

The Austrian

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Economic Hedonism

HOW CONGRESS AND THE
FED MORTGAGE THE FUTURE
page 4





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From the publisher

Jeff Deist

The problem with presidential candidates is not so much what they say and believe, but rather what they don't say and believe. Behind the lying and dissembling and obfuscation there is a palpable suspension of disbelief. Our would-be political rulers simply ignore — or fail to grasp — the gravity of our economic situation.

We are preoccupied with terrible shootings, bathroom wars, and the petty intrigue of political campaigns. We debate trivialities. But the bigger story, the gradual but grinding reality behind how western governments operate, doesn't hold our attention.

This is a time of unprecedented economic hedonism, engineered and encouraged by western governments and their central banks. It is sold to us as banal public policy and technical tinkering, when in fact a radical and anti-human ideology underpins it.

The arc of human progress, marked by capital accumulation and ever-increasing productivity — at least in healthy societies — has been upended. It's a slow-motion catastrophe, whereby Americans and Europeans live today at the expense of tomorrow.

Fiscal hedonism is rampant in Congress, and has been for decades. How do they get away with it? Perhaps because we allow it. US government debt, now more than \$19 trillion, seems almost amorphous to voters. It's been with us so long, and nothing too terrible has happened. ... Yet while Ross Perot made the "national debt" a cornerstone issue of his campaign in 1992, today it's become almost a third rail in American politics. Donald Trump recently discovered this the hard way, after an offhand comment about US creditors taking a haircut on their Treasury bond holdings.

Any talk of actually repaying or (better yet) repudiating government debt is today seen as crankish. That's why the great James Grant took so much heat for daring to suggest that the US government is insolvent in his recent cover article for *Time* magazine.

Monetary hedonism, meanwhile, is the order of the day for nearly all western central banks. The US Federal Reserve, in particular, has shown it will stop at nothing to enable

Congress to spend beyond its means. By providing a ready market for Treasury debt (i.e., quantitative easing, buying Treasury bonds from commercial banks using newly created money), the Fed effectively monetizes federal debt in a shamefully opaque way. And by keeping interest rates artificially low, thus reducing federal interest payments, the Fed helps Congress make annual deficits look smaller.

Consider that the Fed's balance sheet has more than quadrupled since the Crash of 2008, to roughly \$4 trillion. Will this historically unprecedented increase in the monetary base really just vanish into thin air with no ill effects? Will the malinvestment caused by cheap credit from commercial banks flush with reserves not create huge dislocations down the road? Will propping up overheated coastal real estate markets and inflating equity prices for companies with dubious earnings really create long-term economic growth?

"We have had enough, once and for all, of Hedonism — the gloomy philosophy which says that Pleasure is the only good."

C.S. Lewis

The short answer is "No," and the rest of the world knows it. Our creditors know that Congress will never put its fiscal house in order, and that the Fed will never return to "normal" monetary policy. The West cannot continue to live on borrowed time and borrowed money forever, despite our military power. The laws of economics prevail in the long run.

There are hopeful signs, however. Americans and Europeans may not be demanding libertarian approaches to our fiscal and monetary problems, but they are increasingly suspicious of centralized government power and central bank cronyism. Secession and breakaway movements like Brexit in the UK gain momentum, while disapproval of artificially engineered globalism grows. "Unbanking" alternatives grow, as distrust of currencies increases and flaws in cryptocurrencies (namely traceability) are corrected by blockchain engineers. Populism — while always a double-edged sword — threatens state-connected global elites like never before. And the rapid proliferation of social media options makes it almost impossible for the state's media gatekeepers to control the narrative. ■■■

Jeff Deist is president of the Mises Institute.

The Free Lunch Is Over

by Jeff Deist



If there is one overriding economic myth that plagues us today it is the notion that society can do collectively what we cannot do individually: get rich by living today at the expense of tomorrow. It is the doctrine of the political class, professional economists, and central bankers. It is monetary and fiscal hedonism masquerading as technical analysis. And, it leads to fiscal default. It is arguably the biggest untold story of our time, but you won't hear about it from Hillary or Bernie or Donald.

Consuming Today — Paying Tomorrow

Part of the problem lies in the fact that the cumulative impact of bad policies will in most cases be felt only many years down the line. Murray Rothbard pointed out when this is the case, voters will support destructive policies. The idea

This article is adapted from a talk delivered at the May 2016 Mises Circle in Seattle, Washington.

persists that we really can live at someone else's expense. At least for now.

This is what the Fed has been doing with all of its “extraordinary” monetary policy since 2008. But even the Fed admits this comes with big risks for future fiscal solvency. In a November 2010 speech, St. Louis Fed President James Bullard said: “The [FOMC] has often stated its intention to return the Fed balance sheet to normal, pre-crisis levels over time. Once that occurs, the Treasury will be left with just as much debt held by the public as before the Fed took any of these actions.”

The problem is, the Fed has yet to figure out how it will return things to “pre-crisis” levels. In other words, the end of the Fed's experiment in massive debt and easy money will come “some day.” But definitely not today.

I'll leave it to you to decide if extraordinary monetary policy is really the new normal. It's hard to conceive of an event where the Fed would reverse this trend or significantly raise interest rates.

There still appears to be no political will at the Fed or anywhere else to forgo consumption today for the sake of fiscal solvency later.

The Lost Art of Investing in the Future

Looking around this beautiful venue, which often hosts symphonies, we see immediately that it was built by people who wanted to create something lasting — something that would not only survive their lifetimes, but that would provide beauty and lasting enjoyment for future generations.

They broke ground on this building 100 years ago; none of the individuals who built it are alive today. It served for decades as a Christian Science church.

But in a sense the individuals who built it live on through their work, which surrounds us here: through the art glass Tiffany-style lighting, through the terra cotta on the sides of the building, through the thick masonry designed to produce warm acoustics. They persevered for 6 years to complete it — and while they could not have foreseen what kind of events or people the building would host a century later, undoubtedly they knew it was built to last and hoped it would remain standing a long time as Seattle grew up around it.

They built something lasting for an uncertain future.

All healthy societies do this. The notion of being concerned with things beyond one's lifetime is innately human. Humans are hardwired to build societies, and the most ambitious humans have always sought to build lasting monuments and modes of living. That's not possible unless people work toward a future they will not enjoy themselves.

This was especially true for our ancient primitive ancestors, who lived very short and difficult lives. We can imagine how much they wanted to have lasting forms of sustenance: food, water, clothing, shelter — instead of having to produce that sustenance day after day.

**The end of the Fed's
experiment in massive
debt and easy money
will come “some day.”
But definitely not today.**

In fact, this trait perhaps more than any other is the hallmark of civilization. We can call it many things, but we might just say healthy societies create capital. They consume less than they produce. This capital accumulation creates an upward spiral that increases investment and productivity, making the future richer and brighter. Capital accumulation made it possible for human populations to develop beyond subsistence misery. It made the agricultural, industrial, and digital revolutions possible.

Economists talk about savings in the context of time preference, the preference that people have for current consumption over future consumption. People with high time preferences want everything today, no matter the cost, whether we're

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JEFF DEIST, CONTINUED

JEFF DEIST, CONTINUED talking about buying material goods using credit or simply enjoying the empty pleasure of idleness over productive activity.

People with low time preferences are the opposite: they'd rather forgo some pleasure or purchase today to build for the future, whether their own or their offspring's. And it's not just about the future of the family or tribe: society benefits across the board, through economic, cultural, and philanthropic development.

Of course time preference is not only a matter of sociological study, but also a fundamental concept in economics.

In the 1800s the French classical economist Jean-Baptiste Say gave us his law of markets, a law that could be reduced to the proposition that production precedes consumption. We have to produce before we consume, because while humans always have infinite wants — i.e., demand — real-world scarcity means that we first have to produce economic goods before we can consume them. The only other choice is a return to that subsistence life our ancestors escaped thousands of years ago.

Mises posited that from the study of human action itself we could derive the assumption that all other things being equal, individuals prefer to achieve an end sooner rather than later. This is why we'd rather buy our dream house at age 40 than 90. We can understand this preference by deductive reasoning. The question is how

bad we want that house at 40, and what using consuming capital or incurring debt to buy it might mean for our life at 90.

Professor Hans Hoppe states that low time preference, the willingness to accumulate goods for an uncertain future, “initiates the process of civilization” — a positive feedback loop in which developing societies accumulate more and more capital, which leads to greater productivity, which leads to longer lifespans and greater concern for the future.

Professor Guido Hülsmann, in his great book *The Ethics of Money Production*, addresses the damaging cultural and moral effects of using monetary policy to encourage high time preference via inflation and cheap credit. By debasing money, the political class and its bankers not only hurt the economy, but also grow government, make wars more likely, and create moral hazards that encourage bad behavior.

The Rise of Monetary and Fiscal Hedonism

It seems self-evident that capital accumulation and low time preferences undeniably are healthy, virtuous, and necessary elements of an advanced economy and society. So we should not be surprised that the two most powerful forces in the modern world — central governments and central banks — work tirelessly to thwart both. And democracy, so-called, is at the heart of their experiment.

As the aforementioned Dr. Hoppe explains, democracy turns the political class into high time preference plunderers: without any vested hereditary interest in the future of a nation, elected politicians have every incentive to consume the nation's current capital via taxes and future capital via debt. Why shouldn't a politician win votes today, by supporting popular spending measures, when the consequences won't be felt until long after he's out of office? Buy now, pay later is an inherent feature of any democratic political system.





But the moral hazards created by such a system in America are enormous, and we're not just talking about those living on food stamps and welfare because it's only marginally worse than working a low-paying job.

We're talking about huge middle-class constituencies for entitlement programs like Social Security and Medicare. Why buy a Hyundai and vacation in Florida when you can buy a Mercedes and vacation in Europe? How many economic decisions are subtly influenced by the knowledge that at least a portion of one's retirement costs will be borne by others?

As for the Fed, we could spend all weekend studying how it distorts prices across the board, rigs equity and housing markets, misallocates resources and alters the structure of production, fools entrepreneurs, and punishes savers.

As Guido Hülsmann describes, monetary debasement brings about cultural debasement and ultimately personal debasement. It's not a new concept, but rather a problem that existed in ancient and feudal times just as it does today. It infects every aspect of our society: not just our financial lives, but civil society and our personal relationships as well. Cheap credit, the drug pushed by

central bankers, makes us prefer the saccharine pleasures of consumption to the lasting satisfaction of productive achievement. It makes us buy houses that are too big, cars that are too elaborate, and college educations that are too expensive.

It makes us worse people!

In sum, we might say that Congress and the Fed are co-conspirators in a plot to have us live for today instead of building for tomorrow.

It's not hyperbole to say that the political and banking classes have become enemies of civilization. They've sold us a mix of fiscal hedonism and monetary hedonism that threatens to upend the arc of human history.

Our Biggest Challenge Lies in Changing Our Mindset

Remember, our economic future is unwritten. The US economy has very serious structural problems, particularly with respect to debt, the dollar, and entitlements.

But our biggest challenge is mindset. There is no reason on paper that America cannot be a great nation.

Despite all the problems with American schools, we still have one of the most educated workforces in the world. We have abundant and sparsely populated land. In fact, we have more arable land than any other nation — about 17 percent of all US acreage can be farmed. We have 500 million acres of timber. We have two huge coastlines, with access to both eastern and western markets. And we have huge amounts of cheap energy in the form of oil and natural gas.

Our problems are of our own making, primarily caused by lousy voters, high time preferences, and economic hedonism. It's been a great party, ladies and gentlemen. Good luck electing someone who's serious about the hangover. ■■■

Jeff Deist is president of the Mises Institute.

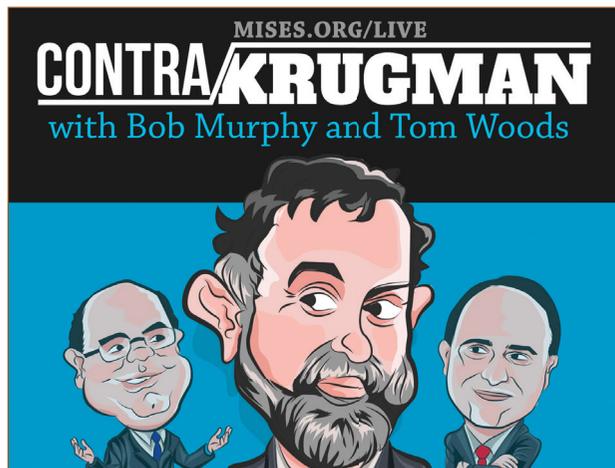
Contra-Krugman Live!

TOM WOODS AND BOB MURPHY TAKE THEIR PODCAST ON THE ROAD TO THE SEATTLE MISES CIRCLE

Since September 2015, Mises Institute scholars Tom Woods and Bob Murphy have been joining forces every week to refute the many fallacies and errors in Paul Krugman's weekly columns.

At our Mises Circle in Seattle this year, Murphy and Woods performed their show for the first time in front of a live audience. As expected, the discussion was a crowd pleaser for its fast pace and laugh-out-loud comedy. However, the discussion also covered a variety of serious economic issues that were used and abused by Paul Krugman in his May 20 column.

The discussion began with a look at Krugman's defense of 2010's Dodd-Frank banking legislation, which Krugman believes could be repealed by Donald Trump if elected. Krugman would have us believe that Dodd-Frank has helped the "little guy" at the expense of big banks.



As Tom Woods points out, that's just not how it works.

As with many government regulations, Woods notes, "smaller institutions bear the largest burden, and larger institutions more or less coast by. ... According to the Kennedy School of Government, since the second quarter of 2010, community banks — your local small banks — *their* share of US banking assets has fallen drastically. This is not a coincidence. The reasons for this include the compliance officers you have to hire and the fact that the burden of regulation is extremely difficult on these smaller institutions."

What’s even worse, as Woods pointed out, is how small businesses suffer because small banks are a leading source for small business loans: “Where are small businesses getting the credit they need for their businesses? From the small community banks. Big businesses can get what they need from the capital markets. But the small businesses rely on those community banks. Now, if those small banks are suddenly under a tremendous amount of pressure, financially, because of Dodd-Frank, they can’t extend the loans. And, if they can’t extend the loans, then the small businesses suffer.”

Dodd-Frank’s negative effects on smaller businesses become more clear once we look at job growth statistics. Woods explains: “When we look at job growth starting in 2002 and going up to Dodd-Frank, a whole lot of it is from small business. But after Dodd-Frank that source of job growth basically dries up. So, we see a divergence between larger firms in terms of their job growth — and job growth in smaller businesses — right about the time that Dodd-Frank begins pummeling your community bank. Krugman says ‘if you want to get rid of Dodd-Frank, that means you want to help the big banks.’ But, the big banks are being quite helped by this current arrangement.”

Later, Bob Murphy analyzed Krugman’s praise of the Obama administration’s recent changes to government mandates on overtime pay. Expanding requirements for overtime, Murphy notes — which will increase the cost of labor — will lead to at least some employers cutting back hours. While looking at the arguments presented by Krugman and other supporters of the new regulations, Murphy explains: “I did not see anybody even bring up the fact that if you say that employers must pay 50 percent more for these hours above 40, employers might purchase fewer hours. We’ve now gotten to the point where [Krugman] doesn’t even give a nod to the fact that making something 50 percent more expensive might make the buyers of that thing [i.e., the employers] want to reduce purchases of it. You could say there are pros and cons, but they don’t even do that. It’s just very naïve ‘you want to help workers, pass this measure, count the people who are affected, and that’s who benefits.’ Who could oppose that except right-wing Neanderthals?”

Tom Woods would go on to cover other aspects of Krugman’s column including inequality, Scandinavian socialism, and government spending.

The full presentation is available at mises.org. 



The Mises Circle in Seattle



On May 21st, 350 attendees from 17 states, Canada, and Estonia joined the Mises Institute in Seattle, Washington for a look at economic myths permeating this year's campaign season. Jeff Deist, Walter Block, Tom Woods, Bob Murphy, and Ryan McMaken all took turns mythbusting on topics ranging from the minimum wage to the benefits of central banks.

Authors and presenters signed books and met with supporters and attendees at breakfast. Later, everyone moved upstairs to the spacious main hall at Town Hall Seattle.

The audience was one of the largest we've ever welcomed to a Mises Circle event, and we're especially grateful to the Harvey Allison Family for their generous contributions which made the event possible. 



Scholar and Alumni News

Recent news from our supporters, alumni, and scholars



WALTER BLOCK

Senior Fellow **WALTER BLOCK** has published several new academic articles including “A Critique of Definitions in Economics from an Austrian Perspective: Macroeconomics” in *The Journal of Economics and Administrative Sciences* (co-authored with Laura Davidson); “Tragedy of the Partnership: A Critique of Elinor Ostrom” in the *American Journal of Economics and Sociology* (co-authored with Ivan Jankovic); “Contra Hoppe and Brat on Immigration” in *Management, Education, Science, Technology*; “John Cochrane vs. Walter E. Block: Debate on Austrian Economics and Libertarianism” in *Economics, Management, and Financial Markets* (co-authored with John Cochrane); “On Ronald Coase as Political Economist” in the *Rutgers Law Record*.



DAVID
HOWDEN

The Japanese edition of Senior Fellow **JESÚS HUERTA DE SOTO**'s 700-page book, *Money, Bank Credit and Economic Cycles*, has been translated by Dr. Kenya Kura and published in Tokyo by Shunjusha Publishing Company. The book has been translated into 21 different languages and published in 16 different countries.



PHILIPP BAGUS

Associated Scholar **DAVID HOWDEN** published several new academic articles including “Central Bank Balance Sheet Analysis” in *Betriebswirtschaftliche Forschung und Praxis* (co-authored with Philipp Bagus); “Time Preference and the Process of Civilization” in the *International Journal of Social Economics* (co-authored with Joakim Kämpe); “Uses and Misuses of Arbitrage in Financial Theory, and a Suggested Alternative” in the *Journal of Prices & Markets* (co-authored with Rafael García Iborra); “The Economic and Legal Significance of ‘Full’ Deposit Availability” in the *European Journal of Law and Economics* (co-authored with Philipp Bagus); “The Efficient Market Conjecture” in the *Quarterly Journal of Austrian Economics* (co-authored with Ricardo Emanuel Campos Dias de Sousa).



RAYMOND
WALTER

Associated Scholar **PHILIPP BAGUS** has published a new book, *Blind Robbery!: How the Fed, Banks and Government Steal Our Money*, with FinanzBuch Verlag publications.

Mises University Alumnus **RAYMOND WALTER** attained joint PhD candidacy in mathematics and physics at the University of Arkansas in May. He is also a finalist for the prestigious Nottingham Prize for which he will compete at the 76th Annual Physical Electronics Conference this year. In June, he received an Honorary State FFA (Future Farmers of America) Degree from the Arkansas FFA Association.

EVENTS

July 24 – 30 — Mises University; Mises Institute

September 16–17 — Supporters Summit, Asheville, North Carolina

October 1 — The Mises Circle in Boston, Massachusetts

November 5 — The Mises Circle in Dallas/Ft. Worth, Texas

December 1 — Mises Institute Seminar with Tom Woods, Orlando, Florida

March 10–11, 2017 — The Austrian Economics Research Conference; Mises Institute

Student scholarships available for all events. See mises.org/events for details.

THE FALLACY OF THE 'THIRD WAY'

DAVID GORDON

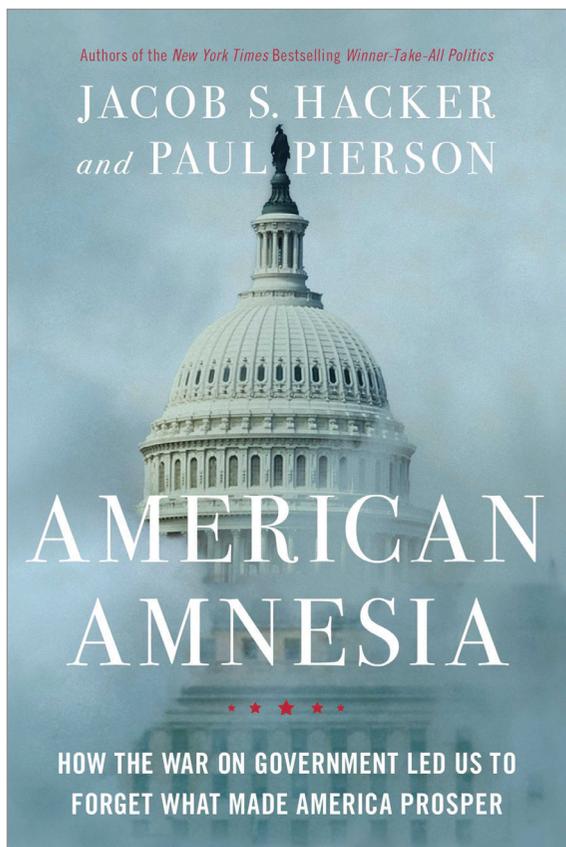
REVIEWS

American Amnesia: How the War on Government Led Us to Forget What Made America Prosper

Jacob S. Hacker and Paul Pierson

Simon & Schuster, 2016

455 pages



The authors, well-known political scientists from Yale and Berkeley, argue that supporters of the free market have forgotten a fundamental truth. Defenders of the market often point to the “Great Fact,” as the distinguished economic historian Deirdre McCloskey terms it, i.e., the amazing increase in human well-being and wealth that began about two hundred years ago, when trade and production in parts of Europe and America became freer than ever before. Does this not make manifest the virtues of the free market? Our authors do not think so. It is the “mixed economy” of government and business that has accomplished the real economic miracle.

They explain in this way what they have in mind: “The political economist Charles Lindblom once described markets as being like fingers: nimble and dexterous. Governments, with their capacity to exercise authority, are like thumbs: powerful but lacking subtlety and flexibility. ... Of course one wouldn’t want to be all thumbs. But one wouldn’t want to be all fingers, either. Thumbs provide countervailing power, constraint, and adjustment to get the best out of those nimble fingers.” (Lindblom, by the way, was so long ago as 1951 a target of William Buckley’s *God and Man at Yale*: Lindblom used some of the same anti-market arguments that our authors deploy here.)

Such is their thesis: what is the evidence for it? “An American born in the late nineteenth century had an average life expectancy of around forty-five years, with a large share never making it past their first birthdays. Then something remarkable happened. In countries

on the frontier of economic development, human health began to improve rapidly, education levels shot up, and standards of living began to grow and grow. ... With the United States leading the way, the rich world crossed a Great Divide — a divide separating centuries of slow growth, poor health, and anemic technical progress from one of hitherto undreamed of material comfort and seemingly limitless economic potential. ... Public health measures made cities engines of innovation rather than incubators of illness. ... Investments in science, higher education, and defense spearheaded breakthroughs in medicine, transportation, infrastructure, and technology.”

The authors’ argument has moved rather too quickly. From the fact that government built something, it hardly follows that the unhindered market could not have achieved the same task, and perhaps better as well. A parallel “argument” will make clear the problem with the “mixed-economy” thesis. Much of the rise of America to industrial supremacy occurred during periods of high protective tariffs. Does this not show that the free market ought to be combined with protection for American industry?

Indeed some, such as Edward Luttwak in *The Endangered American Dream* and Martin Sieff in *That Should Still Be Us*, have argued in precisely this way; but the great majority of economists think otherwise. Economic theory shows the benefits of free trade. If America and other countries became prosperous under high tariffs, there is excellent reason to think that economic progress would have been even greater without them. What Sir Arthur Eddington said of physics applies to our case: “it is ... a good rule not to put overmuch confidence in the observational results that are put forward until they have been confirmed by theory.”

And are there not excellent reasons from economic theory that show that the free market works better than the state? As Ludwig von Mises again and again pointed out, capitalism is a system of mass production for the masses. Businesses prosper to the extent that they meet the wishes of consumers; those that cannot do so cease to exist and their resources pass to the hands of others. By contrast, there is no mechanism to eliminate state-controlled enterprises that fail: the state can continually prop them up through taxes.

Hacker and Pierson might respond that I have ignored a main part of their case. They *do* have a theoretical argument in favor of government investment in public health, science, and education. The market cannot unaided deal adequately with externalities and public goods, and these occur in the types of government investment that they support. “Many important goods in a society are ‘public goods’: they must be provided to everyone or no one. ... In the case of public goods, it is difficult to create an effective market.”

**As Ludwig von Mises
again and again pointed
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The second big case of failure — and it is *really* big — involves markets that produce large effects on people who are neither buyers nor sellers. Economists call these ... ‘externalities.’”

I do not propose here to discuss problems with standard public goods theory, on these, Murray Rothbard’s “Toward a Reconstruction of Utility and Welfare Economics” is an indispensable guide. Instead, let us, just for the sake of argument, for the moment accept the standard theory and see what happens. According to our authors, “The market won’t produce pure public goods at all. Most products yielding positive externalities can sustain private markets (for example, purely private education markets), but these markets will generally be much smaller than we should want them to be.”

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DAVID GORDON, CONTINUED This is a distorted account of the standard theory. It is true of this theory that, where positive externalities are present, the market fails to produce the “optimal” amount of the good or service. But it is not a consequence of the standard view that the market produces a “much smaller” amount than the optimum. To show that would require a detailed investigation of the extent of the externalities: it does not suffice merely to utter the word “externalities” to make the case for intervention. Further, why assume that the state would produce the “optimal” amount? What reason is there to think that the state could calculate the relevant externalities or that, even if it could, its activities would be bound by their limits?

When the authors tell us that a lighthouse is the “classic example” of a public good that the market cannot supply, readers familiar with the relevant literature will be unable to suppress a smile. More generally, it hasn’t been proved that *any* “pure public goods” exist. The authors also unaccountably think that the free market cannot respond adequately to negative externalities. “A hundred years ago, individuals and companies were free to dump raw sewage into municipal water supplies: it took government’s coercive powers to stop the lethal practice.” Surely the problems here stem from inadequate definition of property rights, not market “failure.”

Theory does not support the authors’ case for the mixed economy, and neither do the facts. According to Hacker and Pierson, scientific research and inventions require extensive government support; but they ignore evidence to the contrary. Murray Rothbard notes in *Science, Technology, and Government*, “The myth has arisen that government research is made necessary by our technological age, because only planned, directed, large-scale ‘team’ research can produce important inventions or develop them properly. The day of the individual or small-scale inventor is supposedly over and done with. And the strong inference is that government, as potentially the ‘largest-scale’ operator, must play a leading role in even non-military scientific research. This common myth has been completely exploded by the researches of John Jewkes, David Sawers, and Richard Stillerman in their highly important recent work.”

The case is even worse for Hacker and Pierson as regards public education. They claim that there are positive externalities involved in education, but they do not mention the existence of negative externalities in this area. If, for example, you have an advanced degree, you may be harmed by the fact that many others have such degrees as well. This may make it much more difficult for you to obtain a job. Milton Friedman once thought that positive “neighborhood effects,” his term for externalities, justified a government subsidy for education; but thinking about negative externalities made him change his mind. Of all this our authors seem blissfully unaware.

Much of the book consists of an attack on those who venture to oppose government programs like the Affordable Care Act. These dreadful obstructionists are either hardcore or softcore Randians who dare to put their selfish wish for material gain above the common good. They and others are the amnesiacs who “have never been good at acknowledging government’s necessary role in supporting both freedom and prosperity.”

Unfortunately for our authors, these contentions about the obstructionists do not follow, even if one accepts the view that a mixed economy is necessary. From the “fact,” in my view the opposite of the truth, that government provision of certain services is necessary, it does not follow that one ought now to favor the extension of the government’s activities. How many of the Republicans whom our authors excoriate, one wonders, wish to do away altogether with the mixed economy? The fact that most of them vote for billions of dollars in government programs, albeit in lesser amounts than “progressives” would like, suggests that they too support a mixed economy. This to my mind is an unfortunate fact, but it is a fact nonetheless.

Thus, the authors have failed to make a case for the mixed economy and also failed to show that large numbers of people have forgotten this case. Despite the eminence of the authors, and their book’s fifty-nine pages of notes, *American Amnesia* is a work of propaganda, not of scholarly inquiry. ■■■

David Gordon is Senior Fellow at the Mises Institute, and editor of *The Mises Review*.

THE GLOBAL ECONOMY IS IN UNCHARTED WATERS

A CONVERSATION WITH **BRENDAN BROWN**



Brendan Brown is a frequent contributor to mises.org and is an Associated Scholar of the Mises Institute. He is the Head of Economic Research at Mitsubishi UFJ Securities International. He received a PhD from the University of London, MBA from the University of Chicago, MSc from the London School of Economics, and an undergraduate degree from Cambridge University. Dr. Brown is a regular contributor to financial newspapers in Switzerland and Japan and also to Bloomberg and CNBC TV. He is the author of several books on monetary policy and finance, and we recently spoke with him about his most recent book *A Global Monetary Plague: Asset Price Inflation and Federal Reserve Quantitative Easing* now available from Palgrave.

THE AUSTRIAN: What is the “Great Monetary Experiment” you refer to in your book?

BRENDAN BROWN: The Federal Reserve has sought by using non-conventional monetary tools to produce a stronger than normal economic expansion following the Great Recession. The resort to such tools has occurred in a context where money market rates have already fallen to near zero, meaning that the conventional tool of rate cuts is not available. The ECB and Bank of Japan joined in the experiment with a considerable lag behind the Federal Reserve.

The non-conventional tools have included massive expansion of the monetary base, manipulation of long-term interest rates — and in the case of Europe — sub-zero interest rates. The tools have been applied toward achieving an inflation rate over the medium-term (in practice two years) of 2 percent per annum.

The setting of an inflation target pre-dates the Great Monetary Experiment. Transcripts reveal that at an FOMC meeting in summer 1996, then-Governor Janet Yellen presented a paper (invited by then-Chair Greenspan) arguing that the aim of “price stability” should be interpreted to mean perpetual “low” inflation.

The architects claim the monetary experiment has been a great success even though this is the slowest US economic expansion ever. And of course we cannot estimate the full costs including malinvestment until the record of the full business cycle including its asset price deflation phase is available.

BRENDAN BROWN, CONTINUED

yield? In your book you call it “interest-income famine.”

BB: The nineteenth-century English financial journalist Walter Bagehot coined the concept of “yield starvation” when he said that “John Bull will stand for many things but not interest rates below 2 percent.” He meant that in such a situation the investor would act “madly.” In today’s terms, we could translate that into the observation that if interest income from safe investments is very low, then investors, in their desperation for yield, chase uncritically a succession of speculative ideas. These apparently justify high and rising prices (relative to sober valuations) in presently hot asset classes. Investor decision-making reveals abnormally flawed mental processes.

Of course, sometimes even under a sound money regime interest rates would reach very low levels as during a recession. But so long as these are regarded as transitory and there is no serious danger of an erosion of wealth by the eruption of inflation, rationality would dominate especially as longer term interest rates would remain substantially positive. But under the Great Monetary Experiment investors have been deeply troubled by the far-out danger of inflation — especially given the bloated size of the monetary base. They also fear that the Experiment will eventually bring a crash which would be followed by an even bigger experiment.

Time-horizons also shorten for many investors as they enter into desperate gambles to make returns before the Day of Reckoning. Companies get rewarded by the equity markets for paying out cash and making profits from financial engineering rather than for undertaking bold long-gestation investments.

TA: What does it mean that investors have become starved for

TA: You speak often of asset-price inflation. It seems that measuring inflation is easier said than done, however. What are some of the challenges in measuring inflation?

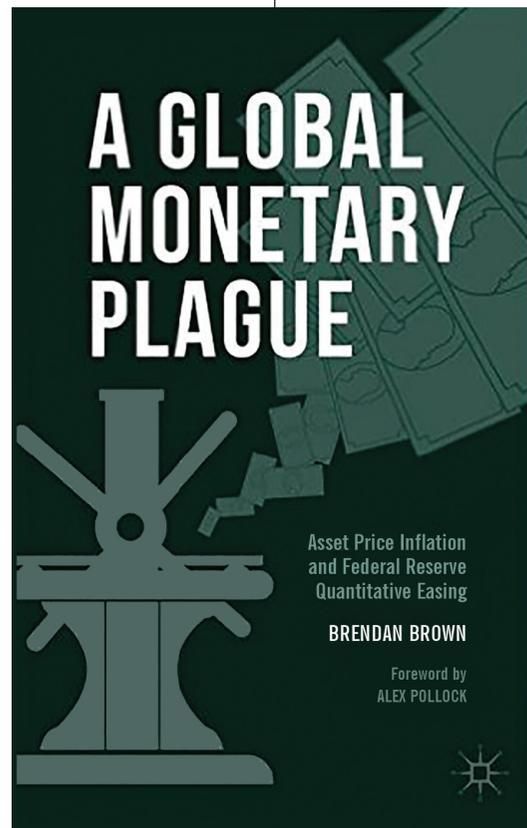
BB: Asset price inflation is hard to measure and diagnose because it involves a comparison between actual capital-market prices as influenced by strong irrational forces, and hypothetical prices that would exist under conditions of sound money. Moreover, asset price inflation does not affect all markets simultaneously. Indeed there is a mid-phase of the disease when speculative temperatures may be rising in some markets at the same time as falling in others.

These difficulties in measurement and diagnosis of asset price have been seized on by some critics to say that the disease does not exist. Other critics admit that there are periods in economic history when irrational exuberance in various forms is evident but maintain that the essence of the phenomenon is purely psychological (i.e., created by “animal spirits”). One answer to these criticisms is to take these episodes through history and demonstrate each time that monetary disorder has been present in a big way. The other part is to outline a clear chain of causality between monetary disorder and the growth of the irrational forces in asset markets. I try to do both in my book.

TA: In the past, we’ve seen the dot-com boom and the housing boom. This time around, the boom is different. What are the

boom industries right now, and why has money gravitated toward those industries?

BB: This time the boom has been in the oil industry (including shale), in other commodity extraction industries, in emerging markets (including their real estate sectors), in export sectors in the advanced economies supplying the emerging markets especially China, and in Silicon Valley. Much of this boom (but not all) has turned to bust.





These stories fueled the flow of funds into high-yield credits and currencies in the pursuit of yield. Fantasy prices for high-yield credits were an essential condition for the boom in the private equity industry which in turn invested in the sub-prime auto finance and aircraft leasing sectors on a highly leveraged basis. Similar things happened in the shale gas and oil industry. Alongside there has been the boom in the currency carry trade into China and emerging markets whose economies were very dependent on the China boom. This speculative inflow into Chinese and wider emerging market currencies and credits as driven by the Great Monetary Experiment created economic boom and bust. The closest historical parallel to the carry trade boom in this cycle was perhaps the huge inflows of capital into the Weimar Republic between 1924–28 as fueled by the combination of monetary disorder as generated by the Benjamin Strong Fed, and the fantastic speculative activity surrounding the German “miracle economy” emerging from the destruction of war and hyperinflation.

TA: There are a lot of people out there who have been predicting a meltdown for years. You, on the other hand have identified several reasons as to why the current boom has not yet collapsed. What are some of these reasons?

BB: Each episode of asset price inflation disease through history has some elements common with others and some distinct. Since the early years of this episode — back in, say, 2010–12 — I have sought to diagnose the stage of the disease that we are in. Yet in my work I have

been very aware of Mises’s advice against firm predictions in such matters. The weak overall economic expansion in the US and other advanced economies meant that an early end to the cycle was not going to come from general overheating accompanied by a substantial rise in interest rates. Indeed the economic sluggishness could be explained by huge monetary uncertainty weighing on business confidence. Instead, the end phase of the disease this time could arrive through a speculative burn-out — a disappointing reality causing rose-colored spectacles to splinter. ■■





Mises Destroys Socialism, Again and Again

BY JONATHAN NEWMAN

We need Mises now more than ever. The Federal Reserve is weighing which month to increase their target rate by a quarter of a percentage point, sending the media into a flurry whenever Janet Yellen so much as sneezes. As millions of US voters fall behind a self-avowed socialist, Venezuela's socialist experiment is crashing and burning: Coca-Cola has shut down operations, toilet paper is a luxury item, power outages are regular, and violence and looting are on the rise. This is a prime opportunity to show others the prescience of Mises.

Only the strong Misesian arguments against central banking and socialism can explode (as Mises himself would say) the claims of their contemporary defenders. Mises's arguments are the strongest because of his unyielding dedication to constructing and maintaining an economic methodology that produces unassailable conclusions. His business cycle theory carries the same certainty as the laws of diminishing marginal utility, comparative advantage, time preference, and other rock-solid economic principles, as an outgrowth of the same line of logical thinking. His critique of socialism is unparalleled among other critiques in its inescapable consequences for socialism in both theory and practice.

Weaker arguments do not rely on the absolutely certain conclusions of economics and are easily parried by opponents. Saying the Federal Reserve needs to be reformed because the policymakers are not representative of the demographics of the US population would fit into this category. Another is the

claim that socialism doesn't work because people don't have an incentive to work hard or because the government just doesn't have enough computing power to calculate the optimal prices of goods. These kinds of weak arguments become cannon fodder and straw men for detractors of unhampered markets and private property.

The Problem with Central Banking

Mises made the strongest case against central banking. He showed that the business cycle is not an inherent part of an unhampered market economy, but the result of artificial credit expansion. Whenever the money issuing authority inflates through credit markets, it pushes interest rates down to artificially low levels and sets in motion investment in lines of production that only appear to be profitable. The new money and low interest rates also fuel increased consumption spending.

Thus the boom is marked by malinvestment and overconsumption — not based on a voluntary expression of real time preferences, but the whims of the central bank officials. The plans of the entrepreneurs cannot be completed due to the prices of the factors of production becoming prohibitively high from the increasing scarcity of capital goods and because much of the remaining capital is employed in the wrong ways. The bust comes when these errors can no longer be sustained by new money flowing in through credit markets. The malinvested

capital is liquidated and laborers too must find new employment in profitable lines of production.

This is a rhetorically strong explanation for business cycles, and there are many examples of economists and historians applying Mises's theory to specific episodes like the Great Depression and the most recent housing boom and bust.

The *Real* Reason Why Socialism Doesn't Work

Mises also made the strongest case against socialism. With private ownership of the means of production, entrepreneurs hire laborers and purchase capital and natural resources based on their contribution to the productive process as measured by consumers' willingness to pay for the final output. Anticipated revenues from the sale of output guide production and investment decisions. Any deviation from the consumers' wishes results in lower profits or even losses.

Under socialism, in which the private ownership of the means of production is abolished, there can be no meaningful prices of the inputs to production processes. Production decisions are merely "groping in the dark," as Mises put it in *Economic Calculation in the Socialist Commonwealth*. Mises showed that there is no forward-looking way to compare anticipated revenues to the costs of production and there is no way to retrospectively measure the success of any production process. Economic calculation,

essential to any growing and flourishing market economy, is impossible.

Socialism, then, must result in the participants' wants and needs going unsatisfied. This is another rhetorically strong argument, and it is especially fortified by the observed tragic failure of every socialist "experiment" (if you can call the deaths of millions of people something so mundane).

Real-World Human Action Is at the Core

Mises didn't just haphazardly stumble upon these brilliant insights. They were the product of careful logical deduction and rigorous self-scrutiny along the lines of his own contributions in the epistemology of economic science.

The logic of human action starts with means and ends and proceeds through exchange, prices, production, money, credit, and the necessary consequences of interventions in these areas. Mises showed that economics does not produce generalities or vague guidelines that may be overcome if only governments are smart and powerful enough. The science of economics reveals laws that cannot be broken. Our persuasive efforts are dramatically improved if we can convey these arguments from Mises and build on his strong foundation. ■■■

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