

# Asleep at the Wheel: The Real Interest Rate Experience in Australia

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*Abstract:* Real interest rates have been unsustainably high in Australia for a generation, yet it seems no one has noticed. A most important change has gone unmonitored. Historically high real interest rates, examined here in terms of the variable housing loan rate, now exceed increases in the returns from production and complicate remediation of pervasive problems. Significant external problems have arisen as the nation has expended more than it produced, and borrowed to service the gap. Issues raised in this paper deserve critical attention, and new policies. Constructive dialogues and new thinking are needed if Australia is to successfully move beyond current debts and difficulties.

## I. INTRODUCTION

The message was a simple one: “*that high real interest rates are part of the costs of combating high inflation; reducing inflation and inflationary expectations will reduce those costs*” (Fraser 1991). The Governor spoke: real interest rates are a *manageable* means to the end of low inflation, and expectations are malleable. Such is the position that persists to today.

However, it was the small graph adjacent and the text following that drew attention to some intriguing interest rate *experiences* which apparently contradicted the Governor’s position. Real rates hardly looked manageable: they had been all over the place. Historically there was much variability in real interest rates. Over a 90 year period when the real bond rate averaged about 1.5 percent, rates averaged over five year periods had been as high as 9 percent around the Great Depression and as low as -7 percent during the 1950s (*op cit* p6).

These observations and those reported here challenge much in theory<sup>1</sup>, policy<sup>2</sup> and practical decision making<sup>3</sup>. Put overly-simply, they explain to a considerable degree why your parents

<sup>1</sup> specifically, that which makes particular assumptions about the constancy and limited impacts on those in the economy of real interest rates.

<sup>2</sup> which has put “fighting inflation” first, whatever the cost it seems.

<sup>3</sup> which for most people is accepting the rates on offer from the banking oligopoly or related financiers. This is especially so for long term investments where personal circumstances, classically family or small business formation, drive decisions rather than some “rational” calculus built upon an assumed ability to costlessly delay or advance decisions.

prospered financially and you have not. An accident of birth (be it of a person or company) can provide fortunate to markedly adverse interest rate circumstances with widespread impacts.

Real interest rate observations are the focus of the first part of this paper with some reflections and provocations then offered as a stimulus to dialogue. The simple message here is: *that neglect of real interest rates and their impacts has imperilled much in Australia.* New ways forward are needed if the problems emanating from unsustainably high real interest rates are to be addressed.

Analysis is of real interest rates *experiences* over periods from 5 to 30 years using moving averages. The Australian variable mortgage rate is used as it represents the condition experienced by the majority of the population.<sup>4</sup> This rate is also the one for which the longest time series is easily available, going back to 1949. We follow Fraser in calculating rates as the difference between the nominal (or quoted) interest rate and the rise in prices for the previous year as measured by the Consumer Price Index.

In keeping with the intent of this section of the Journal, the paper has been written so as to be broadly approachable and provocative. Many comments are phrased simply, with few qualifications offered in the text. A number of footnotes are used to raise some issues and briefly explore related matters. As with any “sweeping” statements, much is caught up “in the pile” but, while the mix needs some further sorting and tidying, overall findings seem robust and challenging.

Real interest rates deserve informed and energetic dialogues. To neglect them is to avoid a key influence on outcomes in an economy. Global crises provide a compelling reason to act. Untoward movements in real interest rates appear to have been significant contributors in the development of many current problems. It is time that past neglect and misinformation were remediated.

*The reader will readily appreciate that the problem here under discussion is a matter of the most fundamental theoretical significance and of overwhelming practical importance... (Keynes 1936 p 184, completing his discussion of the classical theory of interest.)*

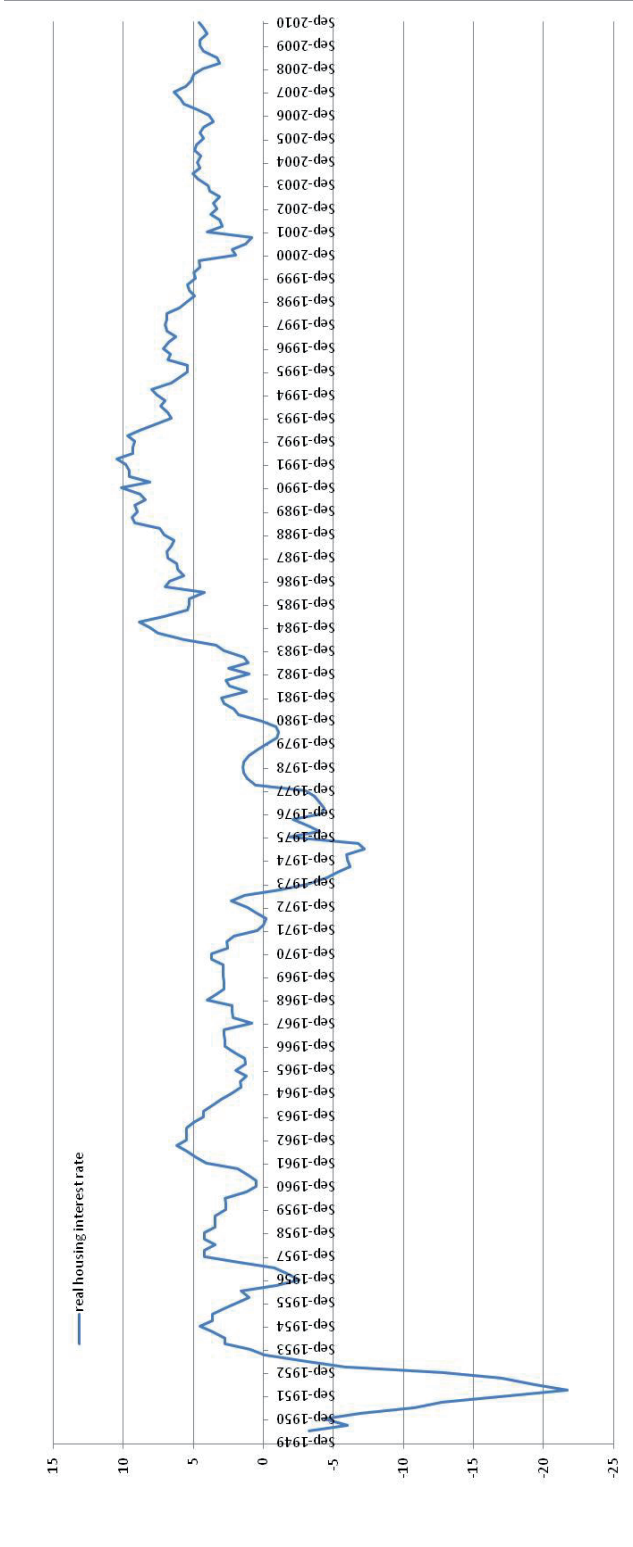
## II. THE AUSTRALIAN REAL INTEREST RATE EXPERIENCE

Real interest rates for housing since 1949 are shown in *Figure 1*. Values are variable home mortgage rates as at the end of each quarter less the inflation rate over the previous four quarters. Considerable volatility is obvious with some broad trends. Most apparent is the general rise in real rates from 1974 to 1991, topping at over 10 percent per annum. Rates then reduced, bottoming in 2001, before returning to around 4 to 6 percent.

It is the effect on a long term investment that is of particular interest. Referring to *Figure 2*, the rising (blue) line indicates the average interest rate applying over the life of a loan that *completes* in the reference year. Thus the 1988 rate is the average over the thirty year life of a

<sup>4</sup> The cash rate is seen as a reference rate and is the most commonly quoted rate. However a variety of margins are added, with (usually) low margins for governments (the bond rate), medium margins for home loans (the mortgage rate), and higher rates for small business and other “risky” borrowers. Unsecured credit cards generally attract the highest rate. Generally these various rates are assumed to move with the reference rate but empirically the story is much more interesting. However, that story must be left to another place.

Figure 1: Real Housing Interest Rate, Australia



**Notes and Sources:**

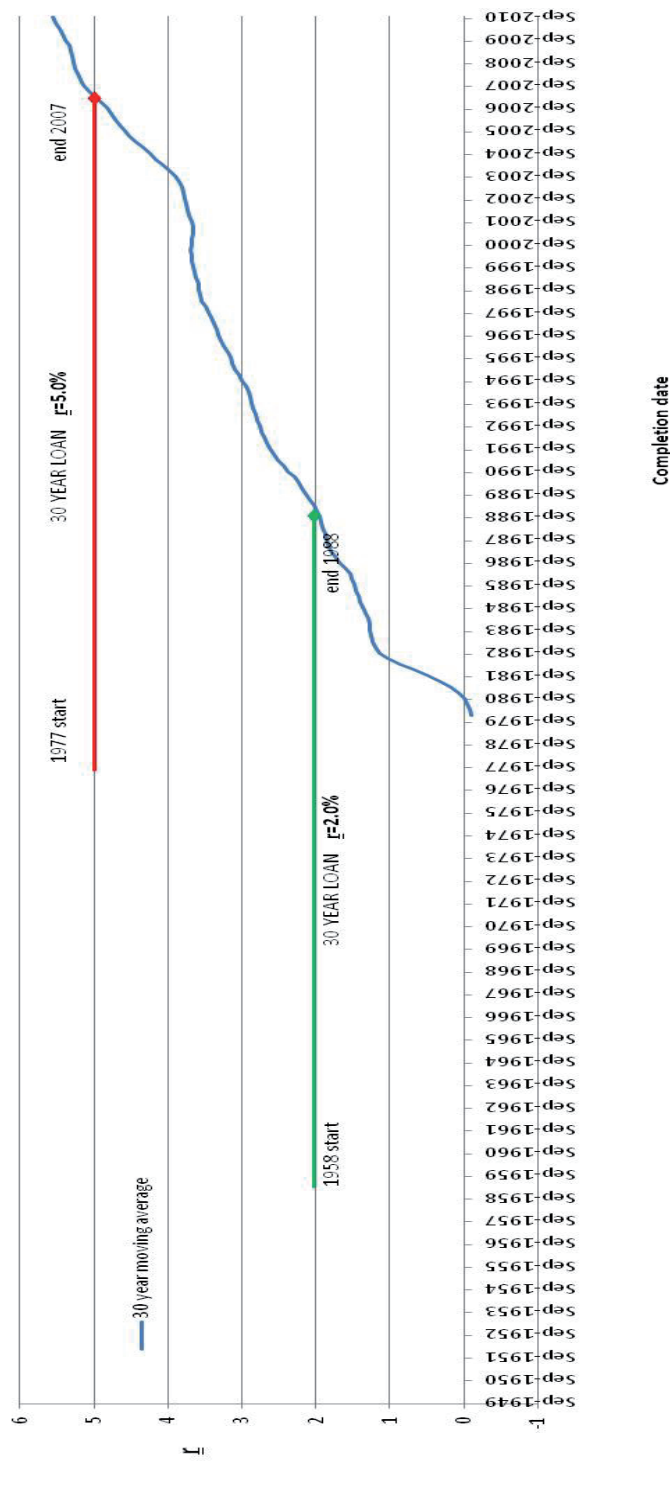
Real interest rates have been calculated as  $r = i - CPI$  where

$r$  is the real interest rate (after adjustment for inflation)

$i$  is the nominal interest rate (ie, the variable rate actually charged by the bank or other lender for housing), sourced from RBA f05hist and 3-21a. Rates used are those at the end of each relevant quarter.

CPI is the consumer price index for the corresponding period, with quarterly figures sourced from ABS 640107.

Figure 2: Real Interest Rate, Housing Australia: 30 Year Moving Average  $\bar{r}$



**Notes:**

The thirty year moving average  $\bar{r}$  is calculated as a simple average of the 120 rate observations that would apply over the term of the loan.

No attempt to indicate the effects of changing loan balances so these can be considered directly as “interest only” loans. Such adjustments made elsewhere in illustrative calculations indicate a worsening of the pattern for some borrowers (those with low initial repayments) and ameliorating it for others (who can reduce the initial principal quickly).

Loans for 1990:2020 could be expected to have a lower  $\bar{r}$  if future  $\bar{r}$  remained around 4%, but it seems “unusually uncertain” what will happen to real interest rates over the next decade.

**Sources:** as for Figure 1.

loan originated in 1958, this average being indicated by the straight (red) line. It is clear that 30 year loans that followed the available variable interest rate have steadily become more expensive to the borrower, **rising in real terms** from 2.0 to 5.5 percent between 1958:1988 and 1980:2010 investments. Such a pattern involves a rising impost on borrowers.

Estimates for shorter terms of 20, 10 and 5 years have also been calculated and are shown in *Figure 3*. While the details of the patterns vary in interesting ways all clearly demonstrate the 1970s dip and subsequent rise in real interest rates. All loans completing in 2010 carried real interest rates above four percent. Note also that the higher peak rates for the shorter-term loans<sup>5</sup>.

Obviously *care* must be taken in interpreting such simple moving average calculations, especially since the principal on which interest is charged can vary over the term of the loan. Those who could pay down principal early in the life of a loan would be doubly advantaged: they would benefit from the usual gains from reducing the balance outstanding and they would also be less exposed to the upward creep of rates. Those maintaining the principal for some time<sup>6</sup> or borrowing against their account in its later stages<sup>7</sup> would be doubly disadvantaged. Clearly, there is some fascinating research to be done in this area, including as to the actual and stereotypical generational experience of current and past homebuyers.

The ability to meet obligations is broadly indicated by the GDP growth rate. Unfortunately, as illustrated in *Figure 4*, GDP underperformed real interest rates almost every year since 1981. While GDP growth rates generally exceeded borrowing rates during the 1960s and 1970s, since 1981 the situation has reversed. Averages over 20 years in *Table 1* show the marked nature of this reversal.

*Table 1: Average Growth and Real Interest over 20 Year Periods*

Period		Growth			Interest
Starts	Completes	GDP(E)	GDP(I)	GDP(P)	r real
Jun-1960	Jun-1980	4.1	4.0	4.0	0.7
Jun-1970	Jun-1990	3.2	3.2	3.3	2.1
Jun-1980	Jun-2000	3.4	3.3	3.5	6.3
Jun-1990	Jun-2010	3.3	3.1	3.1	5.5

Notes:

GDP(E) Total all industries; Gross domestic product – Expenditure based: Chain volume measures – Percentage changes

GDP(I) Total all industries; Gross domestic product – Income based: Chain volume measures – Percentage changes

GDP(P) Total all industries; Gross domestic product – Production based: Chain volume measures – Percentage changes

r real Real interest rate housing, annual basis.

Sources: As for *Figure 4*.

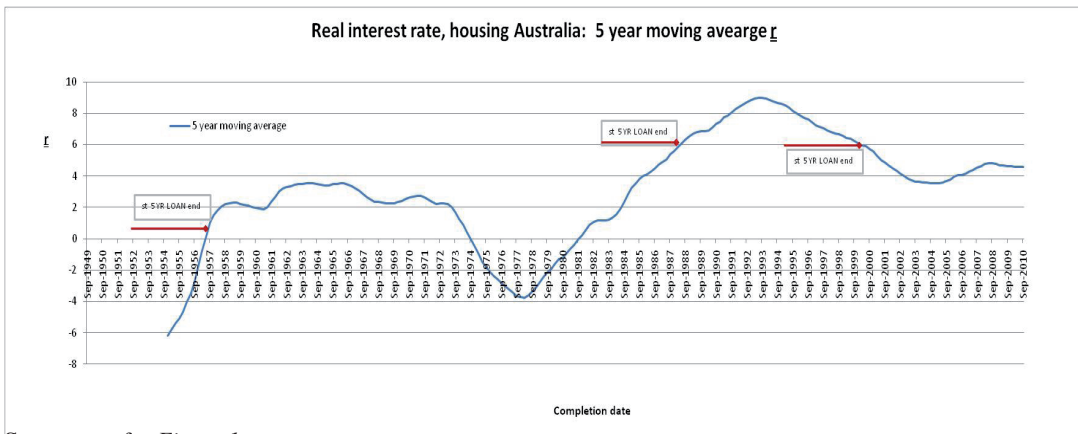
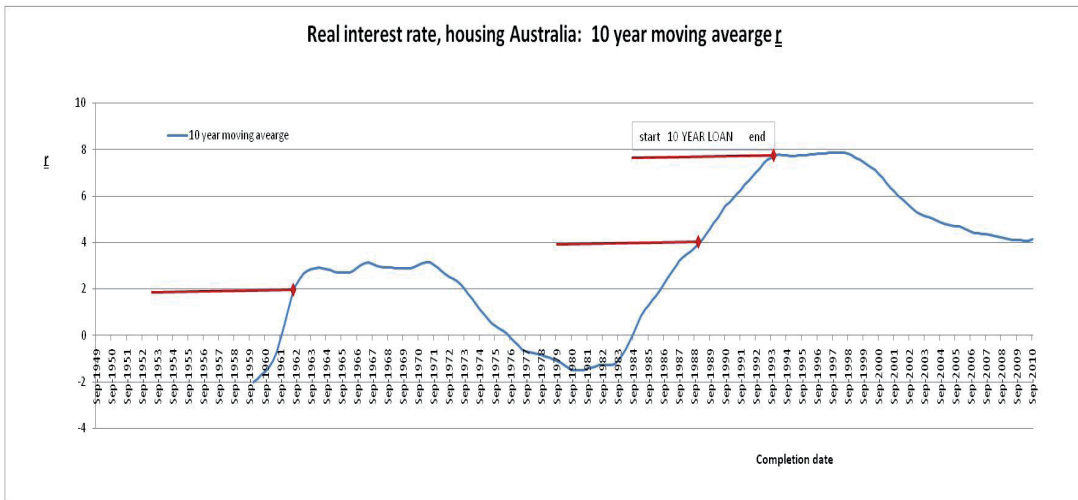
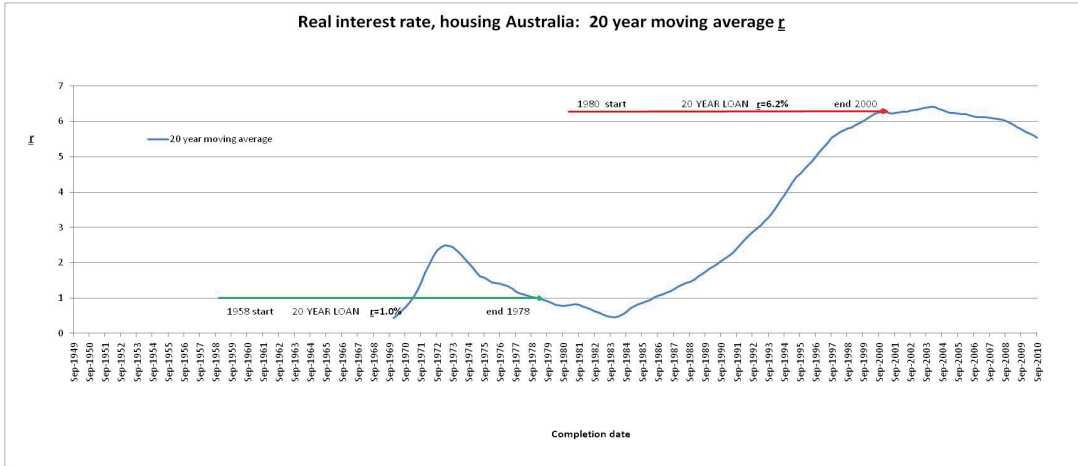
Those households and businesses whose incomes rise in line with GDP were once able to “grow ahead”. Now their debts accumulate or they need to fund debt repayments by reducing other expenditures. This pattern is not an occasional monetary policy squeeze but

<sup>5</sup> due to the omission from the moving average of earlier lower rates

<sup>6</sup> either while accumulating additional interest or having a teaser introductory rate with higher rates later

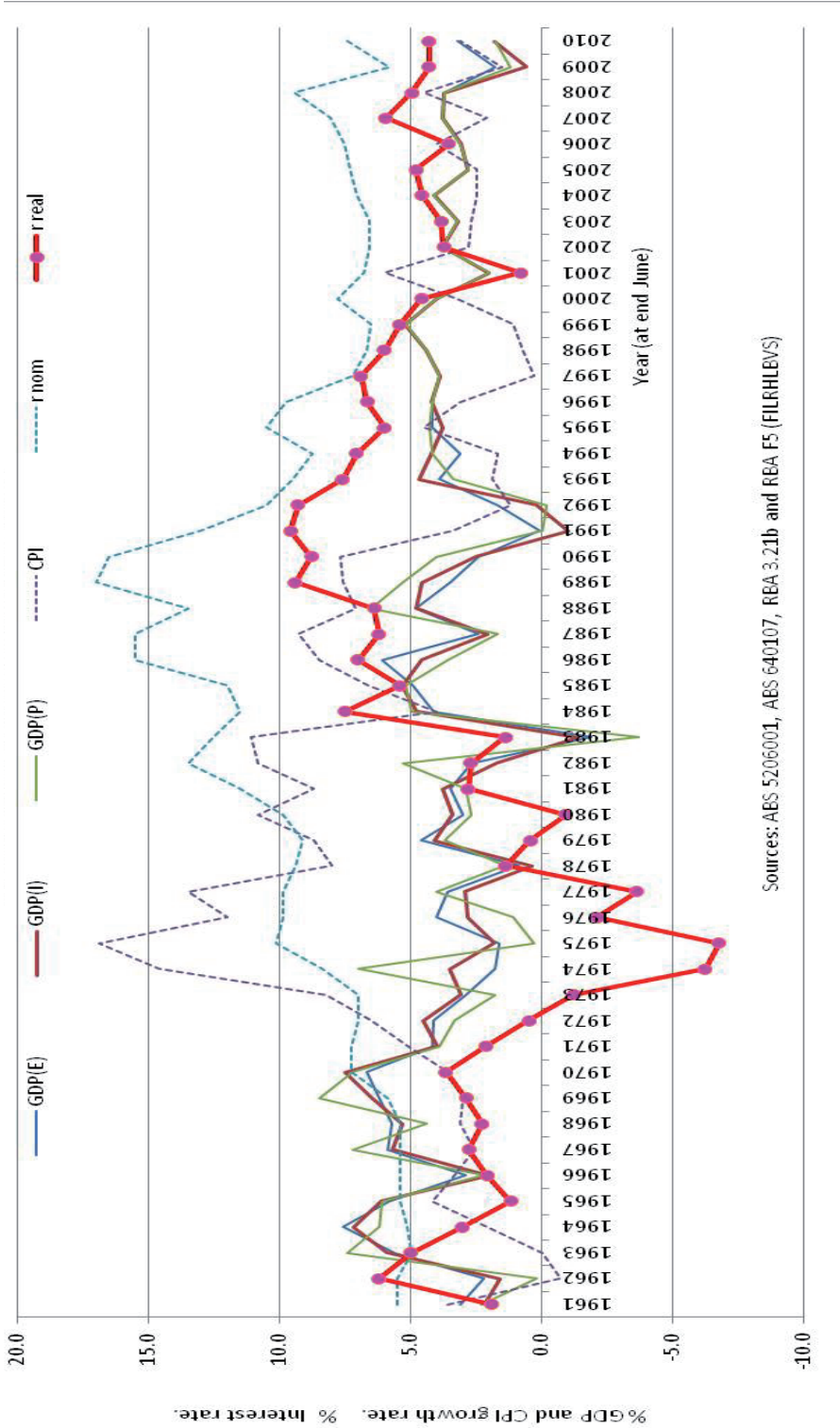
<sup>7</sup> as in promotions to borrow for a holiday, car or whatever against the home loan.

Figure 3: Real Interest Rate, Housing Australia for 20, 10 and 5 Year Terms



Sources: as for Figure 1

Figure 4: GDP, Interest Rates and CPI, Australia 1961 to 2010



Sources: ABS 5206001, ABS 640107, RBA 3.21b and RBA F5 (FILRHLEVS)

one that has incessantly shaped the (lessened) fortunes of a generation with businesses and households both vulnerable. Governments did act to reduce nominal taxes<sup>8</sup> (and services) so those agencies with real capital responsibilities (particularly in the States in Australia) were particularly squeezed.

### III. REFLECTIONS, AND PROVOCATIONS

The implications of such calculations are considerable and, perhaps, profound. Many questions arise and much may be explained by these generational changes in what is arguably the central price in the monetised economy. Following de Bono (1973; 1986), provocations can improve thinking. As an immediate goal is to question our thinking about problems, several provocations are now offered as part of some reflections on the implications of the previous analysis. Obviously, the calculations are simple – and so are the implications about the need for fundamental rebalancing.<sup>9</sup>

Achieving such real interest rate rises has been no mean feat. It is not just the level of the achievement that is impressive but also that it was achieved when monies and credit were plentiful as naive market analysis would indicate falling prices for monies then<sup>10</sup>. Perhaps monies were so plentiful since returns were so good?

That no one seems to have noticed is even more stunning. Provocatively, has this been the heist of the Australian centuries? Not since rum currency days has banking been such fun. Where were the regulators, and of what were they dreaming? In this modern Australian Dreamtime, Giddy-up the Frog drank deep from the Billabong, but slowly so those on watch remained unaware of the receding waters available to them, and their children.

After all, we are talking “big money”. Each change in an interest rate involves a change in the preferential allocation of monies. A one percent rate change involves a \$10 transfer for every \$1000 in principal, or \$10b on a \$1t debt. Repeat this over the years and transfers multiply, and if earlier real interest rates applied today the annual interest impost would be more than halved.

Fundamentally, the issues are not only ones of balances but also of balance. Of course monies may have a price, but what is a fair price? This question is one that should guide those who seek to rebalance debt arrangements in Australia.

A second is “what is a fair contract?” Earlier loans were not only at lower rates but rates could often be locked in for the life of the loan. Under such circumstances, with an interest rate agreed for the life of the contract, it does seem reasonable that the borrower might personally underwrite the obligations. Today, the lender has the right to vary the interest rate unilaterally so having full recourse to the incomes and assets of the borrower does seem unreasonable. A

<sup>8</sup> potentially freeing up some funds for borrowers to then transfer to the finance sector. Rural drought policy until recently involved direct interest rate subsidies to those eligible, again a transfer via the borrower of public funds to the finance sector.

<sup>9</sup> While further analysis is obviously appropriate, it seems likely that more or otherwise-detailed calculations will change neither the fundamental situation nor the implications.

<sup>10</sup> Raising the market interest rate (seen as a price) while product was readily available confounds naive static competitive market equilibrium approaches. Oligopoly theory appears to offer more potential insights, yet many policy discussants continue talking of making a market assumed competitive simply “more competitive”.



Machiavellian prince would be pleased indeed to enjoy such a fortunate circumstance, and even Shylock did not seek to vary the interest rate at his will. Unlike the Prince, the Merchant of Venice shows a morality.

There is no need to become too Shakespearean about this but a tragedy has unfolded under the recent real interest rate regime. A whole generation and the nation have arguably gone nowhere, despite decades of work. Speculation built with the demise of the affordable loan, an interesting coincidence or perhaps something more? Traders ruled with the popular path to gains one of opportunistic buying and selling rather than the earlier ethos of work, save and prudently borrow.

If this seems too dramatic, reflect on Australian experiences during recent decades. As a brief *Internal example*, consider the unaffordability of infrastructure with growing problems as State and local governments seek to provide needed investments under what can now be seen to be a debilitating and impoverishing financial regime. Further, the debt expenses of businesses and “investors” are tax deductible while those of households<sup>11</sup> and governments are not, skewing real interest rate effects and exacting a considerable subsidy for the advantaged. Vertical fiscal imbalances are then exacerbated for governments in the Australian Federation.

However, it is *external* issues and the ongoing balance of payments problems that will be followed here for two reasons: the growth in balance of payments imbalances has been dramatic and banks now provide much domestic finance using external funds. In terms of the balance of payments there has been:

- only the rare and anaemic surplus on merchandise trade despite these “boom” times and increasingly benign terms of trade over the last decade;
- an annual allocation over \$40b or around 4 percent of GDP needed to service net factor income obligations from abroad;
- fresh overseas borrowings of \$50b or so needed annually *via* the Financial Account as national expenditures exceed product which exceeds incomes; and
- the worsening external wealth situation, with deterioration over four decades now accelerating. Despite two commodity price booms and all manner of supposed fortunate circumstances, Australia has gone backwards while others have not.

Any one of these would be an important issue in many nations around the world. Taken together, monumental collective failure in Australia seems likely.

Fortunately, it’s only money. But even that’s worth less than it was, despite a recently appreciating currency. It was 1974 when the Australian dollar topped out at \$US 1.40 after which it generally trended down, bottoming at 49 cents US in 2001. Approximating parity in 2007 was short lived and who knows what 2011 will bring in the currency markets?

This has immediate relevance as banks now source much funding from overseas. “Unfortunately the reality for us is that we have to raise 30 cents in every dollar that we lend

<sup>11</sup> The household aspect has been picked up in Henry, K. (2010). Australia’s Future Tax System: Report to the Treasurer. Canberra Treasury. However, the whole issue of debt funding and taxation deserves a much more complete treatment.

in Australia” (Steve Munchenberg from the Australian Bankers Association 2010) and the NAB says the average cost of funding has been rising and is expected to continue to rise for the foreseeable future (Curtis 2010)<sup>12</sup>.

Australian financial corporations had a net (stock of) private debt of \$405b at the end of June 2010 following two decades of increasing usage, and exposure (Table 2). This almost ten-fold increase over twenty years for financial corporations represents 77 percent of the total \$590b increase in “Australia’s” liabilities. Intriguingly though, the financial corporation increase is only \$5b between 2006 and 2010 yet credit growth appears to have continued apace over this period.

Going global has clearly been a busy but apparently unrewarding time for private-debt-holding financial corporations now claiming rising costs of funding. Further investigations appear warranted, as they do for the calculated residual net debt item. Just what comprises this needs explanation, especially since there appears to have been a \$100b increase in foreign liabilities in just four years. That’s a \$102,598,000 change in four years *unitemised*.

Table 2: Australia’s Net Foreign Liabilities

At end of	Net foreign debt (NFD)			Net stock		Memo item:			Residual net debt
	Official	Non-official	Total (t)	equity liabilities (NEL)	Total	Net private debt (NPD)			
						Financial corporations	Non-financial corporations	Total (t) corporations	NFDt-NPDt
Jun-1990	-2.6	134.0	131.4	41.5	172.8	42.1	54.8	96.9	34.4
Jun-1994	2.3	168.4	170.8	64.5	235.2	58.5	52.5	111.0	59.7
Jun-1998	6.4	219.4	225.9	68.7	294.6	130.2	50.2	180.4	45.4
Jun-2002	-20.6	342.5	321.9	40.4	362.3	246.0	64.3	310.4	11.5
Jun-2006	-38.4	533.3	494.9	33.8	528.7	397.2	91.7	488.9	6.0
Jun-2010	42.3	629.6	671.9	91.6	763.5	404.6	158.7	563.3	108.6

Note: This table is an extract from the RBA publication with italicised elements added.  
Source: Reserve Bank of Australia (2010)

#### IV. ASLEEP OR DUI AT THE WHEEL? INFLUENCES AND INFLUENTIAL SCRIPTS

Some may remember the 1989 Academy Award winning movie “Driving Miss Daisy” where Hoke the faithful chauffeur not only ferries his charge from place to place but also watches out for her. An image of faithfully “Driving Miss Matilda” is something which I expect many Australian regulators and policy adherents might seek, and some would seem to yearn for a Global Economy Award.

Unfortunately, Miss Matilda may have been “taken for a ride” with her shiny modern economy heading towards the seamy side of town. Perhaps Matilda will end up ruined in the House of the Rising Sun<sup>13</sup> or on the Road of Indolent Penury where dealers offer a quick fix

<sup>12</sup> It will be noted that discussion is here in terms of the costs of funds. Earlier justifications were in terms of matching the announced RBA cash rate changes. Some of the confused comments reported in the media do not appear to appreciate the distinction or its implications.

<sup>13</sup> Opening with “There is a house in New Orleans / They call the Rising Sun/ And it’s been the ruin of many a poor boy/ And God I know I’m one” the song recorded by the Animals in 1964 is part lament for life dissipated.

to settle credit and other cravings.

This would not be the warm and uplifting human story of Miss Daisy. Matilda's story is still running but threats loom as we journey through "Act 2". There is much action amid twists in the plot still to come – but how can we script an uplifting and perhaps Award winning resolution?

How should the driver of Miss Matilda be appraised? More importantly, just what is the role and how well is it being played by the present cast? But even the best actor struggles with an inferior script, and it is economists who have written much of the script for today's Matilda. Suffice it to say that the real twists now revealed were not much discussed in the Economics School most attended. So do we stick to the script and ignore reality, or should we do more and change the script?

There are many fine economic actors we might cast as Hoke. A captain of industry, an outstanding bureaucrat, an inspired analyst or an inspirational politician might be chosen, but Hoke was a humble, competent man. He knew his job and did it well, with a warm humanity helping to guide his actions. At least that's how the writers portrayed him, and how Keynes desired economists to be seen<sup>14</sup>. So perhaps it is suitable team efforts from humble, competent Australians that are needed?

Many today would stick to the existing script. Those imbued in the pop<sup>15</sup> Free Market/Trade/Love? genre and "High-Church" rituals of Rational Discipline, for example, would have Hoke follow the GPS system further and perhaps faster along Reform Road regardless of potholes and the hostile external environment. Disciplined thought is ultimately a Romantic tradition, one which enables observed realities to be subsumed within some transcendent ideal, or externalised as irrelevant.

Just as Wordsworth (1798) could romance the ruins of the sacked Tintern Abbey and "*wreaths of smoke sent up, in silence, from among the trees*" (actually polluted smoke coming from smelting in unhealthy hovels those by displaced and impoverished when the Abbey was suppressed), so also a well-disciplined School economist rhapsodies by romancing "*these beautiful forms*" of the genre (be it "free" market, trade, spirit or some such) while ignoring the displaced, impoverishment and ruin. Hughes (1997) spoke of the Australian experience thus:

*"policy-makers behaved throughout the period since 1984 as sadistically as any Taylor rule would have demanded. Real rates (defined RBA-style1) were 5.95 per cent on average in 1984, and remained each quarter consistently above these levels, 1987–88 apart (when the fiscal-year average was 4.15 per cent), until December quarter 1991."*<sup>16</sup>

<sup>14</sup> "If economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be splendid." Keynes, J. M. (1931). *The Future. Essays in Persuasion*.

<sup>15</sup> Krugman, P.R. (1996). *Pop internationalism*. Cambridge, MA: MIT Press. captures well the debasement of ideas about trade by "pop" influences. For "free", recall the final chapter of Friedman, M. and R. Friedman (1980). *Free to Choose*. Melbourne: Macmillan. where "*we explore why it is that in a supposedly democratic political system special interests prevail over the general interest. We explore what we can do to correct the defect in our system that accounts for that result, how we can limit government while enabling it to perform its essential functions of defending the nation from foreign enemies, protecting each of us from coercion by our fellow citizens, adjudicating our disputes, and enabling us to agree on the rules that we shall follow.*" (p7)

<sup>16</sup> Hughes also comments on the downward reporting bias when rates are falling associated with the RBA method of calculating real interest rates. The Taylor rule essentially involves setting a rate by formula given a target inflation rate and deviations from it along with real and potential GDP estimates while precluding other considerations.

Modern romantic verse in economics idealises the Market rather than the beneficent Nature of Wordsworth. This transcendent influence which resonates harmony is regarded as uplifting of mere mortals. Realities are overlooked as we gaze upon the Ideal, and are moved by it. Obviously markets are important, which makes it even more important to appraise them realistically. A movement in accord with the dictates of Nature or the Market becomes just an inevitable Adjustment. Why should “the Market for Money” be any different?

*“Many of the critical issues in evaluating the relative merits of monetary and fiscal stabilisation arise when individuals are, at least ex post, heterogeneous. Such issues are particularly important in the evaluation of monetary policy. The net effect on consumption arises through changes in the relative price of current and future consumption. Hence, individuals may gain or lose depending on their pattern of borrowing and lending.”*(Quiggin 1997)

In discussing this paper Stephens (1997) essentially seems to ignore this issue and talks of wider things. The heterogeneity of individuals and their “patterns of borrowing and lending” are not malleable in the short run. Yet monetary policy operates within this horizon and essentially assumes sufficient malleability without undue loss. While an individual can choose not to *now* spend or save if conditions are adverse, pre-existing obligations must be met else default eventuates. So, stereotypically food is taken off the table so the house can be kept when adverse conditions arise.

To have the setting of such conditions under the influence of a regulator who also takes a particular interest in the health of the lenders (banks) but not equivalently of the borrowers (households and businesses) has always seemed an asymmetry at best, and a potential source of serious conflicts of interest. Consider this comment by the RAB Deputy Governor:

*At the macro level, there are two issues that arise from the developments in household finances over the past decade or two.*

*The first is that the rise in household debt has made the household sector more sensitive to changes in interest rates. This has meant that central banks have been able to achieve their monetary policy objectives with smaller interest rate adjustments.*

*Second, the household sector is running a highly mismatched balance sheet, with assets consisting mainly of property and equities, and liabilities comprised by debt. This balance sheet structure is very effective in generating wealth during good economic times, but households need to recognise that it leaves them exposed to economic or financial shocks that cause asset values to fall and/or interest rates to rise.* (Battellino 2007)

Yet

*“Australians are confident they have the ability to invest money, yet two-thirds of them would not consider risk and return when choosing where to put their savings...”* (anon citing Australian Government Financial Literacy Foundation 2007).

Both comments which were made at the same time raise very significant issues, but we must move on.

The Adjustment now facing the whole Nation of Australia is harsh and potentially ruinous. Though still avoidable, it becomes increasingly likely as we continue present settings and directions. Australia has so far avoided crisis and austerity though many of the preconditions

are present. Such calamities are needless<sup>17</sup> if we can discern a better way forward, and there are several attractive yet responsible alternatives that should be explored.

Offering such comments is an attempt to provoke reflections on how we economic “scribblers”<sup>18</sup> prefer to view and script the world. The works of economic thought are deep and many, so why do we draw so much from the surface of one or another and so little from so many others? Economics and the policies it informs need richer engagements and more adequate interpretations<sup>19</sup>, not just with foundational ideas and their subtleties but also with important distinctions embedded in pure and applied works<sup>20</sup> and the various genre<sup>21</sup>.

Mirroring this broad challenge there is an immediate challenge: to appreciate more fully the real interest rate experience in Australia and to script how we might improve it. Some surprisingly simple things could be done to great effect, if we refresh our dialogues and the scripts so inspired. Thinking, dialogues and actions all needs revitalisation and re-empowerment for good.

There may be some who find such discussions a bit much and want a simple “take-home” message. Nine words for them are: **current real interest rate trends and impacts are untenable**. Rising external dependencies and further impoverishment appear likely. It’s time we stopped kidding ourselves, scripted better policies and worked together for better national and individual outcomes. Australians will need to take the initiative, and economics can potentially offer much to help guide effective actions. But who will act, or even show interest?

*How many times must a man turn his head  
pretending he just doesn't see?  
The answer, my friend, is blowin' in the wind  
The answer is blowin' in the wind (Dylan 1963)*

- <sup>17</sup> The scant heed was paid to warnings raised is increasingly evident in crisis countries such as Greece and Ireland. Earlier pretences that “no one saw it [the GFC] coming” are now increasingly dismissed.
- <sup>18</sup> “*The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. . . . [S]oon or late, it is ideas, not vested interests, which are dangerous for good or evil.*” Keynes, J. M. (1936). *The general theory of employment, interest, and money*. London: Macmillan.
- <sup>19</sup> Recall the distinction made between model solutions and what is socially desirable, with the example offered of an equilibrium at fifty percent unemployment Samuelson, P. A. (1947). *Foundations of economic analysis*. Cambridge, Mass, Harvard University Press. Unfortunately such thoughts appear to have been long lost to the genre of “Economics” texts. Should we be surprised at ‘the triumph of the airheads’ (Gare, S. (2006). *The Triumph of the Airheads and the Retreat from Commonsense*. Sydney: Park Street Press)?
- <sup>20</sup> Can you name the five restrictions that Leon Walras in his applied work stipulated would be needed if his pure ideas were to have practical application? None currently apply, swept aside in the rush to deregulate, compete and model globally.
- <sup>21</sup> Consider this reflection of Albert Rees the outstanding US labour economist whose career included academic, business and policy areas. “In none of these [practical] roles did I find the theory that I taught so long to be the slightest help. The factors involved in setting wages and salaries in the real world seemed to be very different to those specified in neoclassical theory” quoted in Akerlof, G.A. and R.J. Shiller (2009). *Animal Spirits*. Princeton, NJ: Princeton University Press.

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