

## New Horizons Hub: The key to the productivity puzzle

Although the factors contributing to stagnant productivity are well known, economists and policymakers pay little attention to how to address them in a coordinated way, writes Diane Coyle for Project Syndicate. We pick up on this in our top selection of this week's stories from our ING authors and trusted third-party providers

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# VoxEU: A proposal for an Asian digital common currency

This column advocates the introduction of an Asian digital common currency as a multilateral synthetic currency comparable to the euro. We argue that the benefits it would bring are greater than the disadvantages of inefficiencies in multilateral frameworks, write Taiji Inui, Wataru Takahashi, Mamoru Ishida for VoxEU



Source: Shutterstock

## East Asian economies still depend on US monetary policy

Following private crypto assets such as Bitcoin and Facebook's Libra, central bank digital currencies (CBDCs) are currently being studied among the world's central banks (e.g. Auer et al. 2020). Trial experiments have also begun in some countries, and Asia is no exception. The People's Bank of China has already begun demonstration tests and is leading the way in the world in this area. CBDC is also under consideration in South Korea, Malaysia and Cambodia. The Bank of Japan has been conducting joint research with the ECB, and at the request of the Japanese government a specialized team has been set up and a full-scale study has started. One of the merits of digital currencies is that they can be traded cheaply in real time across national borders. With the progress of digital globalisation in addition to economic globalisation, there should be stronger

interest in the realisation of digital regional and global currencies. Although trade in East Asia is currently temporarily stagnant due to COVID-19, economic integration such as building supply chains has progressed for the past half century. Financial integration, on the other hand, has been delayed. The currency used for international transactions is still largely the US dollar. East Asian countries have become more resistant to currency crises, including the enhancement of Chiang Mai Initiatives since the 1997 Asian crisis, but remain vulnerable. In particular, as the US dollar still plays the role of the region's main trade invoicing currency, East Asian economies continue to be heavily affected by US monetary policy. The introduction of a digital common currency could hence be a driving force in promoting integration, although there still remain difficult tasks.

## A key quote from the article

*Using current digital technology, the issuance of an Asian common digital currencies is relatively simple. We need an international organization to supply a common currency. For example, it is possible to use something like AMRO, which was established in the ASEAN+3 as the secretariat of the Chiang Mai Initiatives. One of the main roles of international organisations would be to issue Asian common currency bonds, which are backed by central banks to issue digital currencies denominated in Asian common units. International organisations buy government bonds from central banks and issue Asian common currency bonds. In this way, the issuance of Asian digital common currency would also contribute to the development of the Asian bond market. Another role of international organisations would be the production of the Asian digital common currency (ADCC) as an electronic medium and its transfer to central banks. This process would hence be similar to how central banks today receive physical banknotes manufactured at the printing bureau. The buying and selling of government bonds and Asian common currency bonds would, of course, be digital, and the distribution of electronic wallets, and so on would be done digitally, not to say that the Asian digital currency itself would of course be digital.*

The full and original article first appeared on [VoxEU](#) on the 16th October 2020.

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# Project Syndicate: The Key to the Productivity Puzzle

Although the factors contributing to stagnant productivity are well known, economists and policymakers paid little attention on how to address these problems in a coordinated way. But the need to deliver broad-based prosperity is more pressing than ever, and this shortcoming must be rectified without delay, writes Diane Coyle for Project Syndicate.



Source: istock

## Policy coordination is critical for seeking best results

In a 1996 lecture entitled “Big Bills Left on the Sidewalk,” the late Mancur Olson made a powerful observation: an individual from a poor country – say, Haiti – who migrates to a richer country like the United States immediately becomes vastly more productive and earns a far higher wage than before. The individual has not changed overnight, so their skills or cultural attitudes cannot explain their improved situation. The answer must instead lie in their new country’s environment.

Olson therefore concluded that many (or most) economies are not socially efficient. A better institutional and social context, and higher stocks of assets from past investments, can make an enormous difference to individuals’ productivity, and hence to their living standards.

The challenge, as Olson pointed out, is that individuals cannot change the overall context in which they live and work, except by moving elsewhere. The improvements needed to raise an entire economy's productivity require coordinated, collective action. Olson's own well-known research on the logic of collective action explored why this is so difficult to achieve.

Unfortunately, Olson's "big bills" insight about the need for coordination rarely features in the current productivity debate. Instead, the discussion – whether of why output per worker hour has been virtually flatlining in many OECD countries since the mid-2000s, or of which targeted policies might help to revitalize left-behind towns or regions – has focused on numerous potential contributory factors, rather than the need for coordinated action.

For example, policymakers typically undertake cost-benefit appraisals of potential infrastructure investments on a project-by-project basis. But the returns to any project will be affected by other decisions, both private and public. If a new railway line opens, will local bus timetables change to coordinate people's journeys? Will developers build houses nearby, and will other government agencies open schools in the area? Absent coordinated decision-making, investing in new projects where more of the other pieces are already in place will generally look like the better value-for-money option. Unfortunately, government agencies appraising projects are rarely tasked with conducting a holistic survey of the policy landscape.

## **Economists and policymakers should address these issues together**

Regional or local low-skills traps present a similar problem. If there are no high-paying jobs in a particular area, then individuals have no incentive to invest in their own education. And if the local pool of available skilled labor is small, employers have no incentive to open offices or factories there. The only option for people who want to move up is to move out.

Such examples have now attained almost motherhood-and-apple-pie status among economic researchers, given the widespread acceptance that "institutions" are important for growth and development. But economists need to connect their analysis with an understanding of the political potential for change, the sociology of organizations, and the psychology of decision-making. Simply urging regions to "be more like Silicon Valley" is useless. The challenge for researchers and policymakers is to understand – in each specific context – exactly what coordination is needed to increase productivity, and what actions (and by whom) can achieve this.

Vast inequalities between places, and therefore in people's life chances, are a critical political issue almost everywhere, as election upsets and increasing polarization in recent years clearly indicate. Moreover, the COVID-19 pandemic, the likelihood of economic turmoil owing to extreme weather or civil conflict, the existential requirement of shifting to a zero-carbon economy, and widespread digital disruption will make delivering broad-based prosperity an even more pressing imperative.

Although the obstacles to increased productivity are nearly universal, the solutions will be specific to each place and reflect its asset legacy, industrial history, location, and local politics. There is no science – yet – regarding what kinds of decisions need to be taken at different levels of government, or how to coordinate choices across departmental silos and budgets. (That is why these issues are central to the agenda of the United Kingdom's recently established Productivity Institute.)

Nobody would be surprised that the factors contributing to low or stagnant productivity include lack of investment in physical and intangible assets, skills shortages, inadequate infrastructure, poor management, and a weak macroeconomic environment. More surprising is the lack of attention paid so far to finding a recipe that addresses these problems in tandem. Economists and policymakers must begin to rectify this without delay.

The full and original article first appeared [here](#) on Project Syndicate on 13th October 2020.

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## Project Syndicate: Who's afraid of rules-based monetary policy?

The US Federal Reserve this year has announced a fundamental change in its overall strategy. Yet in doing so, it has unnecessarily introduced more uncertainty into the policy mix, setting a bad example for the world's other major central banks, writes John B. Taylor for Project Syndicate



Fed Chair, Jerome Powell

### The Fed's new approach adds unnecessary uncertainty

Many of the world's central banks have been formally reviewing their monetary-policy strategies in light of Covid-19 and the experience leading up to the pandemic. Unfortunately, they appear to be drawing the wrong lessons from the challenges they face.

One of the first to complete this process was the US Federal Reserve System, which decided to move to a new “flexible form of average inflation targeting,” as Fed Chair Jerome Powell described it in a speech at the annual Jackson Hole monetary-policy conference in August. Similarly, European Central Bank President Christine Lagarde recently told the annual ECB and Its Watchers XXI conference that the ECB is in the middle of its own “monetary policy strategy review.” And according to Bank of Japan Governor Haruhiko Kuroda, there are ongoing discussions with the new government of Prime Minister Yoshihide Suga about how to deal with the pandemic and whether a

new monetary-policy strategy is in order.

In light of these discussions, it previously looked like there was a move underway to reform the entire international monetary system, with each country or region following a strategy similar to the Fed, though attuned to its own circumstances. But it no longer looks that way. “At the very least,” argues Otmar Issing, a former chief economist and member of the ECB Board who was largely responsible for charting the original course of ECB policymaking, “other central banks should not blindly follow the Fed’s new strategy.”

Issing is not alone in seeing problems with the Fed’s new approach. In early September, Robert Heller, a former Federal Reserve governor, argued in a letter to the Wall Street Journal that the Fed should “not target an average inflation rate of 2%.” Then, at a virtual conference convened by Stanford University’s Hoover Institution this month, Charles I. Plosser, a former president of the Federal Reserve Bank of Philadelphia, and Mickey D. Levy of Berenberg Capital Markets criticized the Fed for not being specific about the timespan over which average inflation will be measured. Is it one year or several years?

Powell himself acknowledged this lack of specificity at the Jackson Hole conference in August. Noting that “we are not tying ourselves to a particular mathematical formula that defines the average,” he added that, “Our decisions about appropriate monetary policy ... will not be dictated by any formula.” Then, in a press release the same day, the Fed’s Board of Governors explained that policy decisions would be based on “assessments of the shortfalls of employment from its maximum level” rather than by “deviations from its maximum level,” as had been previously stated.

But whether the focus is on “deviations” or “shortfalls,” this new approach adds unnecessary uncertainty, because shortfalls are not defined. Moreover, there is no mention of how monetary policy will be used to generate higher inflation to make up for periods when inflation is less than 2%. Is the Fed considering additional changes in its procedures beyond the current mix of near-zero interest rates and large-scale asset purchases?

## A rules-based approach would still be preferable

In adopting this “flexible” approach, the Fed seems to have shifted away from the more strategic, rules-based policy that it had been pursuing at least since 2017. As of this summer, its Monetary Policy Report no longer includes material on monetary-policy rules, whereas the previous six reports going had featured a whole section in which different rules were presented and compared with actual scenarios. Among the rules considered were transparent settings for the Fed’s interest-rate policy, including the so-called Taylor rule, a price-level rule, and a modified Taylor rule to deal with the zero bound.

It is understandable that Issing and others would be reluctant to go along with the Fed’s less strategic, discretionary approach, especially when there are alternatives that other central banks can pursue. Rather than casting about for something new or simply different from the Fed, they can embark on the same rules-based-policy path that the Fed itself was on before the pandemic struck.

In fact, this would be easier done than said. When I first developed the Taylor rule, which has been widely discussed for three decades now, I based it on an average inflation rate. But, unlike the vague definition that the Fed has now adopted, I explicitly defined the “average” as “the rate of



inflation over the previous four quarters.” In other words, the Fed could still switch to an average-inflation approach and yet be far more specific than it has decided to be.

Moreover, the formal policy rules previously listed in the Monetary Policy Report all have variables to account for factors other than the inflation rate, such as the unemployment rate or the gap between real and potential GDP. These variables could be included in the current strategy without neglecting the inflation target, as could policy rules to deal with asset purchases and their eventual unwinding. Developing such an approach would not be difficult for the Fed to do, especially if other central banks also chose to go in this direction.

A decade ago, I wrote a paper with John C. Williams, now the president of the Federal Reserve Bank of New York, titled “Simple and Robust Rules for Monetary Policy,” in which we emphasized the importance of rules-based policymaking. And there are reams of additional studies showing the benefits of rules-based monetary policy. That is why so many distinguished monetary scholars have endorsed this approach.

It is promising that the ECB and other central banks often use the word “strategy” when describing their own monetary-policy reviews. A strategic approach is necessarily a rules-based approach, which is precisely how the international monetary system should be run.

The full and original article first appeared on Project Syndicate [here](#) on 16th October 2020.

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# Project Syndicate: Minding the digital economy's narrowing gaps

By collapsing physical distance, the digital economy has overcome one of the largest hurdles to market formation and efficiency. But data-driven digital markets come with their own unique informational challenges, demanding further innovation not just by entrepreneurs but also by policymakers, writes Michael Spence for Project Syndicate



Source: Shutterstock

## Online marketplaces pose additional information issues

Informational asymmetries between buyers and sellers have long been known to impair market performance. But thanks to digital technology and the large, accessible pools of data that it generates, these informational gaps are closing, and the asymmetries are declining.

Until recently, market formation has been circumscribed by physical and geographical boundaries. A prerequisite for a market to form is that buyers and sellers are able to find each other, and this process has traditionally been accomplished in physical spaces like bazaars, stock exchanges, stores, or dealerships (albeit with intermediaries using phones and fax machines to facilitate transactions). Things started to change with eBay, the original model for many online marketplaces. Suddenly, geographical boundaries no longer operated as insurmountable barriers between widely dispersed buyers and sellers.

Arguably, freeing markets from geographical constraints has had the greatest impact on market access for remote populations. In many places globally, and for subsets of potential consumers

everywhere, online channels can be the only practical option for accessing a wide range of goods and services, including primary health care and education. This applies to both the demand and the supply side. And because consumers enjoy expanded access to goods and services, sellers and producers can scale up dramatically to meet the increased demand. In China, for example, the digital expansion of the potential market for small and medium-size enterprises was a major impetus for much of Alibaba's development, demonstrating how digital technologies, together with the rapid growth of the mobile internet globally, can drive more inclusive growth patterns.

As online marketplaces developed, however, it soon became clear that additional information issues would need to be addressed for these markets to function effectively. For example, because it is difficult for buyers to detect variations in quality among sellers and among goods and services offered online, more information was needed to capture the reliability or trustworthiness of market participants. The problem is essentially the same for both buyers and sellers, with the former worrying about receiving what she pays for and the latter worrying about being paid.

It is precisely this kind of bilateral information asymmetry that prevents market formation or limits market exchange in the first place. Hence, a number of digital-payment platforms initially were created to address online markets' fundamental "trust" problem. Following the model of escrow systems that are familiar in real-estate transactions, e-commerce platforms created intermediaries that they hoped would be trusted to collect and hold payments from buyers until delivery of the goods or services had been confirmed.

In the case of Alipay in China and Mercado Pago in Latin America, these systems were initially designed to accelerate the uptake of e-commerce platforms, but over time evolved into mobile-payments systems used offline and throughout the entire economy. This process is very advanced in China, while cash continues to hold on in Latin America. Not only have these systems yielded a growing trove of tremendously valuable data, but they have also allowed market-making platforms to become more powerful with each transaction, as the data accumulates. Ratings of sellers (and sometimes buyers) and products are now a common feature of online marketplaces, and studies indicate that they are highly influential in buyer decision-making. But for this function to serve its proper purpose, the platforms needed to develop additional systems and safeguards to prevent ratings manipulation, and to stop banned users from reappearing under a new handle. Thus, in addition to closing information gaps, ratings also create incentives for market participants to behave better.

## Digital gatekeepers must be trusted too

As more and more "stuff" appeared in online marketplaces, users started having difficulties finding what they were looking for, because they could not browse through options in the same way that one does when shopping in a physical store. To address this issue, online platforms developed search algorithms and recommendation engines based not only on individual users' browsing and purchase history, but also on behavioral data from all other users. These algorithms have been further improved by advances in artificial intelligence and increases in the volume and quality of data. Search and recommendation engines are a partial solution to the "matching problem," and thus a key source of online market performance. They add value for both buyers and sellers, and boost transaction volume substantially, especially for lesser-known sellers and brands.

Moreover, because it is widely available and inexpensive to access, online information has reduced information asymmetries beyond the realm of e-commerce. For example, markets in automobiles,

health care, and insurance have also been transformed, even in the offline world, leaving consumers better informed and more empowered vis-à-vis sellers. A final informational challenge relates to access, specifically giving consumers accessible online identities and tracking records that signal their attractiveness as counterparties in a variety of market settings.

Credit is a good example. In the offline world, people and businesses have track records and financial histories that hypothetically could be used to underpin credit or insurance markets. The problem is that these offline records tend to be scattered and inaccessible, whereas in the digital economy – especially following the high penetration of mobile payments and e-commerce – they become easily retrievable and far more useful. Like knowledge, data is non-rival: using it does not diminish its value for further use or for use by multiple parties.

AI algorithms can be deployed to assess and price credit for people and businesses with no collateral and little prior contact with the traditional non-digital economy and financial sectors. As in platform-based evaluation systems, informational gaps are reduced and incentives are improved, while market access is expanded for households and small businesses. In short, data-driven digital markets have evolved from struggling with informational gaps to having higher informational density than their offline counterparts, leaving fewer information gaps and asymmetries. The accessibility of digital data allows for new screening mechanisms and signaling behavior that are frequently missing in the offline world. Of course, highly accessible stores of data come with their own real and much discussed risks, and these must be addressed in order to achieve the potential efficiencies and inclusivity benefits on offer.

After all, the institutions (including governments) that collect data and act as digital gatekeepers must be trusted, too. At a minimum, they must be subject to enforceable regulation that provides clear definitions of individuals' rights with respect to transparency, data use, privacy, and security. Here, arguably, we are making progress, but we still have a long way to go.

The full and original article first appeared [here](#) on Project Syndicate on 30th September 2020.

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## The feeling of scarcity

At some point, there will likely come a time when we face the prospect of being scarce of something. This may range from money, food, time or any such limited resource. How we manage to be short of resources can be as problematic as the scarcity itself. Here, we look at how thought processes are impacted by scarcity and how this may stifle rational thinking



Source: Shutterstock

A young mother is working remotely at home while a daughter is hugging her

With more people now than ever working from home, traditional office hours are becoming a thing of the past for some. It's not uncommon to hear those who have kept their jobs say they work longer hours now than they did before the lockdown. Evidence supports this.

[Microsoft](#) has found that 54% of parents in a survey of six countries said it's been difficult balancing household demands while working from home while [LinkedIn](#) research alongside the Mental Health Foundation found that those working from home during the pandemic are racking up an extra 28 hours of monthly overtime since lockdown began.

This amounts to almost an additional four days' work per month. For those working from home, managing their time can be difficult because it is scarce. And precisely because it is scarce, they may not manage their time well.

## Defining scarcity

Scarcity is defined in the Oxford English dictionary as “insufficiency of supply”.

When it comes to economics, however, the term has a slightly different sense. The influential textbook on Economics by Greg Mankiw defines [scarcity](#) as the limited nature of society's resources and economics as the study of how society manages its scarce resources. This subtle, yet important change, leads to discussing topics such as efficiency, equity, rationality and opportunity cost.

Another twist to the definition of scarcity was introduced by behavioural economist Sendhil Mullainathan and psychologist Eldar Shafir's in their 2013 book, “[Scarcity: The true cost of not having enough](#)”. They argue that scarcity is more than a physical event. It has psychological effects. They argue: “Scarcity is more than just the displeasure of having very little. It changes how we think. It imposes itself on our minds.”

If Mullainathan and Shafir are correct that scarcity changes the way we think, this has important implications for both traditional and behavioural economics.

## Scarcity affects decision making

Mankiw's textbook argues that “Rational people think at the margin”. This is one of Mankiw's ten principles of economics. Rational people are those who systematically and purposefully do the best they can to achieve their objectives.

People who are more inclined towards a behavioural approach to economics have long argued the traditional idea of rationality used in economics – homo economicus – is flawed. A common rebuttal is that people think either fast or slow – instinctively or deliberately. This idea provided the title of the book by economics Nobel prize laureate Daniel Kahneman, “Thinking Fast and Slow”.

Mullainathan and Shafir go further. They argue that scarcity is not just a physical constraint but also that it changes the way that people think. Even slow and deliberate thinking systems can be compromised. They write: “As the psychologist Daniel Kahneman would say, scarcity captures the mind both when thinking fast and when thinking slow.”

It is important to recognise that scarcity is not simply an accounting concept. It is an emotional response. People exposed to scarcity feel they are rushed even if they may not be. As a result, they narrow their thought processes leading to a tunnelling process that focuses on one objective while ignoring wider effects. The feeling of scarcity means that they have little mental bandwidth to concentrate in a way that allows either rational or slow and deliberate thought.

## There is plenty of scarcity

Scarcity affects almost everyone. Various experiments show that when people are placed into an environment where a particular item is scarce, their decisions differ from those who are placed into the same environment but with a relative abundance of the same item. This is irrespective of their background.

Typically, the items that can be controlled in these experiments are money and time. Interestingly, those who have plenty of money but are so busy that time becomes scarce, appear to make decisions when it comes to time that echo the monetary decisions of those for whom money is

limited.

Many of us would have seen it or experienced it. When time is tight, meetings may be booked back-to-back throughout the day or week. Unfinished work is pushed to the end of the day, creating long working hours and exhaustion. You turn up late to the restaurant for dinner with friends despite guaranteeing them that you would be on time. They are already on the main course and annoyed with you.

These time allocation problems are similar to the monetary allocation problems seen for those for whom money is tight. Bills are not paid on time so they are delayed, risking late payment fees or default. You may have borrowed money from a friend or family member just to tide you over until pay day but an unexpected bill arrives and you pay your friend back late.

## Managing scarcity

The easy answer to managing scarcity is to have more of what is scarce. But that is tautology. The required item would not be scarce if there was more of it. Therefore, the scarce item must be identified and managed.

When it comes to time, Mullainathan and Shafir recommend that having external factors force a change in how time is used. They cite the example of the assistants to busy executives who interrupt meetings five minutes before the end to let everyone know that time is almost up and then deliberately close the meeting five minutes later as an example of an external force. A day each week deliberately set aside to meet with family and others, such as followed by some religions, is also cited as another example.

It can be more difficult with money. Using auto payments to ensure bills are paid on time and budgeting expenditure to ensure it is spread evenly so you do not run out of money before you are next paid can help. But when money is very tight, this may not be possible. Difficult choices may be unavoidable and persistent.

## Scarcity and pandemic

You could dismiss those complaining about the pressures of working from home as people who are poor at managing their time.

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*The Institute for Fiscal Studies in the UK has calculated that during the pandemic, mothers combine paid work with other activities (almost always childcare) in 47% of their work hours, compared with 30% of fathers' work hours*

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For some, they may truly have less time because working from home allows others to place an extra call on their time. Parents, especially women, with children may face this problem. For example, the Institute for Fiscal Studies in the UK has calculated that during the pandemic, mothers combine paid work with other activities (almost always childcare) in 47% of their work hours, compared with 30% of fathers' work hours.

For others, the pressures of working from home and the difficulty of allocating their time may have changed the way they think about it. An external intervention allowing them to change the way they make decisions may be necessary. And as experiments have suggested, nobody is immune to the effects of scarcity.

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