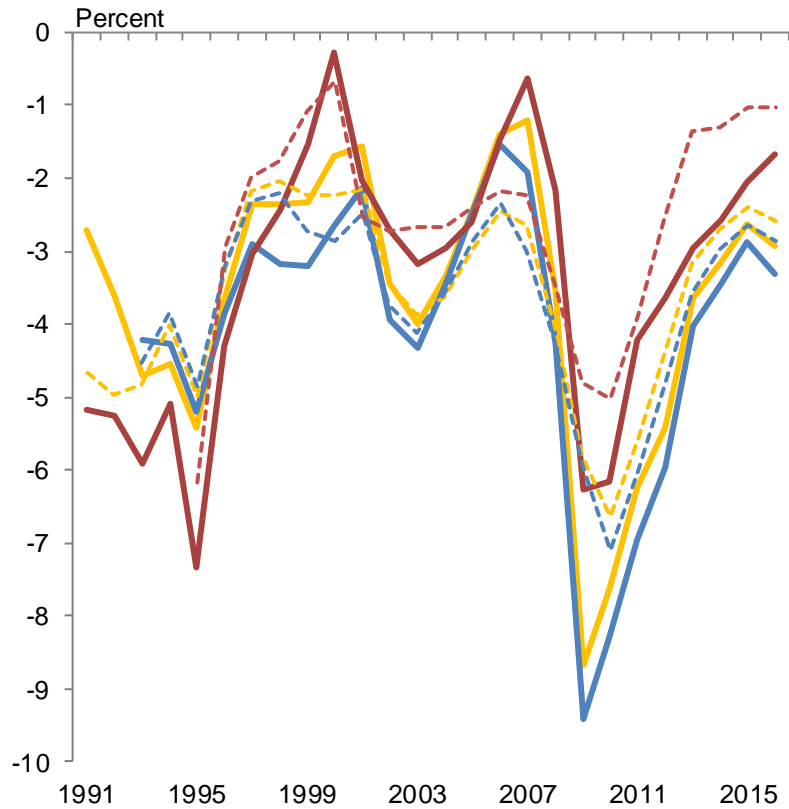
Monetary policy rates



... as does fiscal policy

Net Public Lending

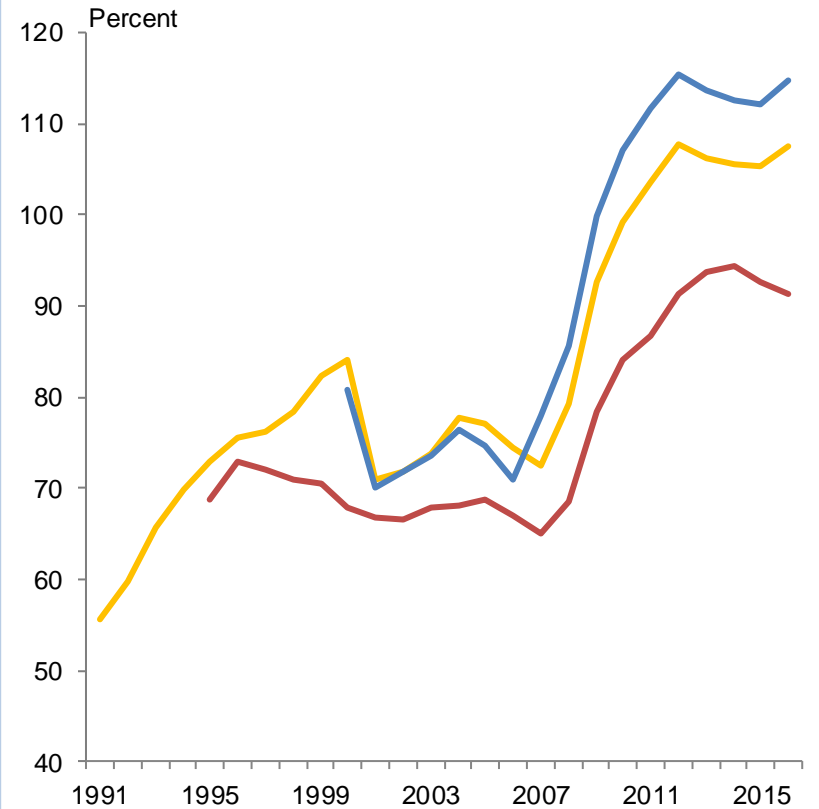
Advanced Economies G20 EMU



Annual Data. In relation to nominal GDP; Dotted lines: Cyclically adjusted.
Source: IMF, Fiscal Monitor.

Gross Government Debt

Advanced Economies G20 EMU

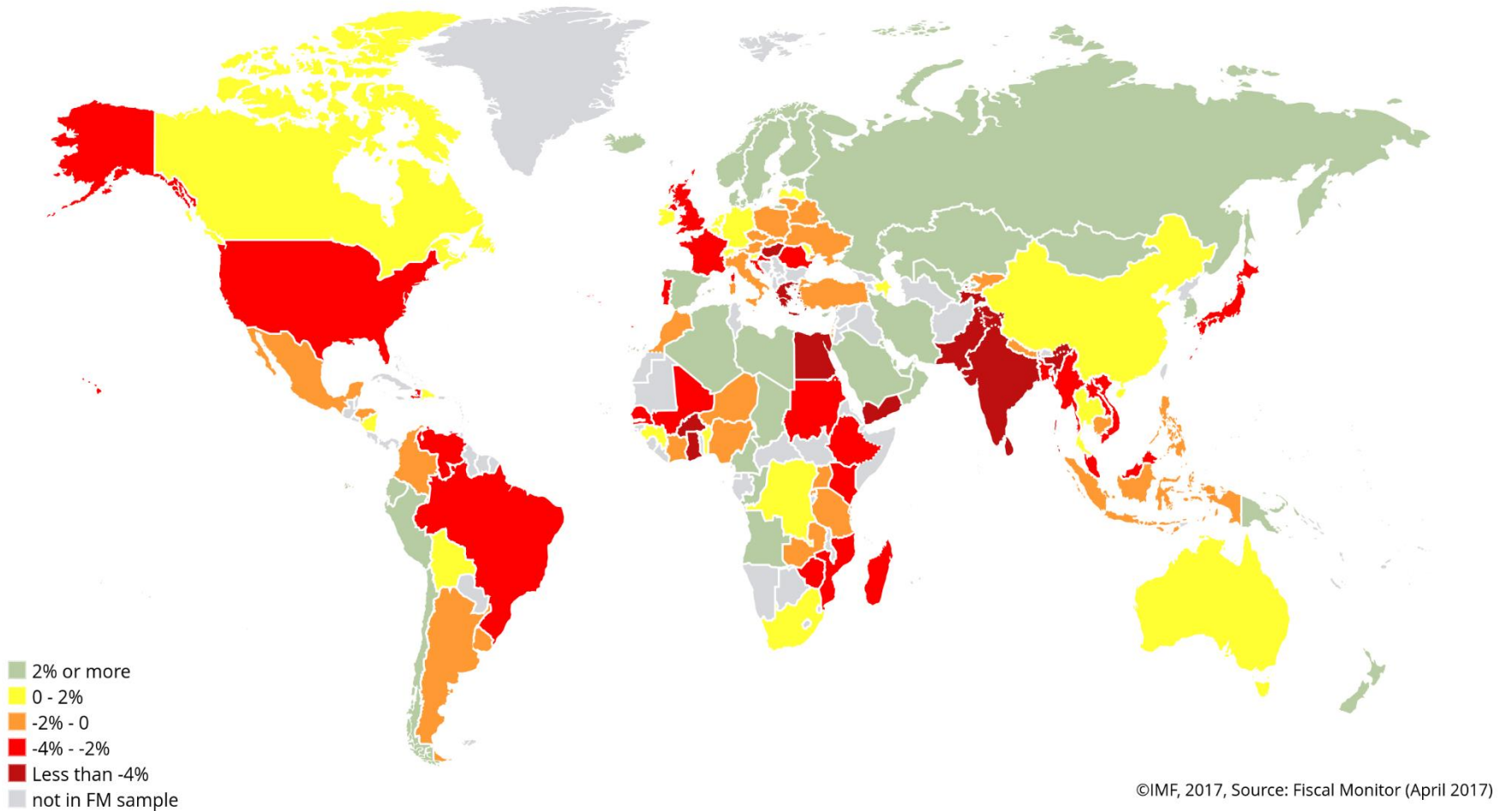


Annual Data. In relation to nominal GDP.
Source: IMF, Fiscal Monitor.

Fiscal stance 2007 (pre-crisis)

IMF DataMapper

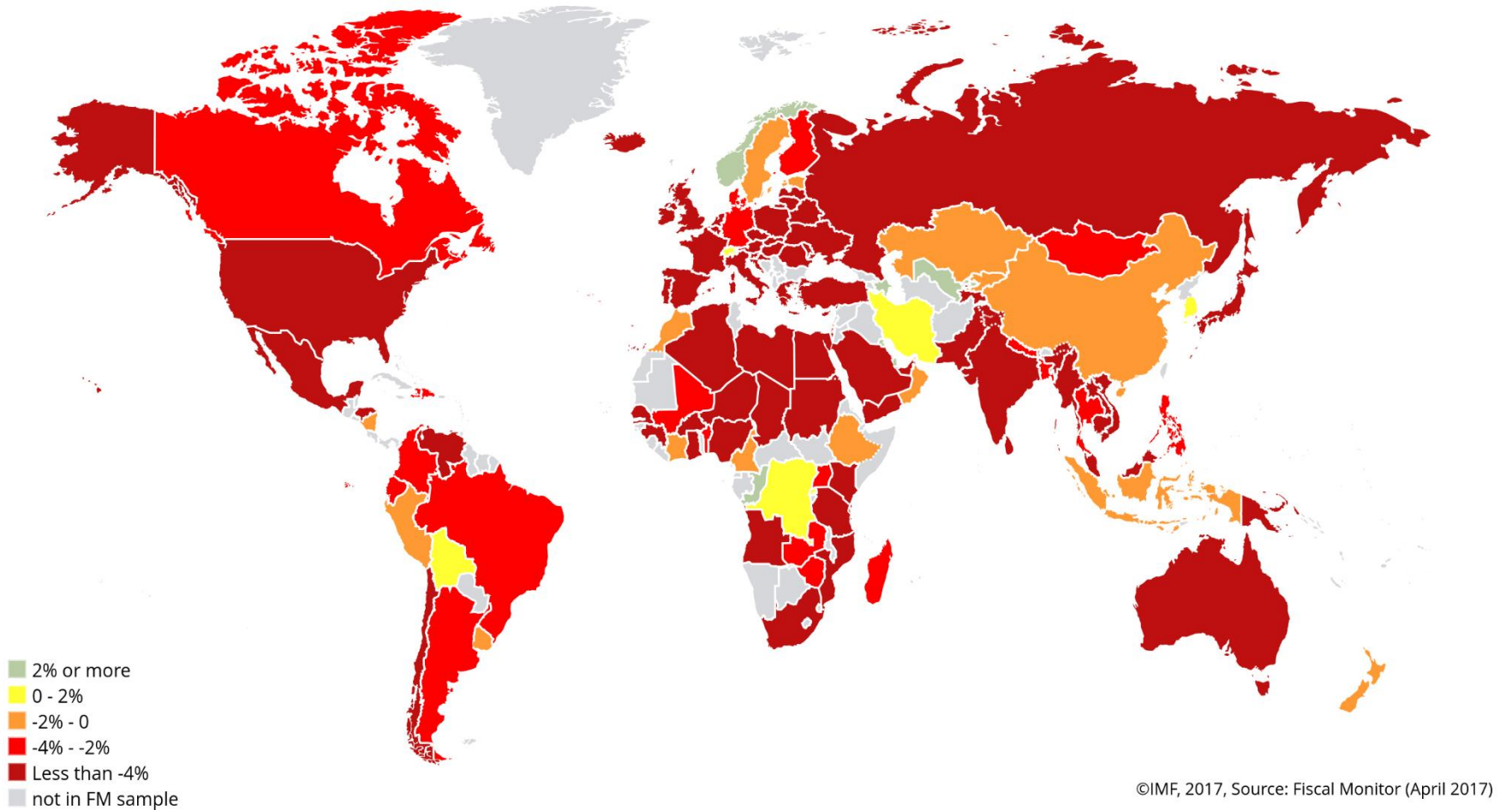
Net lending/borrowing (also referred as overall balance) (% of GDP, 2007)



Fiscal stance 2009 (in crisis)

IMF DataMapper

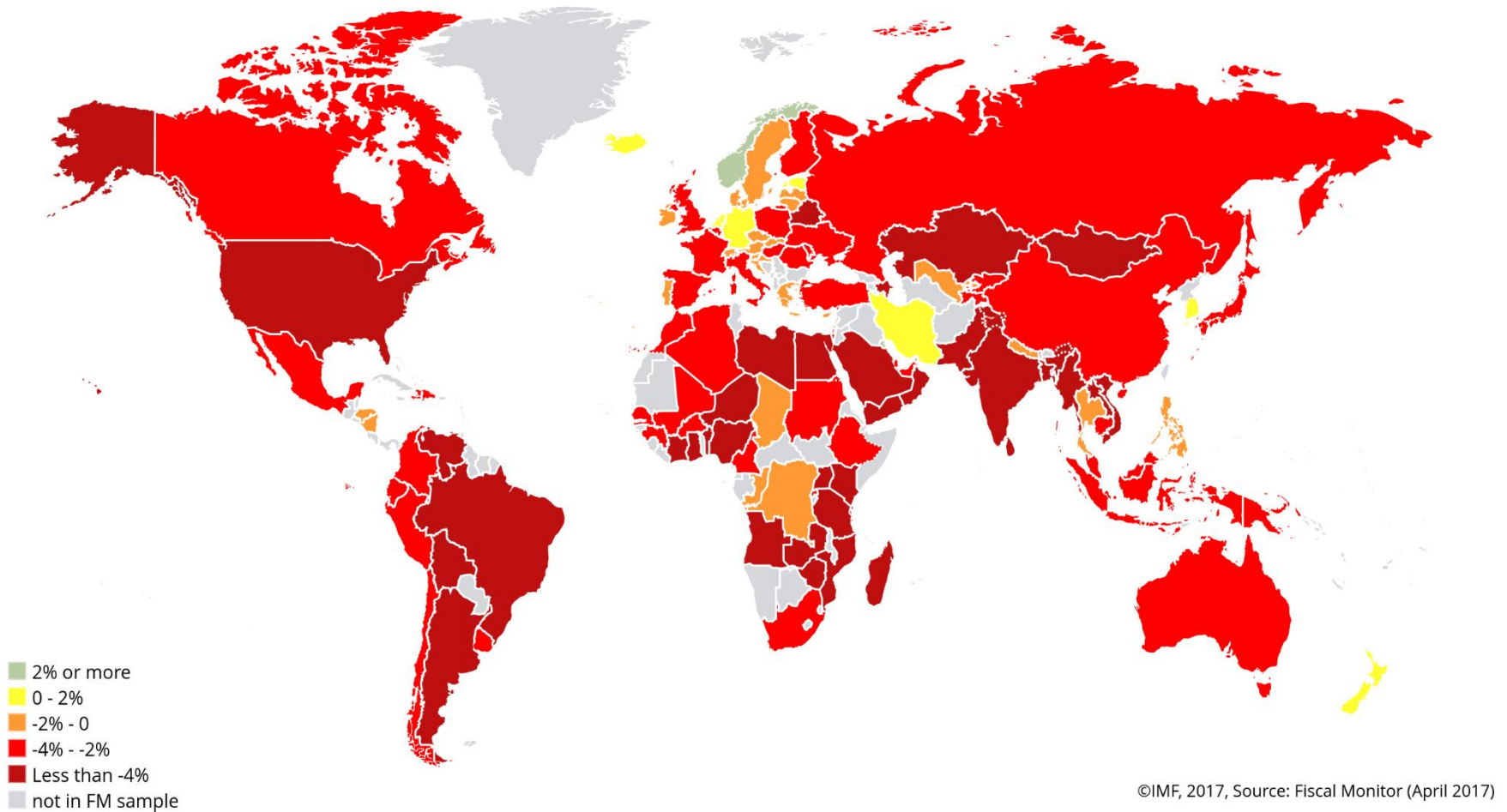
Net lending/borrowing (also referred as overall balance) (% of GDP, 2009)



Fiscal stance 2017 (post-crisis?)

IMF DataMapper

Net lending/borrowing (also referred as overall balance) (% of GDP, 2017)



The world economy on the search for growth

■ Structural Reforms

- » Even more important as economies are aging ...
- » ... but remain unpopular

**Structural
reforms**

**Overstretched macro-management
(core problems are non-cyclical)**

**Monetary
policy**

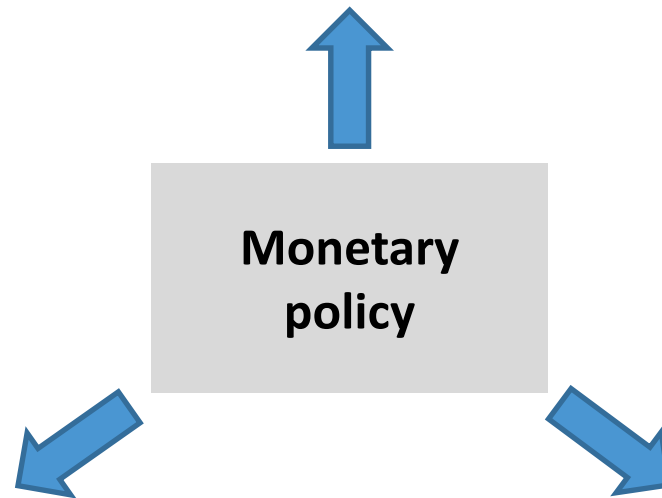
**Fiscal
policy**

■ Neo-protectionism

- » Beggar-thy-neighbor gains momentum
- » Popular (but destructive) temptation

**Neo-
protectionism**

Money-policy-nexus



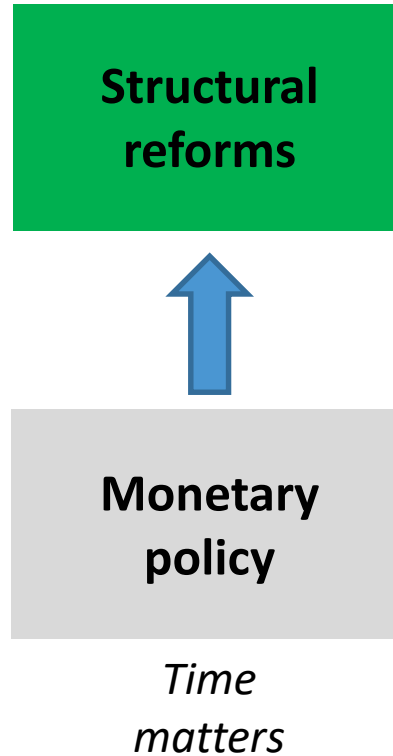
**Structural
reforms**

**Monetary
policy**

**Fiscal
policy**

**Neo-
protectionism**

The Non-neutrality of money

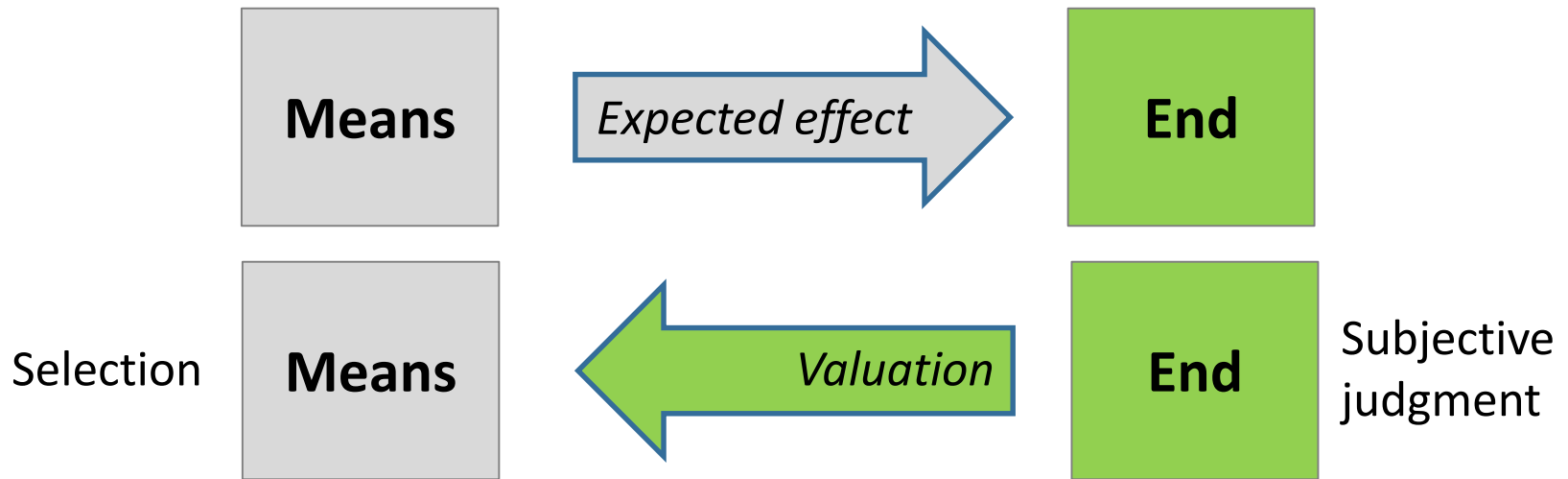


Interest, capital, and production structures

Interest rates ...

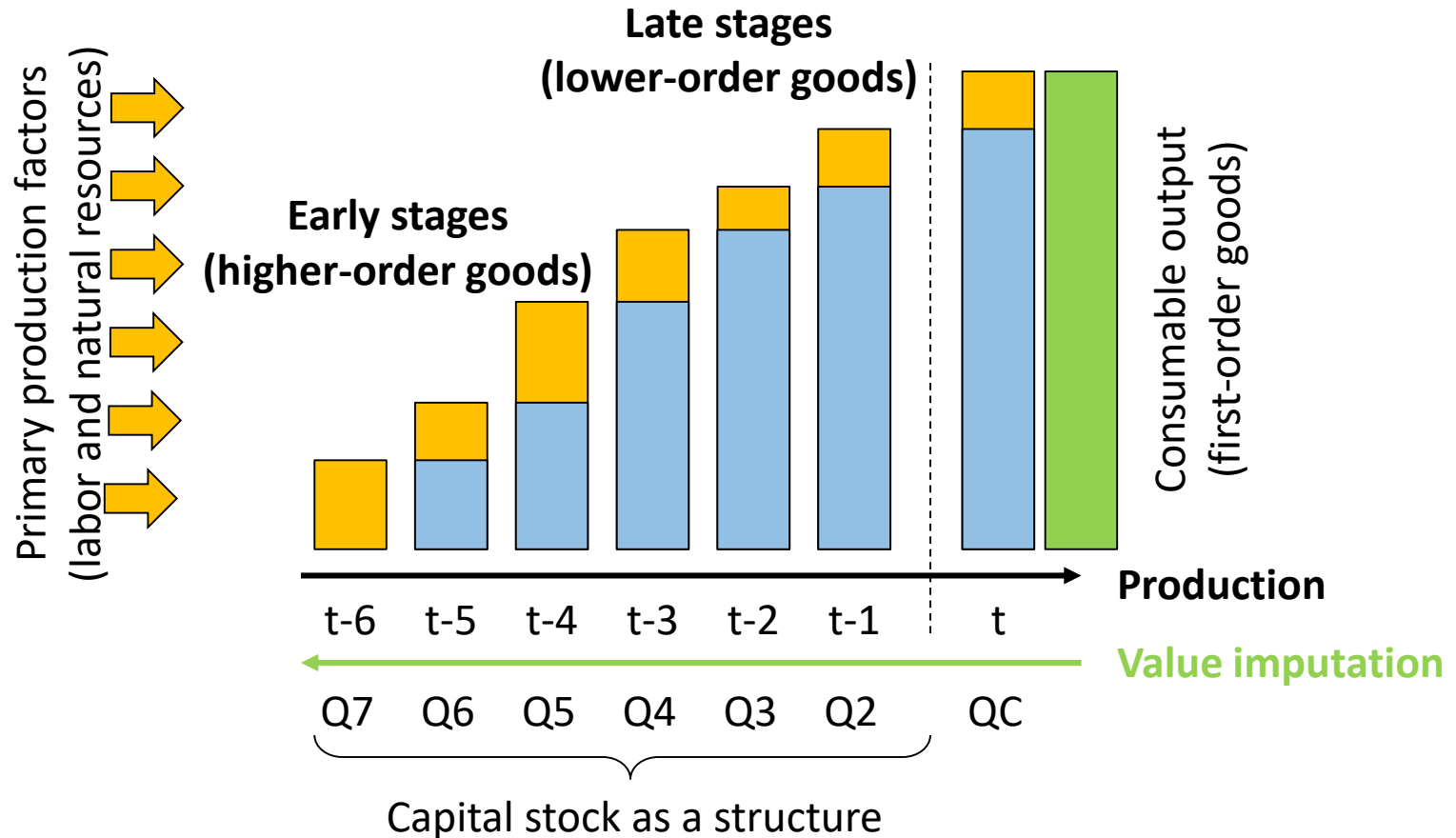
- ... just another instrument for macro-management?
 - ... or the key price relation within the market system?
 - » Time preference
 - » Coordinating savings and investment
 - » Component of all prices for goods and services (relative prices)
 - » Impact on capital/production structure
- ⇒ **„Capital gives money time to cause trouble.“ (Garrison)**

Human action: Means, ends, and values



- Reverse value imputation
 - » The end may not „sanctify“ the means, but it **values** it!
 - Limited knowledge
 - » Action under uncertainty (= speculation)
 - Rationality
 - » Humans do not purposefully act against their aims
- ⇒ **Final purpose of economic activity: Consumption goods**

Production: A time consuming, multi-stage process

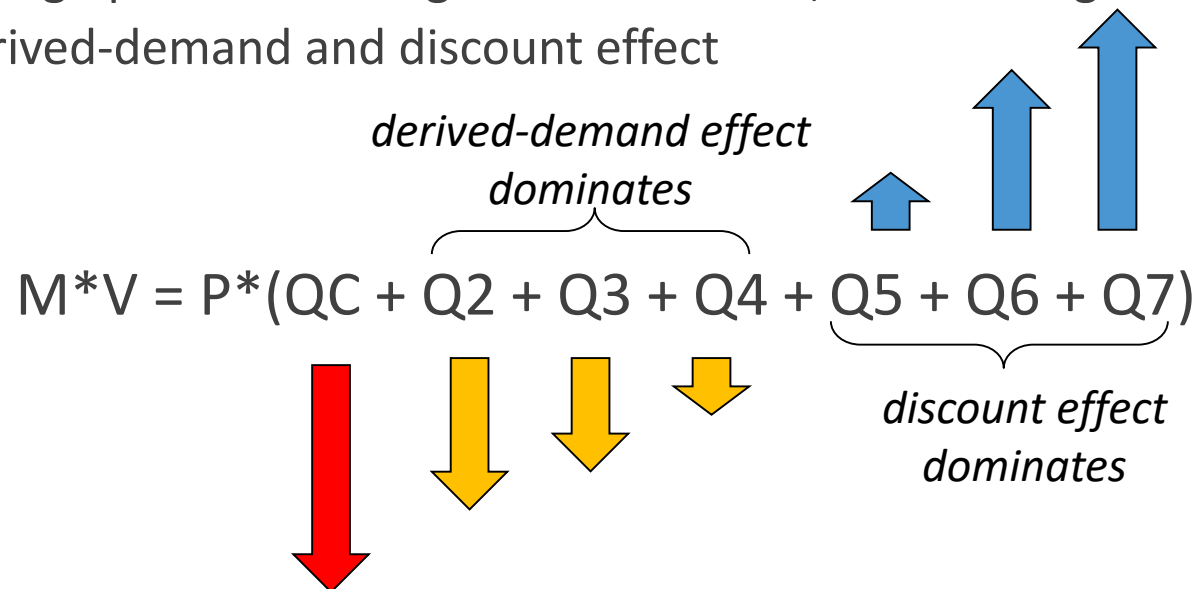


⇒ **Capital formation: intertemporal intermediate consumption**

Coordinating saving and investment

- Saving

- » Saving up for something: Future demand, not a leakage
- » Derived-demand and discount effect



- Investment: Stage pattern matters (not volume alone)

⇒ **Entrepreneurial challenge: bringing capital structure in line with pure time preference (intertemporal arbitrage)**

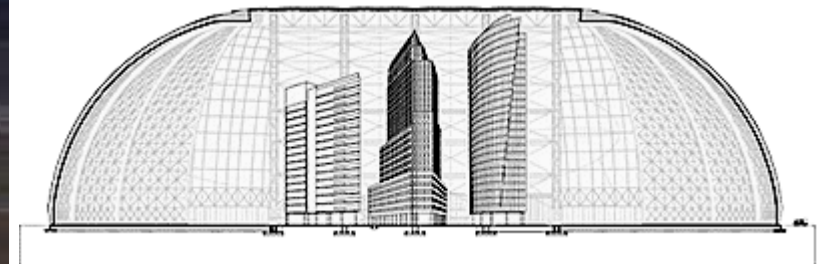
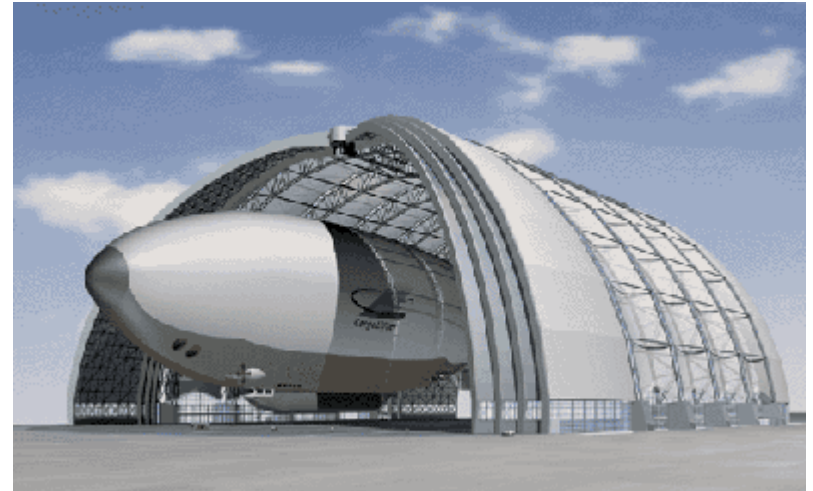
Two types of mal-investments

- **Idiosyncratic: Entrepreneurial ventures**
 - » Wrong expectations of one market participant
 - » Happens every day, no systemic risk
 - » Liquidation, reallocation of resources

- **Pervasive: Expansionary monetary policy**
 - » Systematically wrong expectations of all market participants
 - » Financial crisis (debt crisis = flip-side of heavy capital stock distortion)
 - Fragile financial system
 - Excess debt positions destabilize monetary system

Case study Cargolifter

The plan ...



Case study Cargolifter ... and the outcome: Tropical Islands



Assembly hangar ⇒ Tropical Islands hall

Production cost:

78 million euro (1999/2000)



Liquidation value:

17.5 million euro (2003)

Cargolifter in the national accounts

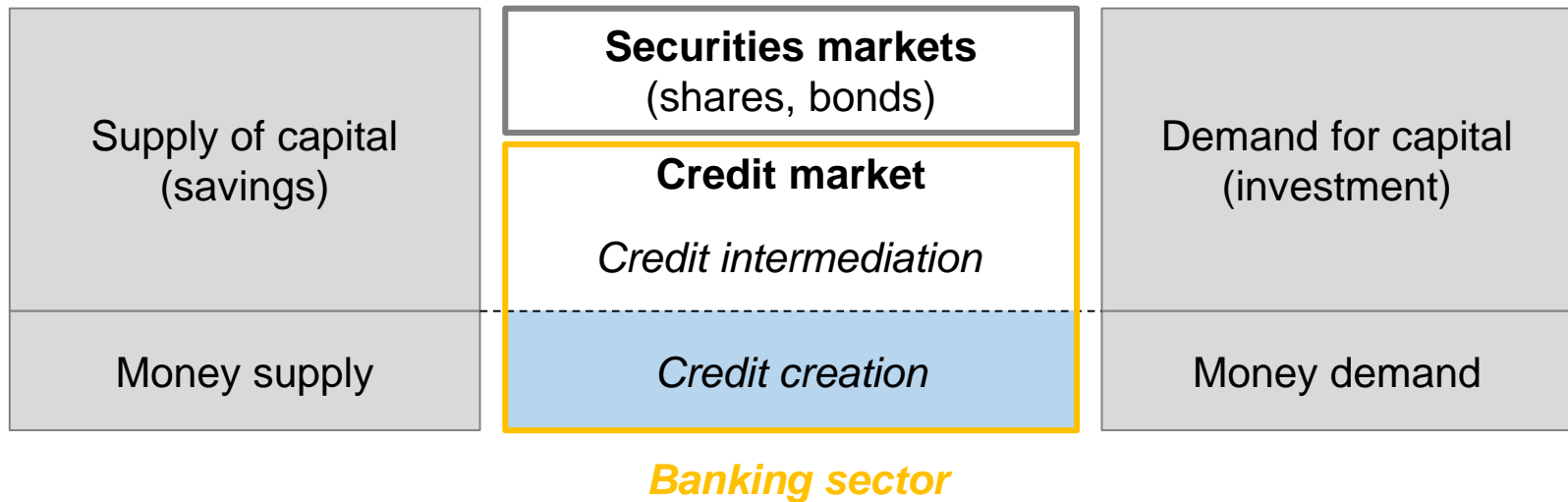
A hangar is a hangar is a hangar ...

Two types of mal-investments

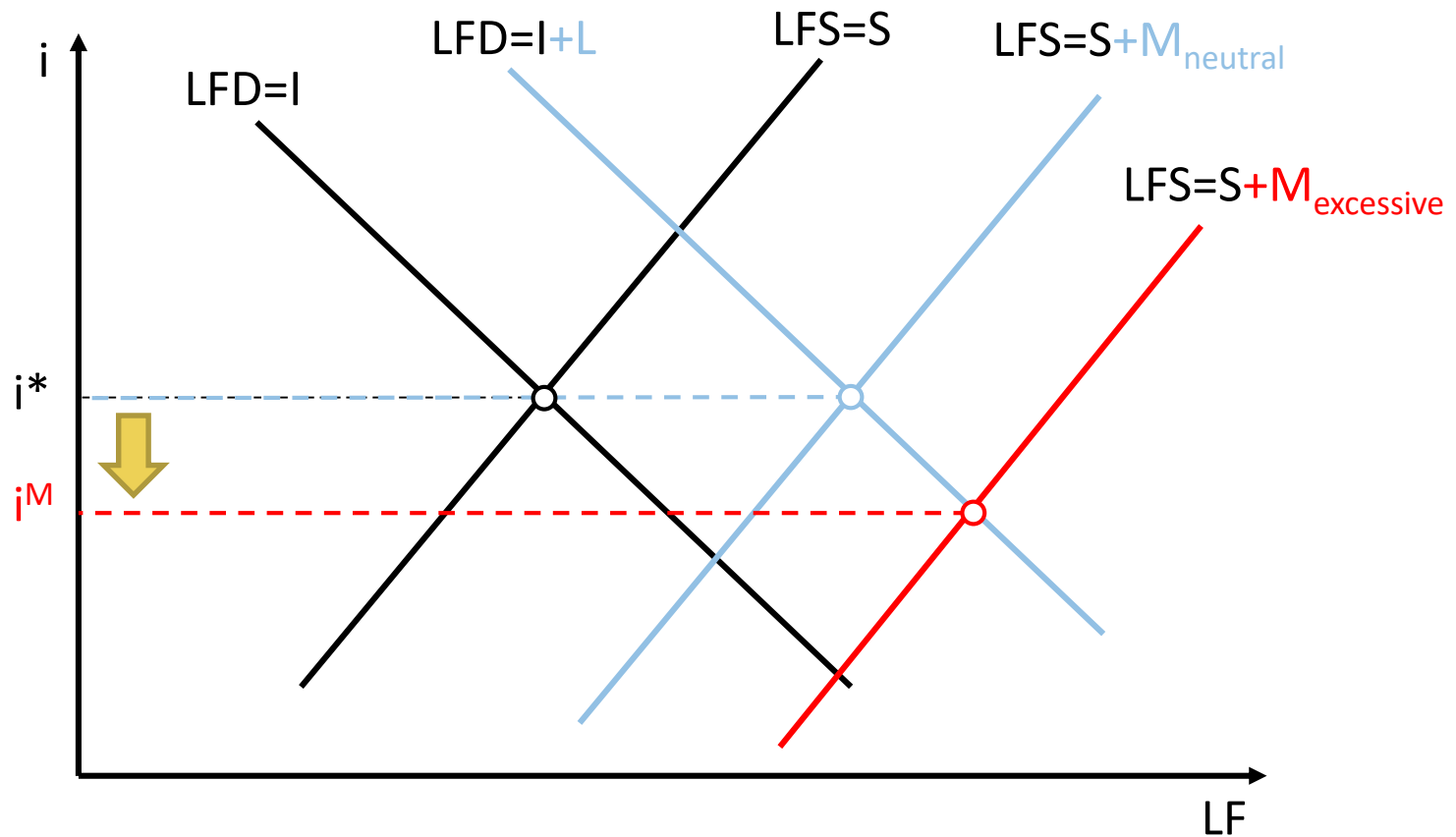
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Financial markets



Interest rate and monetary policy



Case study Spain

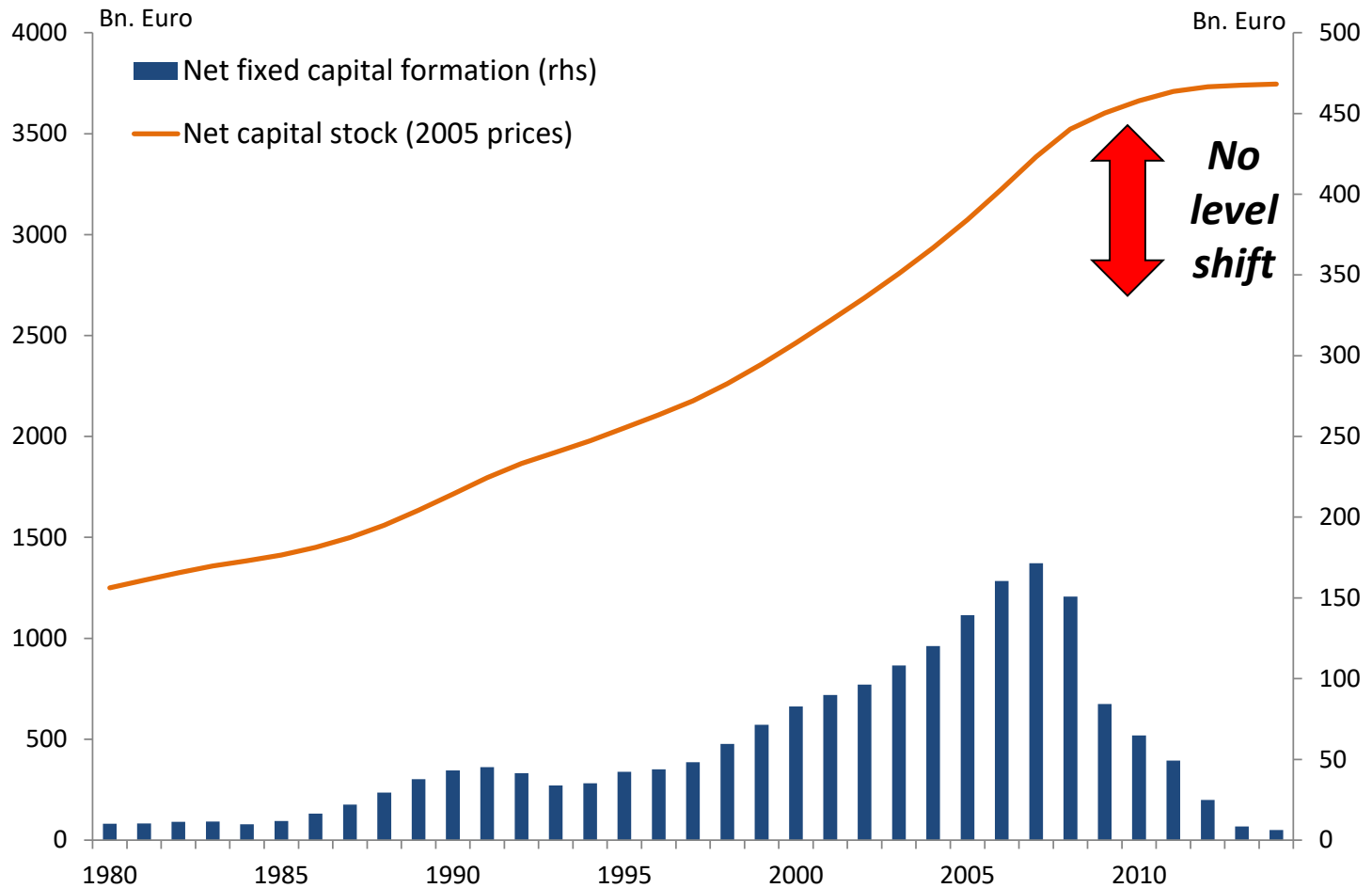
Ghost estates (example: Seseña)



Source: Oli Scarff/Getty Images

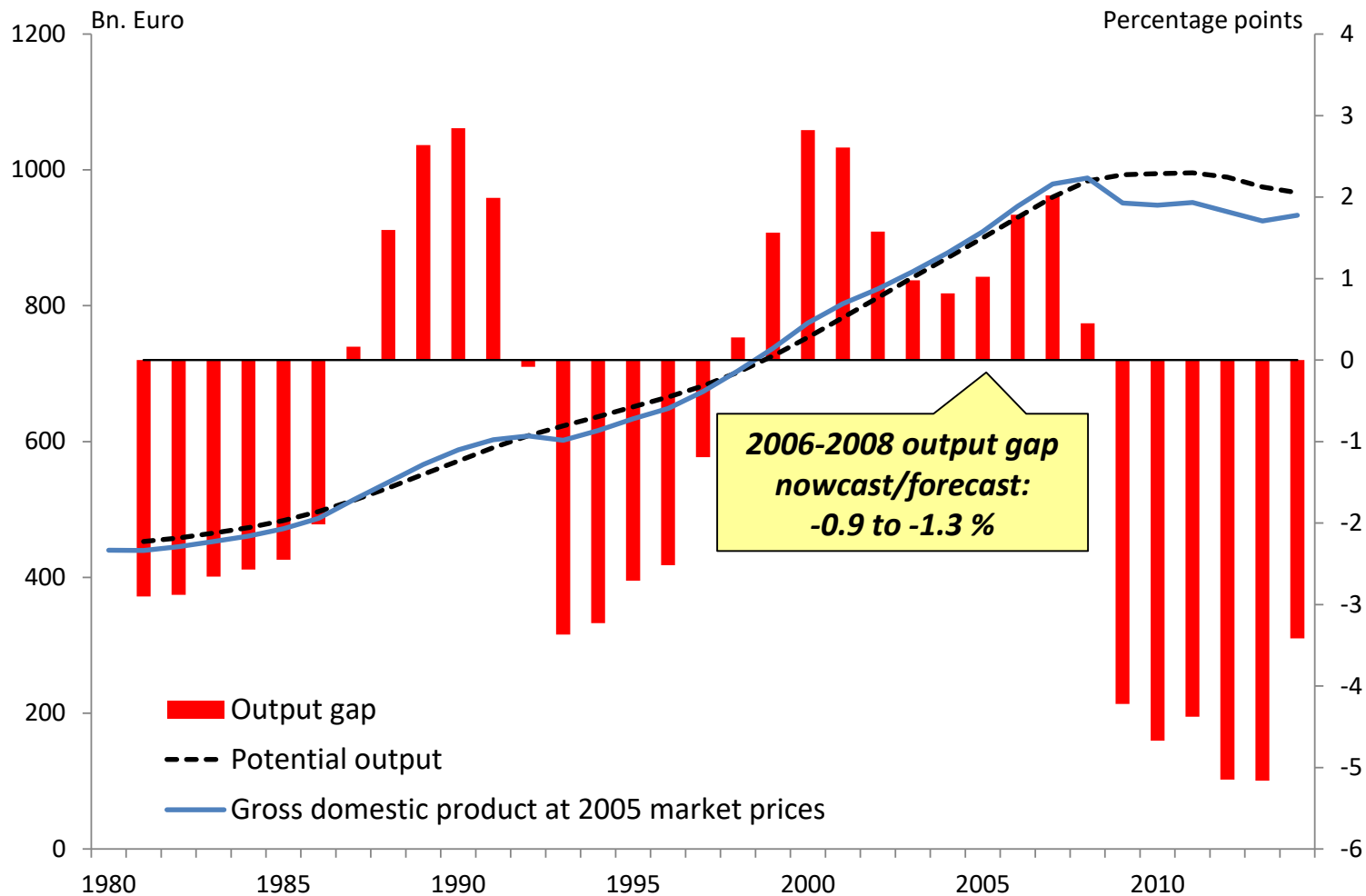
Case study Spain

Value of the capital stock?



Source: AMECO Database.

Ghost estates still part of potential output



Source: European Commission, AMECO and CIRCA databases.

Three options of coping with debt-crises

■ Public bail-outs

- » Shifts private debt to public sector
- » Private debt crisis \Rightarrow sovereign debt crisis
- » No solution for fiscally distressed countries

■ Inflating the debt away

- » Takes a long time, promotes zombification
- » Puts the currency at risk
- » Not targeted towards non-performing loans

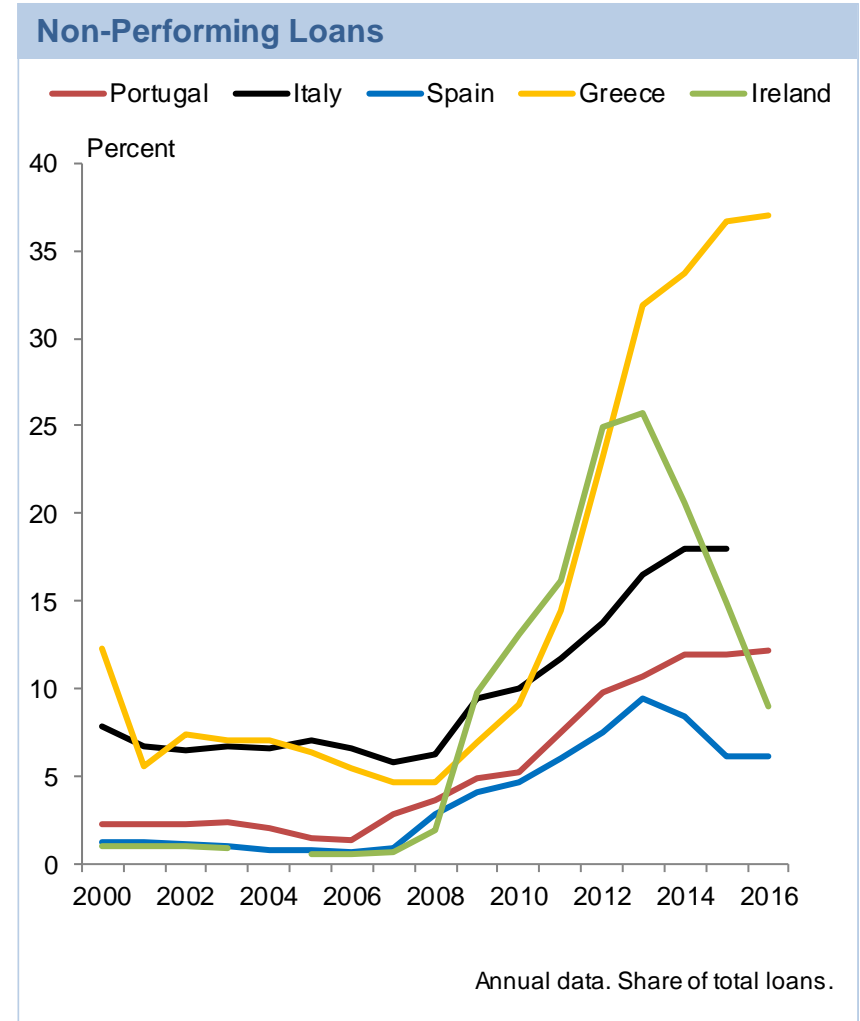
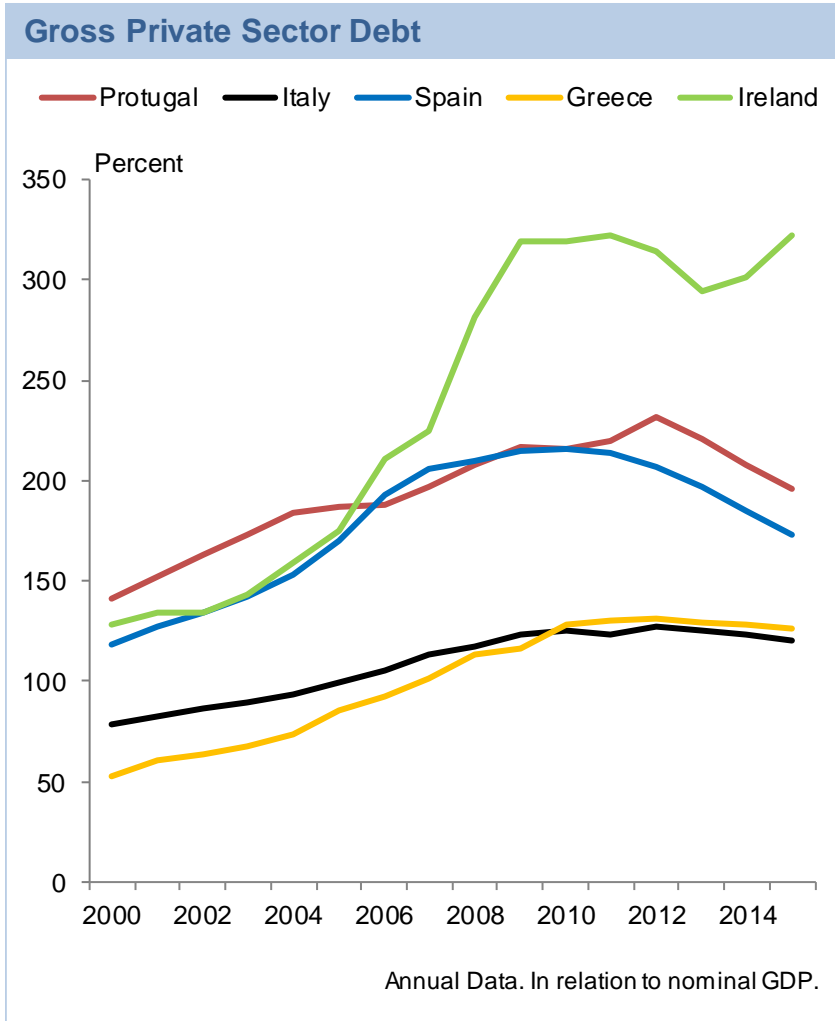
■ Liquidation

- » Tough (cold turkey) in the short-run ...
- » ... but targeted (and root cause oriented)
- » Puts capital at second (now first) best use

Anti-capitalist approach
(harms principle of accountability, creates moral hazard risks)

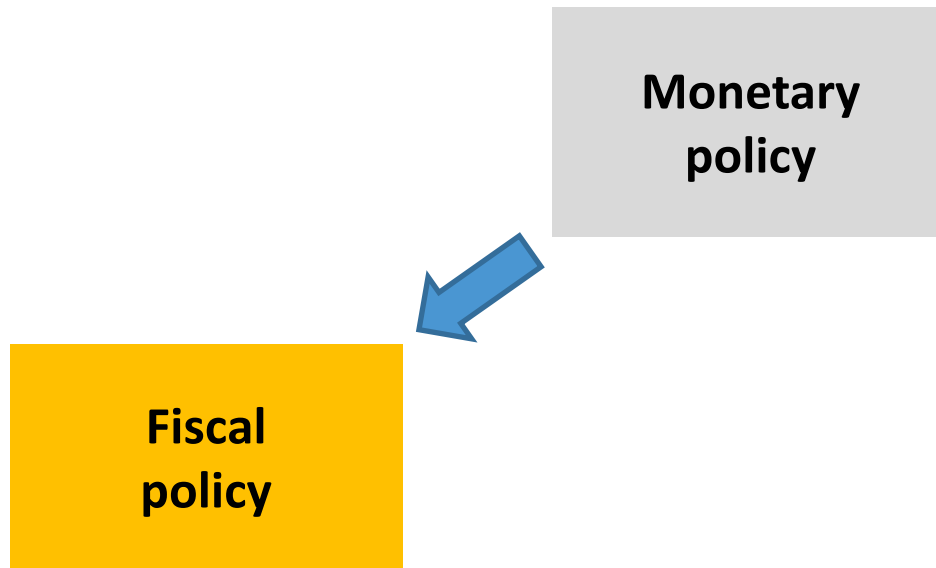
Capitalist approach
(in line with free market principles)

Flip-side of not liquidating (= “buying time”): High debt positions hamper credit channel



Data source: Bank for International Settlements, World Bank.

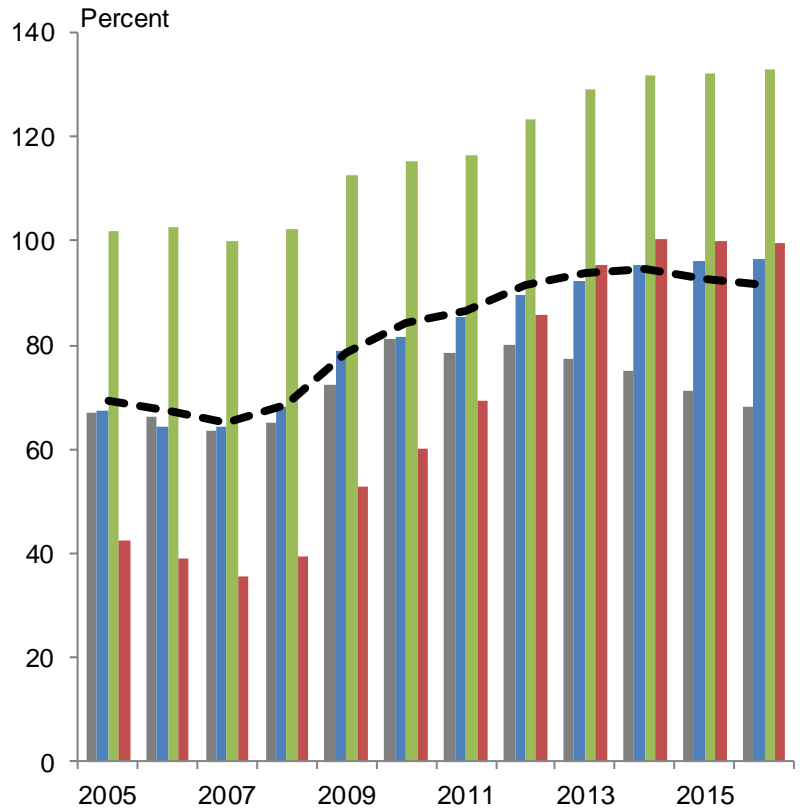
Easing fiscal consolidation?



Euro Area: Monetary financing of governments

Gross Government Debt

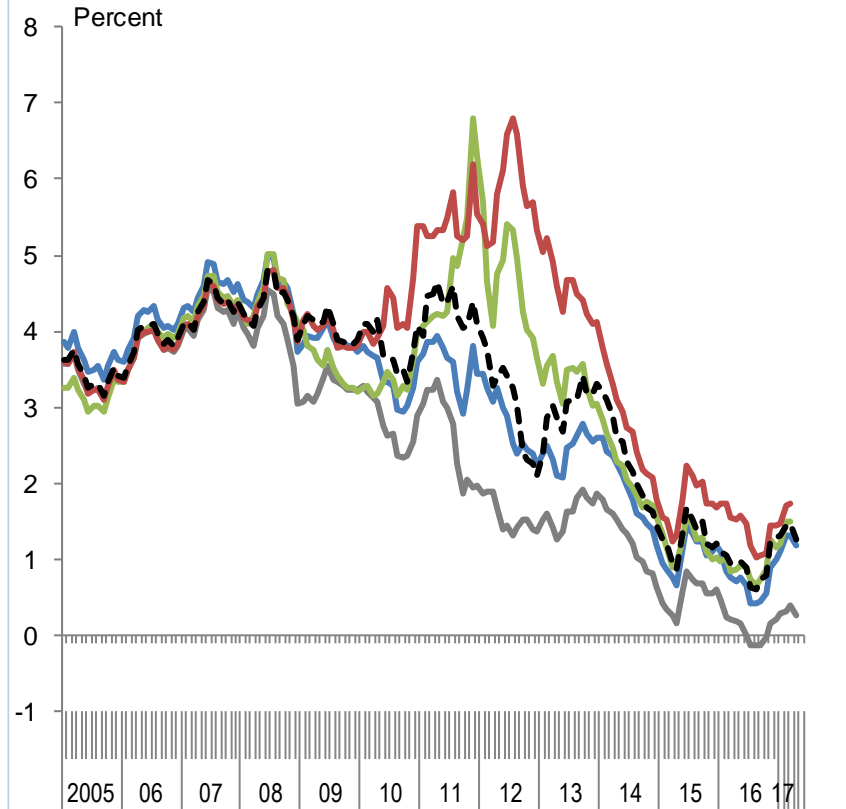
Germany France Italy Spain EMU



Annual Data. In relation to nominal GDP; EMU: Average.

Government Bond Yields (10-year)

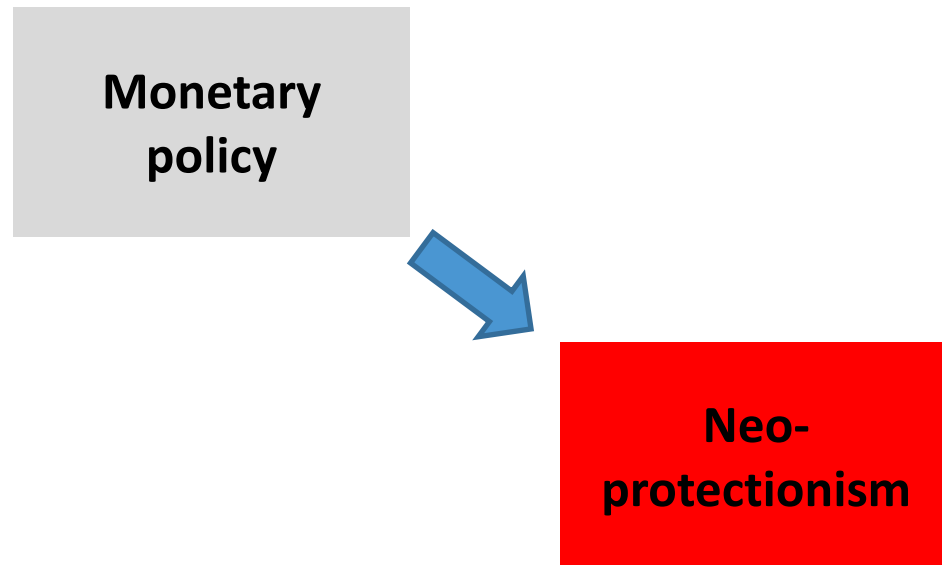
Germany France Italy Spain EMU



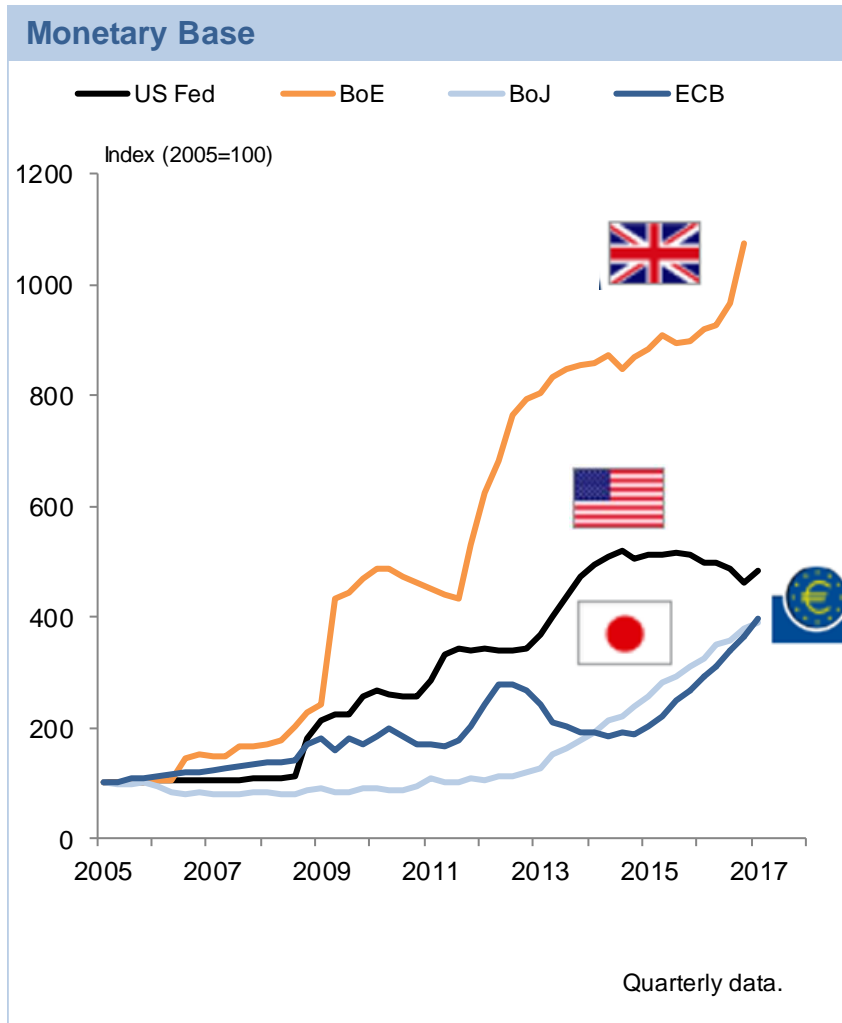
Monthly data. EMU: Average.

Data source: Eurostat, European Commission.

Monetary policy and currency manipulation



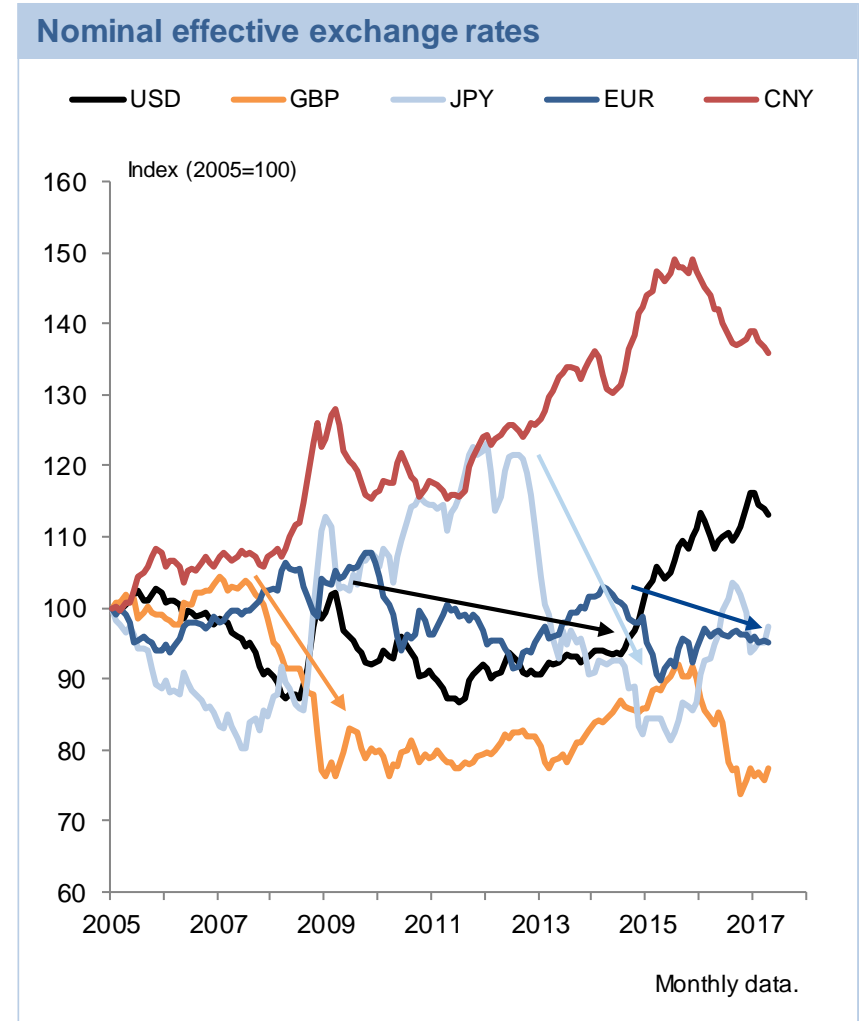
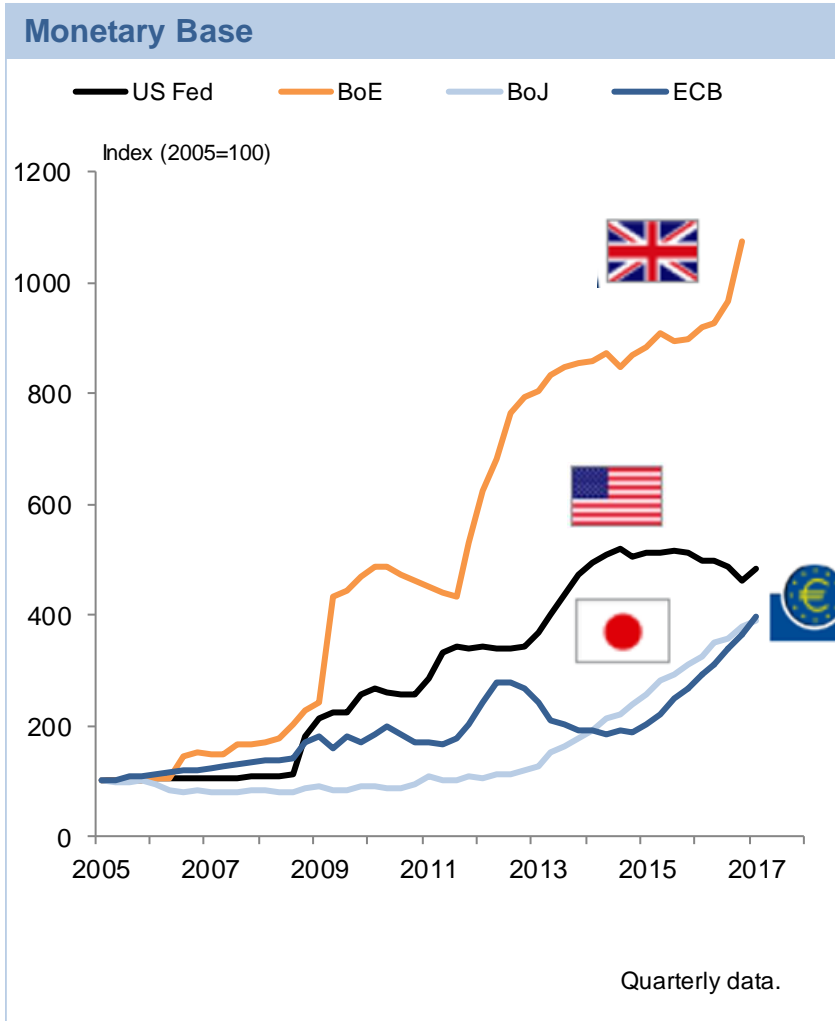
Quantitative „Easing“



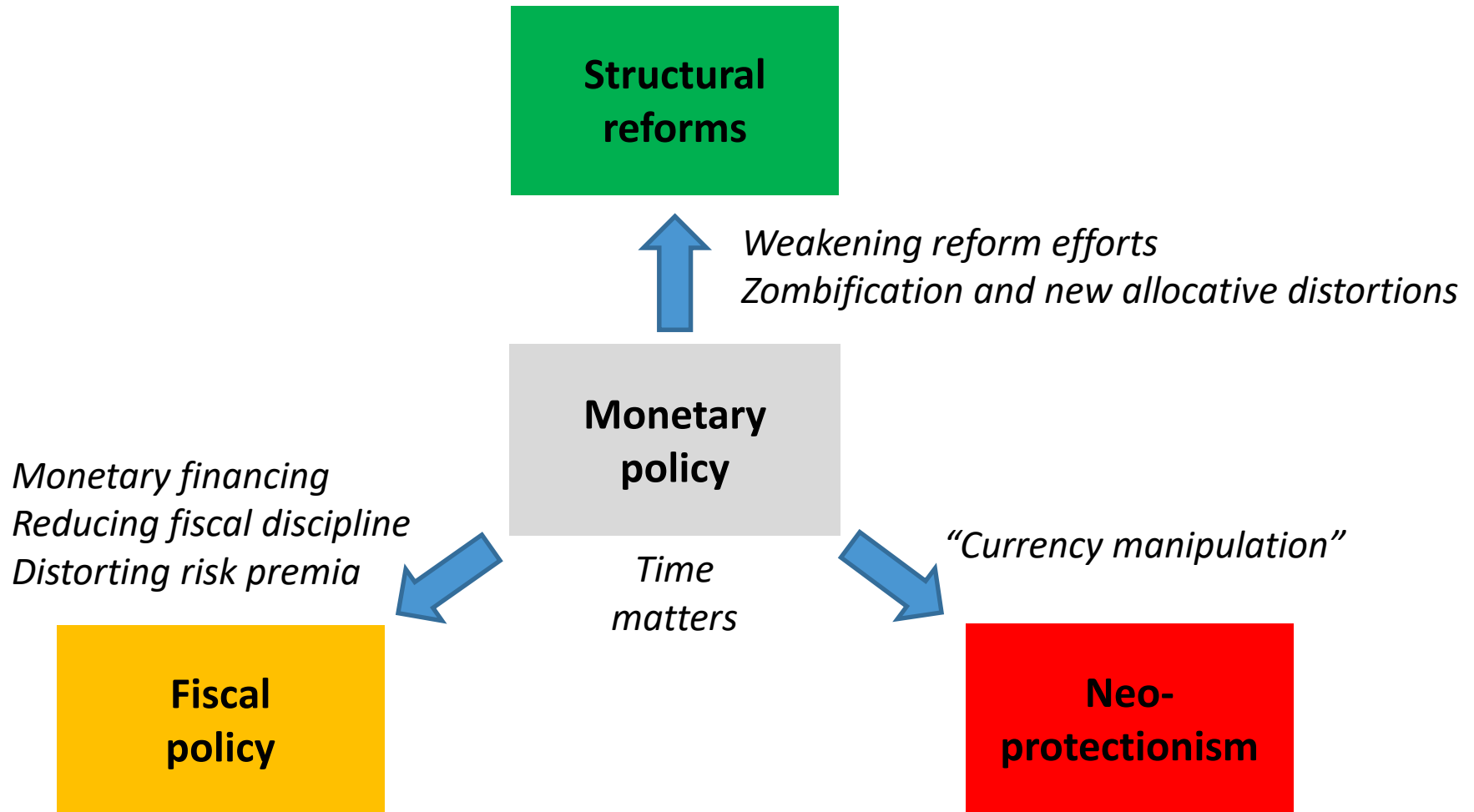
- **Type 1:**
Liquidity provision in times of financial stress
 - » Effective
- **Type 2:**
Stimulus at the zero lower bound
 - » *Domestically* ineffective
 - » Externally effective (in isolation)

Global QE: Risk of currency wars

Source: Thomson Reuters Datastream, IfW-calculations



ZIRP/QE: A risky game to play (for longer)



Monetary policy: Overloaded



Quelle: FAZ, 26th October 2011, p. 11

(Radical) Policy instruments to enhance the effectiveness of QE

- Buying risks upfront instead of lowering risk free yields
 - » More private sector securities
 - » Distortion of risk premia and related cost of capital
 - Targeting non-performing assets
 - » Monetary bail-out
 - » Turning the Eurosystem into a bad bank
 - Helicopter money
 - » Bypassing the credit channel to inflate the debt-overhang away
 - » Transforms the Eurosystem into a pure fiat money system
- ⇒ **Hardly in line with ECB's mandate, radical consequences**
- ⇒ **Chicago plan 2.0 requires credible post-resolution design**

Master program

Overview and guiding principles

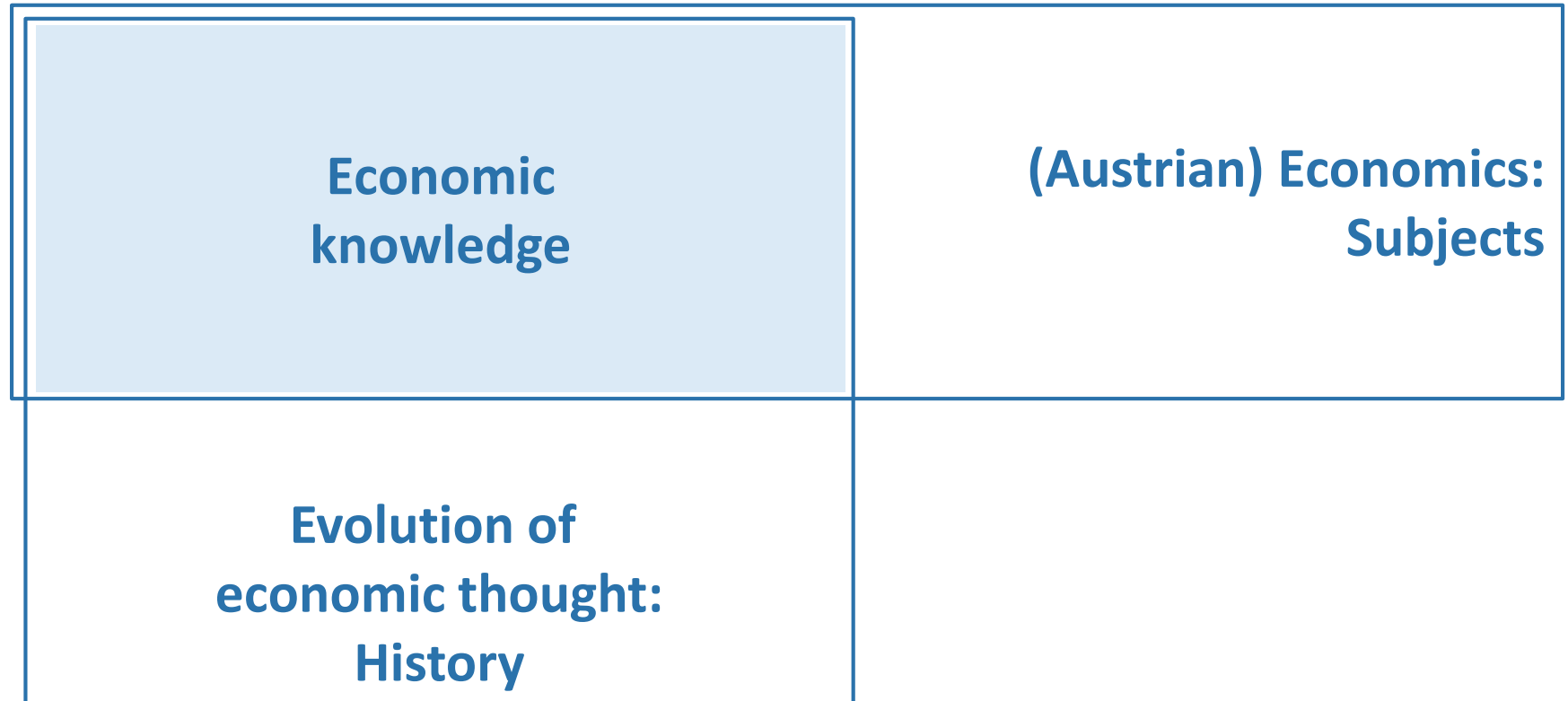
Master program Entrepreneurial Economics

1 st Semester	CP	2 nd Semester	CP	3 rd Semester	CP	
Catallactics	6	Capitalism	6	Economic Dynamics	6	(Austrian) Economics
Goods and Value		Capital and Production		Business Cycles and Crises		
Exchange and Price		Time and Interest		Calculations and Interventionism		
Market Processes and Competition		Money and Banking		Knowledge and Growth		
Roots	5	Classicism	5	Modernity	5	Evolution of economic thought
History of Economic Thought I: Roots of Economic Thinking		History of Economic Thought II: Classical Marxism/Vocationalism		History of Economic Thought III: Modern Mainstream Economics		
Evolution of the Austrian School I: The Origins and Carl Menger		Evolution of the Austrian School II: From Menger to Hayek		Evolution of the Austrian School III: Contemporary Economists		
Human Action I		Human Action II		Human Action III		
Business Control	8	Economic Methods	8	Organisational Change	7	Business & methodology
Planning and Budgeting		Mathematical Economics		Corporate Consulting & Project Management		
Financial Reporting		Praxeology		Finance Management		
Controlling: Operational and Organisational Structure		Cooperation, Logistics		Corporate Restructuring		
Networking	5	Culture	5	Negotiation	6	Soft skills
Network Analysis		Intercultural Competence		Strategies of Negotiation		
Key Leadership Qualifications		Business Mediation		Balanced Leadership		
Qualitative Research Methods		Quantitative Research Methods		Advanced Statistics		
Learning Leadership	6	International Experience I	6	International Experience II	6	Leadership & training
Learning Leadership		International Experience I		International Experience II		

Understanding
(rules of the system)

Application
(methodology/skills)

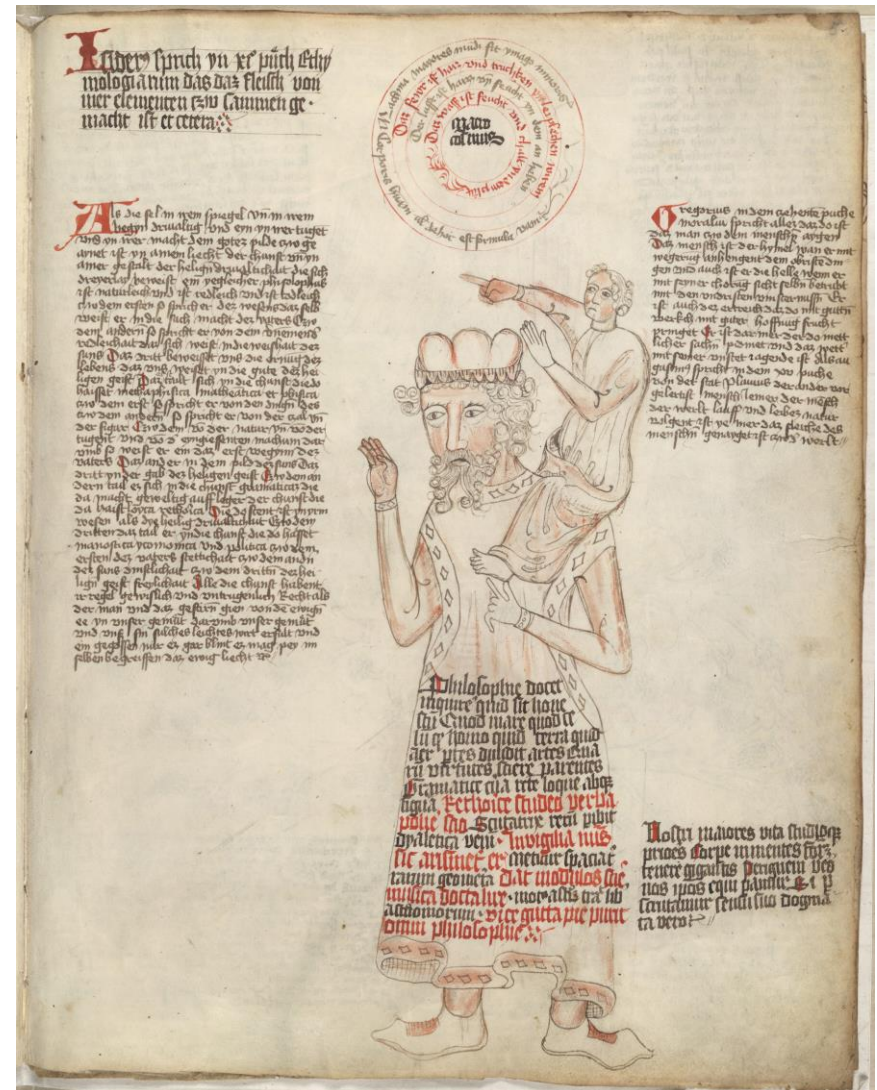
Matrix structure for reinforcing understanding



⇒ **Interactive classes + reading, reading, reading**

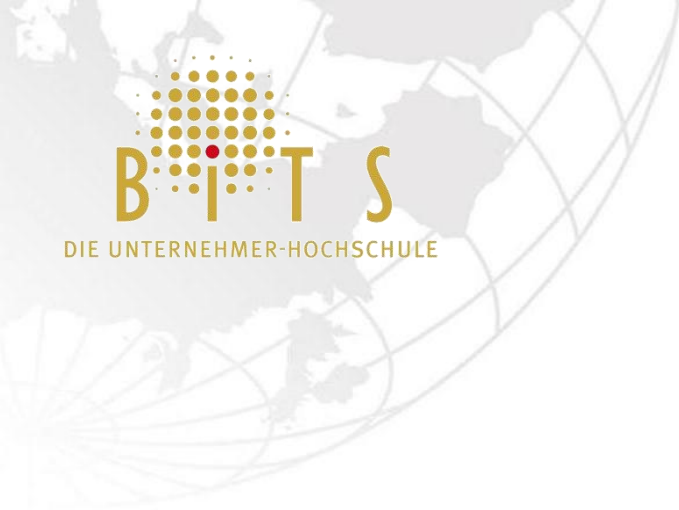
Standing on the shoulders of giants ⇒ requires climbing

- “A concept of science drawn from [textbooks] is no more likely to fit the enterprise that produced them than an image of national culture drawn from a tourist brochure” (Kuhn 1970 [1962]: 1).
- “I don’t care who writes a nation’s law (...) if I can write its economics textbooks.” (Samuelson)



Foundations matter





Time for Q&A

General perspective

- “Austrian” Economics?
 - » Methodenstreit with German Historical School
 - ⇒ **Pronounced pro-theory approach in economics**

- Cradle of modern economic thinking
 - » Marginal revolution, concept of opportunity costs
 - » Subjectivist theory of value
 - » Methodological individualism
 - ⇒ **Next significant stage of economics after the classics**

- Criticism of homo oeconomicus and Neoclassics
 - » Over-simplistic assumptions (economic core is assumed away)
 - » “Pure-and-perfect competition” as model without true competition (e.g. problem of representative firms, absence of profits)
 - » Problematic macro-micro-dichotomy
 - ⇒ **Economics as a social science, comprehensive view on entrepreneurs**

Holistic approach

- Praxeology: Economics as the science of human action
- Catallactics: Science of human inter-action (exchange)
- Aprioristic analytic framework
 - » Set of fundamental claims describing economic/social reality
 - » Strictly deductive logic as ultimate proof only
(vs. eclecticism and data-driven “empirically evidence-based” work)
 - » Focus on pattern prediction
- Liberalism as a social philosophy
 - » Search for laws driving voluntary social cooperation
 - » Evolutionary view on institutions (trial-and-error), “spontaneous order”
 - » Contractual society as benchmark for human interaction

Human action and praxeology/economics

- Psychology
 - » Why man chooses various ends
- Ethics
 - » What man's ends should be
- Technology/natural sciences
 - » How to use means to arrive at ends (in line with laws of nature)
- History
 - » What man's ends have been, and how man has used means in order to attain them in the past
- **Praxeology/economics**
 - » **Formal implications of the fact that men use means to attain various chosen ends**

Source: Rothbard (2009), p. 74; see also: Rothbard (1960): [The Mantle of Science](#).