EU, US, and Russia in the Middle

By Almas Myrzatay

In order to establish world dominance, major players such as European Union (EU), US and Russia have set the weapons aside, and instead switched to fight using economic sanctions. Since the collapse of Soviet Union, Russia has been actively working to establish itself as a major player in the world arena once again. On the other hand, the European Union and the US, or so-called “the western world”, want to prevent Russia from becoming the “democratic Soviet Union”. As a result of Russia’s ambition to seek growth (by annexing Crimea, creating BRIC Development Bank, or agreeing to accept Chinese Yuan as a form of payment instead of the US Dollar) Russia is receiving rebuff from the western world in the form of economic sanctions. The western world hopes that sanctions will weaken Russia’s rather aggressive political and economic growth. Early August sanctions must have had some impact on Russian economy by now. The question is how severely damaged is the Russian economy. Or are Mr. Putin’s words, about making Russia independent of western goods and the US Dollar, true after all?

Instead of initiating consensus with the west after annexing Crimea, Vladimir Putin has decided to fight sanctions in his own way. Mr. Putin said that, “…[EU] sanctions are inefficient”, he called imposition of sanctions, quoting directly, “weird”. On August 1st, EU sanctioned Russia’s 5 major banks, and on August 5th, Mr. Putin signed sanctions on food coming from EU. Relating to the EU sanctioning Russian banks, Mr. Putin gave an interview to German ARD TV channel where Mr. Putin said, “…up to 300 thousand people [in Germany] have their jobs because of our [Russia-German] economic and trading relations, at expense of our [Russian] orders in large amounts, at expense of our mutual [business] companies.” It seems that Mr. Putin wanted to warn Germany that Russia could potentially damage the biggest EU economy. Relating to the importation of EU food, it seems that by using sanctions Russia wants to increase productivity in its agricultural sector through acquiring new partners and increasing its independence on foreign goods. According to Russian experts, the new trading partners such as Brazil, Poland and Turkey will replace the EU and the US. Brazil will replace the US in exporting beef and chicken legs, and Russia’s own apple producers will replace Poland, who exports to Russia 50% of its yearly apple production. Moreover, Russia
banned oil and gas equipment from the EU and instead agreed to work with Iran, who will also help Russia to export oil in Asian-Pacific market. Nevertheless, Russia’s growth and growing independence from the western goods will be biased and rather fabulous.

How exactly is the Russian government dealing with sanctions? For starters, Russia will see a decrease in the oil and gas industry, an increase in the inflation rate, and huge government expenditures. Arkady Dvorkovich, Deputy Prime Minister, said that due to an increase in taxes, gas and diesel fuel will have a 10% increase in prices in the coming year. Some experts say that in the first quarter of 2015 oil prices may increase as high as 45 rubles per liter, which is an increase of 20% from the current oil price. The Minister of Economic Development, Aleksey Ulyukaev, predicted a further inflation rate increase from 6.1-6.5% (Jan, 2014) up to 8.6-9% by the end of this year. Moreover, speculations in the oil market caused distress in The State Duma (Russian Parliament), which had to review the budget for 2015-2016 years in one sitting, on November 14th. Overall, The State Duma accepted pre-arranged 250 amendments and declined 139 amendments in the budget of the following years. During the sitting, Deputy Chairman of the Parliamentary Budget, Andrey Makarov, reminded his colleagues that every US Dollar change in the oil price is equivalent to a loss of 85 billion Russian Rubles and that further budgetary adjustments might be necessary. Makarov pointed out that deficit will be 431 billion Russian Rubles (approx. 9 billion USD) and proposed to draw money from the National Reserve and the revenues from privatization. In addition, the second largest Russian bank, VTB, asked the government to give 250 billion RUB (approx. 5.4 billion USD), and largest publicly traded oil company, Rosneft, asked the government for 43.2 billion RUB.

Given the circumstances, Russia is gaining not only economic independence but also, quite literally, isolation. The EU sanctioning banks and the US government purposefully fluctuating oil prices are driving Russian economy into a deep recession and huge budgetary deficits. In addition, sanctions on Russia will certainly result in a boomerang effect that will hit the west, and, on top of that, result in domino effect as in the financial crisis of 2008.

2014: The Year of the French Economists
By Rifat Mursalin

French economists made worldwide headlines twice in 2014—once for writing an exceptional book on income inequality and once for winning the 2014 Nobel Prize in Economics. There has been an ongoing rivalry between the two eminent French institutions – Paris School of Economics (PSE) and Toulouse School of Economics (TSE). The rivalry led to a resurgence of economic excellence in France. According to The Economist, in the recent list of the world’s 25 best young economists by IMF, seven were French.

The book that has attracted the attention of millions of economists and non-economists alike is Capital in the Twenty-First Century, written by Thomas Piketty. Piketty is an economics professor at the Paris School of Economics who works on wealth
and income inequality. Piketty’s best-selling book takes a historical and statistical approach on income inequality that emphasizes wealth distribution over the past 250 years. Piketty argues that the rate of capital return in developing countries is greater than the rate of economic growth, and this will inevitably cause increasing wealth inequality. He proposes deliberate redistribution through a global tax on wealth as a solution to this problem.

*Capital in the Twenty-First Century* was published in 2013 in French, and in 2014 in English. The book’s main focus is on Europe and the United States since the 18th century. Piketty’s central argument, which has garnered much worldwide attention, is that wealth inequality is not an accident but rather a characteristic of capitalism. He proposes the amelioration of this problem through state-intervention and wealth taxation. Piketty’s solution is a global system of progressive wealth taxes to reduce the inequality and avoid the majority of wealth under the control of a minority. The book reached number one on *The New York Times* bestselling nonfiction list in May of 2014. The French version of the book has sold over 50,000 copies while the English version has sold over 100,000 copies.

While Piketty has garnered a myriad of worldwide attention for his book, fellow French economist Jean Tirole received the Nobel Memorial Prize in Economic Sciences for his analysis of market power and regulation. Tirole is a professor at the Toulouse School of Economics in France and has a Ph.D. in economics from Massachusetts Institute of Technology. Since the 1980s, Tirole’s research has contributed to how governments should regulate large and powerful firms that dominate markets. The Royal Swedish Academy of Sciences has stated, “Jean Tirole is one of the most influential economists of our time. Most of all, he has clarified how to understand and regulate industries with a few powerful firms.” The Academy has also commended Tirole for his work on governments dealing with mergers, cartels, and monopolies.

Tirole is the first French economist since 1988 to win the award, and the first to be specifically recognized for work on market regulation since 1982. Tirole’s research indicates that market regulation should be particularly adapted based on the conditions of specific industries, instead of general regulations such as price caps that can harm the market. Not regulated properly, industries dominated by single, powerful firms can produce negative externalities. Tirole’s microeconomic research on how large firms should be regulated in order to maximize socially optimal behavior has great effects on strategies to prevent large companies such as Google from using its vast market share in the internet-search business to behave as a monopoly, according to *Bloomberg News*.

2014 has been the year for French economists, and the two top French schools of economics—PSE and TSE—have rebranded their missions, created a private fund-raising foundation, recruited worldwide, and introduced English as the teaching language. PSE ranks seventh among economics departments worldwide, and TSE is currently 11th, according to the RePEc ranking used by economists. French economists clearly displayed their brilliance in 2014, and with the initiatives from these top two schools, one can only await greater excellence.


The Minimum Wage Debate
By Matthew Birnbaum

What Is Minimum Wage?

A minimum wage is the lowest wage an employer can legally pay an employee. In the United States, there is a federal minimum wage which applies in all 50 states, but each state may set a higher state minimum wage. The federal minimum is $7.25 an hour which equates to about $14,500 a year assuming a traditional 40 hour work week. A significant portion of US workers earn at or below minimum wage; of workers that earn an hourly wage, 1.5 million workers earn federal minimum wage while 1.8 million workers earn less than the federal minimum.¹

Initiatives to Raise Minimum Wage

Since 1996, there have been fifteen state ballot initiatives to raise their respective minimum wages; all fifteen have passed.² Most recently, five states and one city voted on initiatives to raise their local minimum wage in the November 4th, 2014 election. The six recent initiatives, varying in scope, all passed as well. The details of the initiatives voted on in the November 4th election are seen below:

<table>
<thead>
<tr>
<th>State/City</th>
<th>Current Minimum Wage</th>
<th>Proposed Minimum Wage</th>
<th>Deadline</th>
<th>Approval Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>$7.75</td>
<td>$9.75</td>
<td>2016</td>
<td>69%</td>
</tr>
<tr>
<td>Arkansas</td>
<td>$6.25</td>
<td>$8.50</td>
<td>2017</td>
<td>65%</td>
</tr>
<tr>
<td>Illinois</td>
<td>$8.25</td>
<td>$10.00</td>
<td>2015</td>
<td>66%</td>
</tr>
<tr>
<td>Nebraska</td>
<td>$7.25</td>
<td>$9.00</td>
<td>2016</td>
<td>59%</td>
</tr>
<tr>
<td>South Dakota</td>
<td>$7.25</td>
<td>$8.50</td>
<td>2015</td>
<td>53%</td>
</tr>
<tr>
<td>San Francisco</td>
<td>$10.74</td>
<td>$15</td>
<td>2018</td>
<td>78%</td>
</tr>
</tbody>
</table>

Despite the many successful minimum wage raises, there is a perpetual debate over whether raising minimum wage will be beneficial or harmful. With only inconclusive data to support each argument, the divide stems from fundamental economic theory.

In Favor of Raising Minimum Wage

Proponents of an increased minimum wage argue that a higher minimum wage will benefit low-paid individuals and the nation’s economy.

Historically, minimum wage has not increased at the same rate as inflation. This means minimum wage has not kept up with the cost of living and minimum wage earners are increasingly unable to afford the necessities of life. Accordingly, many minimum wage earners live below the poverty line, the minimum income required to provide for a household. Minimum wage earning households with three or more members are typically those that fall into poverty. As you can see on the following graph, the poverty level for a family of three has steadily increased while minimum wage remains consistently lower.³ Raising minimum wage will directly increase incomes and enable minimum wage households to live better lives.

Raising minimum wage will also benefit the economy. By increasing the average standard of living, a higher minimum wage will decrease expenses for government-run social aid programs as people are increasingly able to survive without assistance. The higher incomes associated with a higher minimum wage will further stimulate the aggregate economy because households have more money to spend. Lastly, raising minimum wage will not significantly increase unemployment. The majority of employers that pay minimum wage are
large corporations. As such, many can likely afford to pay higher wages should they be required to.

![Minimum Wage Below Poverty Level Since the 1980s](image)

Source: www.iowapolicyproject.org

**Against Raising Minimum Wage**

The opposition argues that an increased minimum wage will have disastrous results: increased unemployment and a damaged economy.

![Labor Market with a Minimum Wage](image)

An analysis of labor markets theorizes that raising minimum wage will raise unemployment. As seen on the graph, when a minimum wage is in place, there is a surplus supply of labor known as unemployment. Raising the minimum wage corresponds with a larger employment gap and increased unemployment. A higher minimum wage could further lead to layoffs at employers with a fixed compensation budget, as they can no longer afford to pay all their employees. Additionally, the resulting increase in unemployment will occur among low-paying, entry-level jobs. This lack of entry-level opportunities will make it increasingly difficult to launch a career and advance to higher paying positions.

In addition to harming individuals, increasing minimum wage will damage the economy. It is generally accepted that human capital development leads to economic development. However, high minimum wages lead to a reduction in human capital development. Higher minimum wages incentivize companies to invest in automated processes rather than in human capital. In the long run, if it is cheaper to utilize a machine than an employee, many corporations will choose machine labor over human labor. Additionally, higher wages for low paid employees may lead to a wage suppression among those with high wages. This further
What is Quantitative Easing?

Central banks are tasked with maintaining full employment and stable prices. When the economy moves away from long-term targets, the central bank uses the Federal Funds Rate, the interest rate for between-bank lending, and open market operations, buying and selling of bonds, to encourage the economy towards those targets. Lowering interest rates will stimulate borrowing and thus tend to increase economic activity. However, stimulation may also increase inflation to unacceptable levels. Thus, attempts to influence economic trends require measure and balance. Over the long-run, the central bank can only control nominal interest rates, but they can temporarily influence real interest rates, nominal rates minus expected inflation, because expectations of inflation rates do not change in the short-to medium-term (Fawley and Neely). However, people can either hold currency or deposit it in a bank or other investment; therefore, nominal interest rates cannot go below zero (Fawley and Neely). Otherwise, people would only hold currency and the banks would not invest any money they have because they essentially earn money without providing loans. When traditional monetary policies fail to turn the economy back toward long-term targets, central banks resort to unconventional policies such as quantitative easing.

Quantitative easing is a policy where the central bank injects large amounts of new money into the economy as part of an expansionary effort. According to Fawley and Juvenal, quantitative easing has historically been when the central bank changes strategy from lowering interest rates to expanding excess reserves of banks through purchases of their assets. The central bank could instead purchase government bonds or mortgage securities as the Federal Reserve Bank of the U.S. did (“The Economist Explains: What Is Quantitative Easing?”).

The injection creates an artificial surplus of money. Banks use the new excess reserves or people use the new money to buy bonds which lowers the real interest rate. The lower interest rate encourages investment and spending, moving the economy closer to its long-run potential. In addition to boosting the economy through investments, quantitative easing can boost consumer confidence and thus consumption if it convinces people that the Fed is serious about fighting high unemployment and declining prices, which may seem desirable but actually destabilizes an economy (“The Economist Explains: What Is Quantitative Easing?”).
Conditions Under Which Quantitative Easing Was Implemented:

During the burst of the housing bubble in 2007, the housing market plummeted, dragging with it large players in investment banking (Ball). The commercial banks that survived responded by tightening lending standards, making it more difficult for credible individuals and small businesses to invest (Gagnon). In addition, banks understood they would soon have to deal with stricter regulations once the Dodd-Frank Act, an act limiting what banks will and will not be authorized to do, has been completed; this act will cause banks to be more wary of making loans or simply unable to provide the loan to a credit-worthy individual. Plus, the demand for credit had decreased since a large number of people became unemployed and were struggling to pay for the loans they already had, especially if they managed to avoid bankruptcy while still carrying a mortgage much greater than the value of their house. After reducing the Federal Funds interest rate to near lower-bound zero proved unsuccessful, the Federal Open Market Committee, generally referred to as the Fed, attempted to keep employment and inflation at target levels by implementing a policy of quantitative easing (“The Economist Explains: What Is Quantitative Easing?”; Gagnon). However, the Fed also implemented a policy of forward guidance, i.e. announcing in advance that they would keep the Federal Funds Rate, and therefore interest rates, low after ending quantitative easing and tying the end of the low Federal Funds Rate to a decrease in unemployment (“QE, or Not QE?: An Assessment of the Most Controversial Weapon in the Central Banker’s Armoury”).

The U.S. Experience

In 2009, The Fed began its first round of quantitative easing with $1.25 trillion in asset purchases and the second round of quantitative easing was announced in mid-2010 with $600 billion in asset purchases (“QE, or Not QE?: An Assessment of the Most Controversial Weapon in the Central Banker’s Armoury”). To boost confidence in lower interest rates for a longer period of time, the Fed announced in September 2009 the Maturity Extension Program, another form of pumping money into the economy (Fawley and Neely). Finally when high unemployment persisted and prices threatened to fall, the Fed announced a third round of quantitative easing in September 2012 in which it would continue to purchase mortgage-backed securities until the labor market improved.

What has quantitative easing accomplished?

Most of the debate hangs on exactly how much these policies improved the state of the economy or if the Fed should have done more. Several economists, including Dobbs and Gagnon, agree that quantitative easing and forward guidance improved the economy moderately, though “moderately” is not quantified. The economist article “QE or not QE?” argued that the policies improved the unemployment rate by 1.5 percentage points and real Gross Domestic Product by 3 percent. On the other hand, Curdia and Ferrero argue that the effects of these policies have provided the economy with a moderate stimulus but the effects depend on the percentage of long-term vs. short-term investors and the efficacy of forward guidance. Finally, investment and consumer spending has not increased despite the large injections of money into the economy. This has been predominately attributed to increased lending standards by banks along with the unease of the upcoming regulations in the Dodd-Frank Act. Overall, there is a general consensus amongst economists that quantitative easing and forward guidance prevented a deeper and longer recession that what was experienced after the crash of the housing bubble.

Life after quantitative easing

Rutter argues that the increase in aggregate demand caused by the reduced interest rates and the increase in the monetary base would not necessarily end in inflation if it employed currently unused resources in the short run. Once aggregate demand intersects the inelastic portion of aggregate supply, the central bank will naturally start implementing contractionary
monetary policy to prevent rampant inflation. Rutter argues, however, that this implementation is a delicate process; if it occurs too fast or before the economy is strong enough, the beginnings of recovery will be squashed. He suggests that the central bank should pay interest on the cash reserves it holds, which would gradually move bank reserves into the economy since banks would only lend at rates higher than the interest thus earned. He also suggests the central bank could use reverse repurchase agreements, selling assets with the promise to buy them back later at a higher price. He argues these strategies give the central bank more flexibility with contractionary monetary policy and allow its assets to mature as opposed to risking losses by selling too soon.

Summary

With quantitative easing being an unconventional monetary tool, it has sparked much discussion on its function, its consequences, and its effects on the economy. Most of the debate is actually less about whether or not quantitative easing prevented a deeper recession than what was experienced but rather more about how much it actually improved the economy compared to not implementing these policies. However, there has been a lack of an increase in investments and consumer spending, though most of this has been attributed to increased standards by banks. Finally, there is much concern over when and how the Federal Reserve will exit quantitative easing and what the effects will be on inflation. Rutter suggests paying interest on reserves and using reverse repurchase agreements to allow some flexibility as quantitative easing ends. Overall, quantitative easing seems to have had a moderately expansionary effect on the economy when conventional monetary tools were no longer an option.

Works Cited


