Addressing Comprehensive Capital Run-down

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Introduction

We are living in times of comprehensive capital run-down. Due consideration of all manner of capitals, from the built and financial to the natural, has been absent since it was assumed by some using economics that 'the problem of production' was solved half a century ago.

Returns to capital have been inadequate. Widespread depletion of all manner of capitals followed. Debts accrued as soils, people and ecosystems were inadequately renewed. Worn-down enterprise, natural and community capitals are now all too common.

Yet we still persist with clearly inadequate options. A dollar here or package there can never address deep problems. Significant changes are needed to meet the challenges of rebuilding sound enterprise, community and ecosystem balances. More insightful approaches to 'the problem of production' offer good returns to all manner of capitals and efforts.

Pervasive economic distress and capital run-down are succinctly discussed in this paper, with elements identified for effective turnaround. Principles, stances and agenda issues are listed before a brief concluding consideration of eco-renewals and capital rebuilding.

The immediate need is to recognise how foundational mistakes have perverted even the best-intended and resourced efforts, and to consider how to respond more effectively. The wider need is to bring about significant change in perceptions, practices and policies. Key capitals may then be renewed.

Times of Flawed Thinking and Ignored Problems

The roots of many current problems were established over half a century ago:

> One of the most fateful errors of our age is the belief that 'the problem of production' has been solved. Not only is this belief firmly held by people remote from production and therefore professionally unacquainted with the facts – it is held by virtually all the experts, the captains of industry, the economic managers in the governments of the world [who conclude that things] not going as well as they ought to be going must be due to human wickedness. We must therefore construct a political system so perfect that human wickedness disappears and everybody behaves well, no matter how much wickedness there may be in him or her (Schumacher, 1973).

These twin beliefs come into sharp focus in agriculture: with the "problem of production"[1] assumed solved, failures to produce must logically reflect wicked farming that can be purged by "a political system[2] so perfect that wickedness disappears" (ibid.). Assumed is that problems in one "system" can be offset by perfection in another. Such beliefs were seen as widely applicable, including to financial and environmental problems. Naïvely assuming that paired systems can mutually co-regulate irrespective of context is risky in analysis, and demonstrably foolhardy in policy and practice.

Evident limitations in such thinking help explain why degradation of capitals goes effectively un-noted and unchecked. Policy operatives (private, operational and public) *systematically* discount any reports of damage, decline, degradation or despair as a righteous purging of wicked imperfections *in the other system*. Policy maladaptedness worsens while problems build unchecked and needed returns to capitals diminish.

In a nutshell, building an encompassing abstraction of an economy (cast as a perfect system) competed with understanding economic realities.[3] The systems view prevailed with reality assumed conformable to abstraction. The neoclassical synthesis mathematically linked production and consumption via markets. Despite serious internal and logical problems, first- and second-generation neoclassicism dominated a century, with 'new neoclassicism' now a third-generation aspirant.

At heart, neoclassical analysis argues suppliers continue to supply markets as long as price exceeds *average variable cost*.[4] Prices need not cover full measured enterprise costs. Further, not all costs may be accounted for, particularly if problems of measurement (notably for capitals), money value attribution, production factor mix or externalities exist. And they all do.

Not only was the problem of production not solved, but the preferred analysis was partial, logically invalid and misleading: financially unsustainable market outcomes became part of posited equilibria. Still, the system and dreams of neoclassicism held great appeal, notably to those who might so profit.

Not only did 'the system' render the complex as simple and automate policy setting around the kernel of productivity (which is logically inadequate, especially in an open economy). It also sidelined people, government, nature and other third parties or capitals unless market failure was accepted.

Liberalisations gave much freer rein to particular interests while supply chain and industry concentration increased. In particular, legislative adjustments saw: the global rise of financialism (McGovern, 2019); historically very high debts (McGovern, 2011a,b); a propensity towards financial crises (Roubini, 2007; McGovern, 2008); and an ongoing Australian rural financial crisis (McGovern, 2014b) exacerbated by (to date) ever-extending drought or other natural disasters.

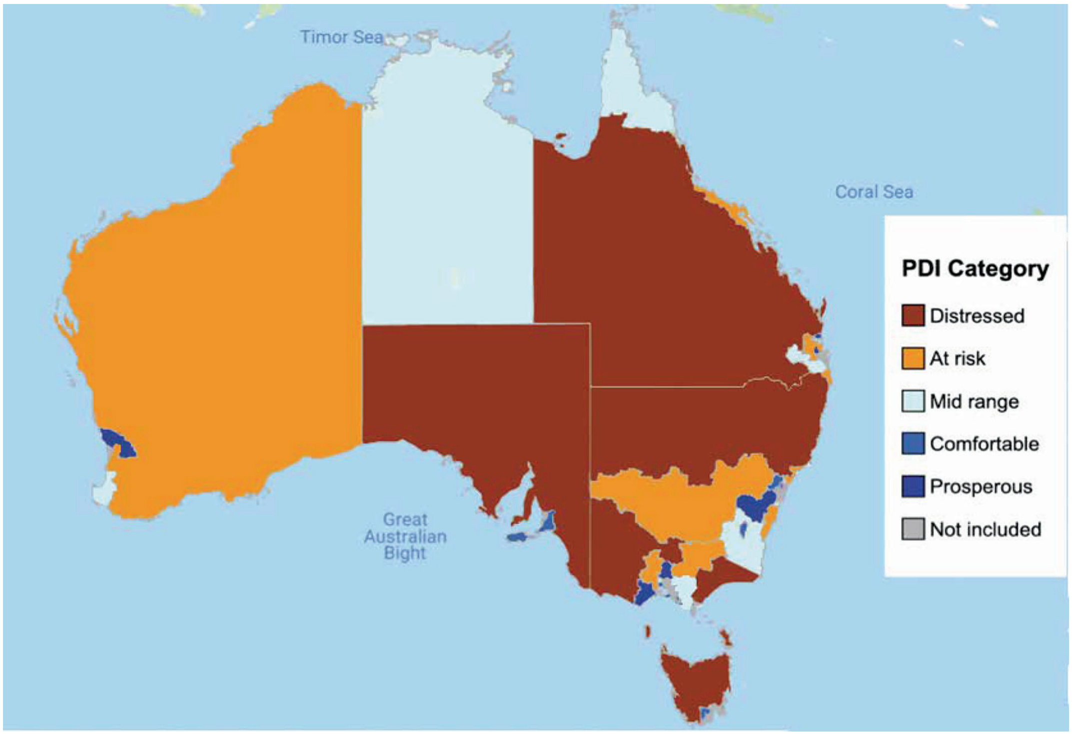
Across Rural Australia

Prosperity in Australia is concentrated in the major centres. Elsewhere, distress reflects the loss of many 'value-adding' enterprises and capitals as part of the decline in profitability of the rural sector. A top-level view shown in Figure 1 maps Federal electorate values of a Prosperity and Distress Index (PDI). The PDI is used to distinguish between communities that endure economic distress compared to those that achieve economic prosperity (Baum et al., 2019).

While variations do occur within electorates, the overall distress of major rural areas (including the bulk of the rangelands) is evident. Other works in this volume, such as that by Rees on populations and lost employment, help build a tragic picture of distress in once prosperous enterprises and communities. Research[5], various field activities including with the Rural Debt and Drought Taskforce (Katter, 2016), dialogues as part of Rural Debt Roundtable (McGovern, 2013, 2014a) and public Inquiry reports (such as Hayne, 2018) detail significant dislocation and deepening distress.

Economic distress is driven by poor returns to economic capitals, be these human, built, natural, financial or other. Economies and their communities decline towards deep crises if real depreciation and capacity run-down are allowed to develop into an accelerating downward spiral.

Figure 1. Prosperity and Distress across Australian Federal Electorates (Baum et al., 2019).



This suggests five key points[6]:

- Drought has highlighted underlying (sectoral, regional and societal) imbalances as well as public and private policy deficiencies, so *foundational problems*, *not symptoms*, need to be addressed.
- We are living at the high-risk end of a long period of *capital run-down* across human, physical, financial, environmental and other styles of capital. Negative economic profits across agricultural sectors and rebalancing of government policies in ways that discriminated against rural and remote areas have driven decline in the rangelands.
- Inept use of theories and *malformed policies* is evident. Pop economics and dangerous strategies such as asset inflation drove decline and despoliation. Naïve competition policies, denial of trade realities and theories, woeful regulation and polluting debts from unchecked Ponzi finance streams were all part of a self-reinforcing destructive logic, and still are.
- Much can be done to *restore* financial/economic/environmental/societal *viability*. Continuing the approaches, policies and 'quick fix' thinking that led to today's problems will not solve anything. Rather, we need to sensibly build on what can deliver real results on the ground now and over the medium and long term, and so rebuild vital entities, communities and ensembles.[7]
- There are always losses (and gains), but losses today are needlessly high. *Key capacities* are seriously *weakened*, so it is past time for some fresh thinking and use of relevant insights.[8] The challenge is to conserve and transition essential existing capacities while also developing well-distributed

> needed new capacities. Timing and placement across public, community and private areas is part of the reconstruction of the social accord which underwrites efficient and equitable economic activity.

An unprecedented extraordinary cycle is now ending, locally and globally. Its hallmark is a progression of crises as evident in Australian (and other) rural areas over recent decades. These are now also increasingly evident in the cities.

However, misplaced beliefs still hold sway today. This inertia helps explain not only how current problems arose unchecked over many years but also why responses have been so limited. Community impoverishment, environmental degradation and societal fracturing consequently continue unchecked. Equivalently, comprehensive capital run-down continues unchecked.

Self-reinforcing delusions can be hard to change, especially when part of the conventional wisdom. As problems surface, some think it easier to double down on the system or our beliefs while reducing reporting and information flows so that *wickedness disappears*. History attests that problems then only grow unchecked. Failures cannot self-correct by using the policies and approaches that incubate them.

In passing, François Quesnay was, amongst other things, surgeon and physician to Louis XV of France. He was also an early economist who in 1758 published the *Tableau economique*, a descendant form of which Samuelson saw in the 1960s as offering a potential way around neo-neo-classical[9] shortcomings.

Promising development research was done, including in Queensland and on agriculture, during the 1970s and 1980s, but dogmatic doubling down by the 'neo-neo-class' saw research findings ignored while productive lines of development stalled.

Louis' conservative son died on the guillotine in a revolution promoted by economic distresses exacerbated by state debts made markedly worse by financing an American war. Capital disputes have all manner of resolution, and avoidance of crises sensibly requires apt thinking, tools and tactics.

Turnaround

Capital is essentially a stock with which we may variously engage in living life. It is of many types. It may be built by the efforts of humans and wider nature, and also so depleted. Capital availability offers choices with impacts consequent on all manner of organisms, whether it be drinking from a stream to support life today or storing gathered foods in anticipation of adverse times.

Capital usage necessarily links stocks and flows as we draw down or build up stock levels and/or quality, typically as part of some event. For Harcourt & Laing (1971), "capital theory became relevant when the problem of the choice of technique, and the explanation of distributive shares and of productivity change over time, both theoretically and empirically, were discussed". Clearly, relevant contributions should be sought from capital theory, and other areas.

Capital maintenance requires suitably balanced flows so as to maintain the stock quantity and quality. Production which is transformative allows us to enhance capitals, and enhancement offers prospects that we may assess as good, bad and otherwise. Capital enhancement drives development, as the ongoing contributions of your own stock of cumulative learning from experiences to your personal development, capacities and functioning attest.

People routinely mix and combine capitals over various time horizons at work, home and play, with all manner of effects. Persistent interdependencies arise, and obligations may be imputed so as to allow maintenance and development, or not, of all manner of capitals.

The brilliance of neo-neo-classicism was to imagine a way to systematically combine all such things. The folly was to assume any such system autonomous, perfectible and fully inclusive. The key mistake was in uncritically seeking to implement both. The resultant tragedy is the parlous position of too many capitals, and of those dependent on them.

Complications obviously arise when, for example, imputed obligations unexpectedly cannot be met. This was recently posed as an unanswered question by Commissioner Hayne: "How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events?" (Hayne, 2018, p. 242).

The wider issue can be posed as: how are capital stocks and flows to be well managed and developed over all manner of events and uncertainties? Articulating 'well managed and developed' into a prudent approach is the central challenge on many levels. Approaches involving mutuality, stewardship and well-grounded decision making can do what competitive markets and perfectible systems by design do not, and cannot do.

Avoidance of needless destruction of capitals and key capacities is pivotal in stabilisation and any successful turnaround. Rectification via effective transitions with sound outcomes properly involve inclusive:

- recognition and *remediation* of foundational flaws;
- *rebalancing* and capital rebuilding;
- apt knowledge, dialogues and policies yielding well-formed *responses*;
- *restorations* of viability and vitality; and
- insightful approaches and efforts that underpin *robustness* of enterprise and capitals.

For those still awaiting a market correction, remember to tell your family, colleagues, and friends: "The market can remain irrational longer than you can remain solvent" (attributed to Keynes).

Rectifying Imbalances in Finance, and in Other Capital Usage

Finance is a good area to start as it is a fully human creation with pervasive effects on all manner of capitals. It is an area that is conceptually easy to modify, and if there is a sufficient will, acceptable ways will be found to stimulate and expedite needed rebalancing.

Financial imbalances can derive from a variety of causes, including systemic capital misallocation as in this example:

> And [in the minutes of Rural Bank Credit Committee meeting of 17 August 2011] at 0075 we see that the chairman noted that:
>
> > A presentation was made approximately five years ago which highlighted that the value of Queensland cattle properties were heading into a pure asset bubble, and these warnings appear to have been ignored (Orr & Gartmann 2018).
>
> An asset bubble arises when the ratio of the value of productive capital assets to likely income is excessive. Assets will be traded as such prices only if speculation is present.
>
> As this Royal Commission witness relates, the Rural Bank was aware in around 2006 that, *at issue*, income to service any Queensland beef property loans issued would be likely insufficient. Other banks should have been aware, and like bubbles existed in other areas of agriculture. The Commissioner chose not to pursue this extremely serious issue.
>
> Yet senior bankers and policy bureaucrats declared 'no problems' in front of senior responsible Ministers on two occasions (in 2012 and 2015) when I was present, and I suggest likely other occasions. APRA's evident awareness was not related to government it appears. Clearly, proper Inquiry is needed.

There is ample evidence of serious systemic problems in finance, persistent denial and comprehensive failures to responsibly respond for many years. There are also available insights, methods and past experiences that demonstrate how to prudently respond. Capital distress and needlessly ruined lives and lost capacities will continue until viable capital balances are restored across all capital types.

Currently, returns to financial capitals are excessive, degrading the returns to other capitals. Excessive debts pollute. Denial ensures degradation spreads and accelerates. Doing nothing ultimately impoverishes all, including the dominant beneficiaries of neo-neo-classicism and ascendant financialism.

Principles that would be prudently publicly adopted in Australia include:

1. Government is not a bank, and should not use its balance sheet to act like one.
2 The Reserve Bank of Australia (RBA) is a *public* bank with an apt but neglected charter of responsibilities.
3. Development which requires long-term patient finance is the core business of development banks.
4. Loan destressing and reconstruction are part of balance sheet rectification, on all sides.
5. Orderly workouts are better than panic, hubris and fire sales.
6. Principles, policies and practices that incubate problems will not solve them.
7. Transparency, mutuality and subsidiarity aid robust, inclusive evaluations and successful investment.

Financial stresses are complex, but skilled interventions can make a real difference. The scale of targeting to rectify imbalances ranges from enterprise to nation depending on 'goodness of fit' criteria along with current and potential capabilities. In a nutshell, as the emphasis moves from unchecked capital consumption to capital (re-) development, the use and abuse of all manner of capitals returns to being a central ongoing concern.

Stances will variously need changing, with an overall move from 'damaging' to 'restorative' as a means of rebuilding the common wealth and individual prosperity of thriving Australians. To illustrate, consider some Stance Attributes cast for finance which have immediate and wider application.

Alternative Finance Stances: Damaging and Restorative

Damaging	Restorative
Denial	Honesty
Overlooking key contributing factors	Recognition of factors beyond control of parties
'All your fault' attributions for failures	Shared responsibilities for rectifications
Secrecy	Transparency
'Letter of the law' contract dealings	'Spirit of justice' contract resetting
Entitlement of banker 'rights'	Due recognition of all party interests
A private interest dominates	Public interest accommodated
Asymmetries unchallenged	Power and other imbalances recognised
And more …	And others …

Agenda items are many, with many well suggested in rangelands conference discussions and this publication. However, positioning, analytic and evaluative frameworks that are 'fit for purpose' are needed, along with people who are not only willing but skilful for the many and often critically interlinked jobs at hand.

Some agenda recommendations to advance the seven listed Principles include that:

1. Commonwealth farm loan funds currently made available to temporarily ameliorate (but not solve) severe balance sheet strain could be diverted to rural capital stabilisation and restoration of natural assets, including via stewardship projects with demonstrable public outcomes using decoupled income support[10] arrangements. These and other options open to responsive

State or Commonwealth government are World Trade Organisation compliant.

2. Public reconstruction and development banking activities be responsibly re-instituted and coordinated by the RBA so as to organise and resolve rural financial matters constructively and equitably. Historically these have been key responses in dealing with 'the consequences of uncontrollable and unforeseen external events' and so resolving Hayne's unanswered question 'after the event'. Currently touted 'before the event' approaches are demonstrably unworkable so better options available need to be evaluated, as applied as apt.
3. Development bank lending to underwrite needed industry and infrastructure developments be carried out using suitably structured banking arrangements, prudent investment evaluation and financial products that are fit for purpose given uncertainties and investment needs.
4. Borrower and lender balance sheet imbalances be monitored with, in the case of persistent or worsening strains, timely and prudent financial reconstruction allowing restoration of enterprise financial vitality.
5. Orderly workouts which prioritise conservation of key capacities and avoid needless destruction of capitals be standard market practice across the full life of any investment.
6. Solutions to problems of production be targeted in policy and practice in an ongoing way so as to optimise investment evaluation and realisations.
7. System and market failures in the context of an open economy, both as evident and as likely, be addressed with particular attention to transparency, mutuality and subsidiarity so as to improve evaluation and investment processes and outcomes.

Improved balance sheets and capital positions are the overarching goals of all seven. Balance sheet resets which benefit borrower, lender and community by apt enterprise revitalisation are clearly superior to current denial with deepening debt-deflation depression.

Conclusion

> We argue that at the heart of the correct response to high unemployment, is expenditure on improvements in physical and human capital, with an emphasis on green friendly projects and that this should be financed by borrowing and usually by borrowing from the Central Bank … (Harcourt et al., 2013).

Prudently funded investments that rebuild key capitals and capabilities drive economic development and the renewal of community prosperity and viability. Stakeholders in mutually beneficial relationships that sensibly allow for risk and uncertainty can drive economic turnaround.

Re-establishing apt ways of linking capital positions and returns, over time and events, to investments and development is both a conceptual and practical challenge. Neoclassical abstractions are not up to the task due to logical and conceptual problems evident in the formulation and the singular approach employed. Recognising that a variety of feasible capital combinations can produce desired products and capital formation or renewal promotes prudent choices by investors. operators, regulators and other engaged parties. 'Fit for purpose' arrangements need to replace 'one size fits all' dogma with its neglect of real profit and capital issues.

New business and policy modes are needed to address current stresses, debts and run-down. Entrenched multi-faceted problems require a range of new capabilities, some of which have been outlined. However, it would be particularly tragic if ongoing denial or a rushed effort by some advocating further refinement of existing flawed approaches and non-delivering policy products was seen as in any way reasonable or responsible. We can do better, but the time is short as damage to key capitals is deepening and accelerating.

Just as Mutually Assured Destruction (MAD) arguments moved the world away from nuclear war options, so also MAD capital threats need to be sublimated with capitals applied more beneficially and profitably elsewhere. All stand to gain, as do all manner of capitals.

Rural areas, particularly the rangelands, will benefit as we address the challenge of subprime agriculture (McGovern, 2014b). Parasitic finance culminating in disorderly workout, typically via inequitable firesales, is needlessly damaging. Financial reconstruction provides ways back towards prosperity through capital adjustments and reinvigoration. Orderly workouts can be complemented by new capital rebuilding opportunities, as occurs when farm stewardship realises renewal of the varied capitals used in, and affected by, the production process.

I look forward to engaging with those who would like to work on initiatives that have a good chance of rectifying capital imbalances, destressing overburdened balance sheets and achieving good capital development.

Endnotes

[1] Broadly, the problem is how we make "best use of resources to meet human needs" by making products. That a solution had been found was an understandable assumption when Schumacher published in 1973 as the previous quarter century had seen an historic, widespread advance in material prosperity. This was supported by a regime of well-set policies, international arrangements, technologies and "economic systems". However, limitations went unheeded. So while many understandably considered that past successes would continue, monetary and economic crises broke out. These reflected unresolved stresses in resource usage, observable as major unaddressed capital imbalances. Current crises similarly reflect unaddressed capital problems. It is just the mix and manifestations that have changed.

[2] A system is an ideal form: a whole of many interacting parts. Typical dual claims of 'the whole being (in some ways) more than the sum of the parts' and 'the parts fitting within the whole' signal ambiguities and complexities that proponents too often ignore.

[3] The conflict was most intense over the nature and treatment of capital. Capital was made conformable to markets by those centred at MIT in Cambridge MA while the (differentiated) nature of, and timing of returns to, capital mattered to those centred around Cambridge University UK. Harcourt & Laing (1971) provide details. While MIT's Samuelson (1966) "admitted the logical validity of the British critique of the neoclassical theory of capital. … the debate [became] largely a sideshow to the core of neoclassical analysis" (Tsoulfidis, 2008). Oversimplification won, with returns to capitals, and their attendant condition, excluded by the modal economic system. Consequences of this oversimplification of the economic system are increasingly evident.

[4] The usual statement (routinely taught in Introductory Economics) is that competitive market equilibrium occurs where marginal revenue equals marginal cost *and* price is above average variable costs (or $MR = MC$ *and* $p > AVC$).

[5] The problem is long standing, broad and deep (as discussed for example in McGovern, 1997, 1999a,b, 2000b).
Building on "Four Key Points" in part of the 2018 RAPAD submission to the Queensland Drought Program Review.

[7] Viability is an ability to live. This is today typically considered in the abstract, using measures, ratios and abstractions in a propositional or formal manner. Formal systems which by design target protocols will likely struggle in situations that are unusual, or beyond their design brief. Cambridge MA centred on highly formal systems which promote viability by conformance (which might include to capital/labour or asset value/income ratios deemed optimal). Questions of 'how?' go largely unaddressed.

Vital entities or ensembles live, and so act and adapt situationally. Cambridge UK recognised not only the variety of ratios "in real life and times" but also the consequences of various ratios, some of which would signal the need to adapt if the entity or ensemble was to remain vital. The 'how?' question is then central.

[8] To name a few, we can draw from: successful restructuring and development efforts (past and present); conditions that foster enterprise successes in agriculture, including in past Australian experience; industry theory and production realities (and the impacts of their avoidance by market theorists and concurring analysts); public Inquiries including the 2019 Senate Inquiry into Jobs in Regional Areas, and Hayne (2018, 2019); and how past financial arrangements fostered the development of agricultural capitals, including relevant imbalances.

[9] Using the neo-classical synthesis, economists were able to link production and consumption via markets through a series of interconnected equation sets (and hence the predisposition to mathematical exposition). The market became the focal active unit, with production and consumption as passive adjusters (and hence for any product type, the centrality of market prices coordinating production and consumption).

[10] "Support for farmers that is not linked to (is decoupled from) prices or production" (WTO Glossary). Stewardship can fit. In the EU, for example, "the 'green direct payment' (or 'greening') supports farmers who adopt or maintain farming practices that help meet environmental and climate goals. Through greening, the European Union (EU) rewards farmers for preserving natural resources and providing **public goods**, which are benefits to the public that are not reflected in market prices. EU countries have to allocate **30% of their income support** to 'greening'" (European Commission, 2019). Australia could easily do likewise. It is just a matter of recognising the public will to act.

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