



Arie Ruttenberg (left), seen here with the writer, Shlomo Maital, turned Keshet Barel into Israel's largest advertising agency



OFER CHEN

The great money mystery

THERE IS a major economic mystery in Israel, the US and the West. Governments are running big budget deficits, printing mountains of money, and yet – there is virtually no inflation, while the inequality of wealth and income has grown alarmingly.

Why? And should we worry?

I spoke with my friend Arie Ruttenberg about this. Ruttenberg built Keshet Barel into Israel's largest advertising agency, sold it to the global McCann-Erickson, founded Club 50 and sold it to Migdal, and wrote a book with me about creativity (*Cracking the Creativity Code, 2014*). He has expanded his assets through clever, at times contrarian, investments. He is widely known in Israel for masterminding the successful political campaigns that led to Menahem Begin's reelection in 1981, and brought

Yitzhak Rabin into office as prime minister ("Israel is waiting for Rabin") in 1992.

Ruttenberg, who has a graduate degree in economics from the Technion, is a fiercely creative thinker. His explanations for the growing inequality of wealth and income in Israel and abroad are crystal clear. I believe they should cause all of us to lose sleep.

What in the world is going on? Can you summarize your theory?

In the old economy, the money that reached the marketplace was spread among everyone. When they used the money to buy goods, prices rose and this led to inflation. In the new economy, the money reaches only a few of the very rich, who mainly buy stocks, bonds and real estate. These are not included in standard measures of inflation, therefore it seems like there is no inflation.

Lately, US President Donald Trump has boasted about his ability to flood the system with limitless amounts of money and without causing inflation.

Really? How can this be understood?

There have been a few explanations of this phenomenon that on the face of it contradicts the Keynesian economic model: huge budget deficits, together with an expansionary monetary policy and zero interest rates, and all this with full employment... and no inflation.

A true economic miracle that invites other politicians, including some among the Democrats, to offer the nation a paradise on earth of unlimited prosperity through printing money. How did this happen? Is this really sustainable? Or, is it an illusion, with inflation hidden and disguised as

something else? And is there a ticking time bomb, very very quiet, a social 'bomb' that will result in a deafening explosion soon?

A common explanation for this phenomenon is linked to globalization and technology. The argument is that we are at the dawn of a new macro-economic age, based on enormous global productive capacity and perfect competition through digital trade accessible for all. This explanation is only very partial, because it fails to explain why huge amounts of printed money enter the market and "evaporate" without causing any increases in prices.

So what then is your own explanation?

My argument is that the budget deficits and the monetary expansion indeed have had an enormous impact, but in contrast with the past, they have not caused significant inflation in consumption goods but instead have mainly brought a rise in the price of equities, bonds and commercial real estate, which in turn increase economic and social inequality.

John Maynard Keynes's model assumes a uniform economy in which all consumers have similar preferences and compete for the same goods and services, available in limited quantities in the consumer goods markets. In this case, any additional money in the hands of consumers competes for the given amount of goods, and so necessarily causes a rise in prices.

I propose that we think about consumers in terms of two groups: a) owners of capital and b) those who earn a living by their labor. Owners of capital earn far more than they need for their subsistence, and they save the difference, mostly by investing in equities, bonds and commercial real estate. These investments continue to expand their incomes, from year to year, but the added income does not necessarily increase their consumption, which is already very high. The second group, wage earners or freelancers who make a living from their wages, spend nearly all their income on their subsistence, and their savings are mostly targeted toward their pensions – that is, future consumption. Ultimately those savings will be almost completely eroded in value.

The gap between the two groups continues to grow over time, and continually increases the degree of inequality between them.

So, in your view, what happens to the economy when the government vastly expands

the amount of money? Or when the Central Bank creates huge amounts of credit at zero interest rates?

The answer is most of the money and credit flows into the hands of the owners of capital, who grow wealthier as their assets expand, and as they continue to grow their wealth and create more jobs for wage-earners, until the economy reaches full employment. The wealthy grow even wealthier and those who live on their wages earn only enough to barely survive. In this way, the economy reaches full employment, but income and wealth inequality grow."

But if the demand for workers grows, why don't wages increase too?

Because of the two new phenomena I mentioned, globalization and technology. Through those two forces, we have turned the majority of workers into commodities – that is, into a basic good that has cheap plentiful substitutes. These two forces create a situation in which the supply of labor becomes almost infinite – in economists' jargon, perfectly elastic. Therefore, when the owners of capital expand their businesses and assets, they do so almost without raising wages at all. When there is full employment, you can always hire cheap foreign workers.

And why doesn't the fall in unemployment bring a major increase in the demand for consumer goods and hence, a rise in their prices?

Because of the same two reasons: globalization and technology. Workers today can buy cheaper goods anywhere on earth via the Internet, and the supply of such goods is becoming nearly infinite. In this way, inflationary pressure in the goods market is prevented.

So why doesn't the rapid growth in incomes of the owners of capital cause inflation, when they spend that income?

There are two reasons. First, because wealthy capitalists cannot eat two steaks for breakfast; and second, because it does cause inflation, but it is not called inflation, it is called "a rise in the stock market" and "a rise in the price of commercial real estate." Yes, the excess demand caused by the budget deficit and cheap credit creates strong inflation in the main "goods" that the wealthy consume, but because these rises in equity prices and real estate prices are not included in the consumer price index, it is regarded as part of economic prosperity,

and not as inflation.

So why do the wealthy people continue to buy stocks, bonds and real estate after they have become so costly?

Because the rate of interest is zero, and because there are no other investment opportunities. Thus, the wheel continues to turn, over and over, never stopping, when: a) the wealthy grow more and more wealthy, pocket trillions of dollars of wealth, and feel super-rich; b) the wage-earners enjoy full employment, stretch their income to last the full month, and are content. This can be described as the "happiness of the poor"; c) the politicians waste money endlessly and are pleased with themselves; d) the governments expand the debt they owe and nobody cares; and e) the central banks expand their balance sheets, and again, nobody cares. Hallelujah! The messiah has come!

Can this go on forever?

There is no reason why not, on condition that: a) a few madmen do not arise and start to complain about the social inequality that is becoming unbearable; b) a 'crazy' US Central Banker does not appear who starts to raise interest rates, and thus puncture the stock markets, bond markets and real estate prices; and c) a stupid American president does not appear who crushes globalization, imports of cheap goods and imports of cheap foreign labor through trade wars.

Then what happens to the global economy? It becomes an economy of rich feudal lords, and contented vassals who earn exactly as much as they need to go to bed with a full stomach, get up the next morning and to serve their lords. Is this what Paradise looks like? No, this is what the economics of wealth inequality looks like.

At the end of the 1970s, Israel had a cabinet minister who used the phrase "blessed inflation" to describe the impact of influence on accelerating economic activity – until, that is, the inflation destroyed the Israeli economy. When the US president brags about flooding the American economy with money in order to create growth, he is boasting in fact about "increasing blessed inequality."

How long will this last?

Heaven knows! ■

The writer heads the Zvi Griliches Research Data Center at the S. Neaman Institute, Technion and blogs at www.timnovate.wordpress.com