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RESEARCH REPORTS

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BUSINESS CONDITIONS MONTHLY

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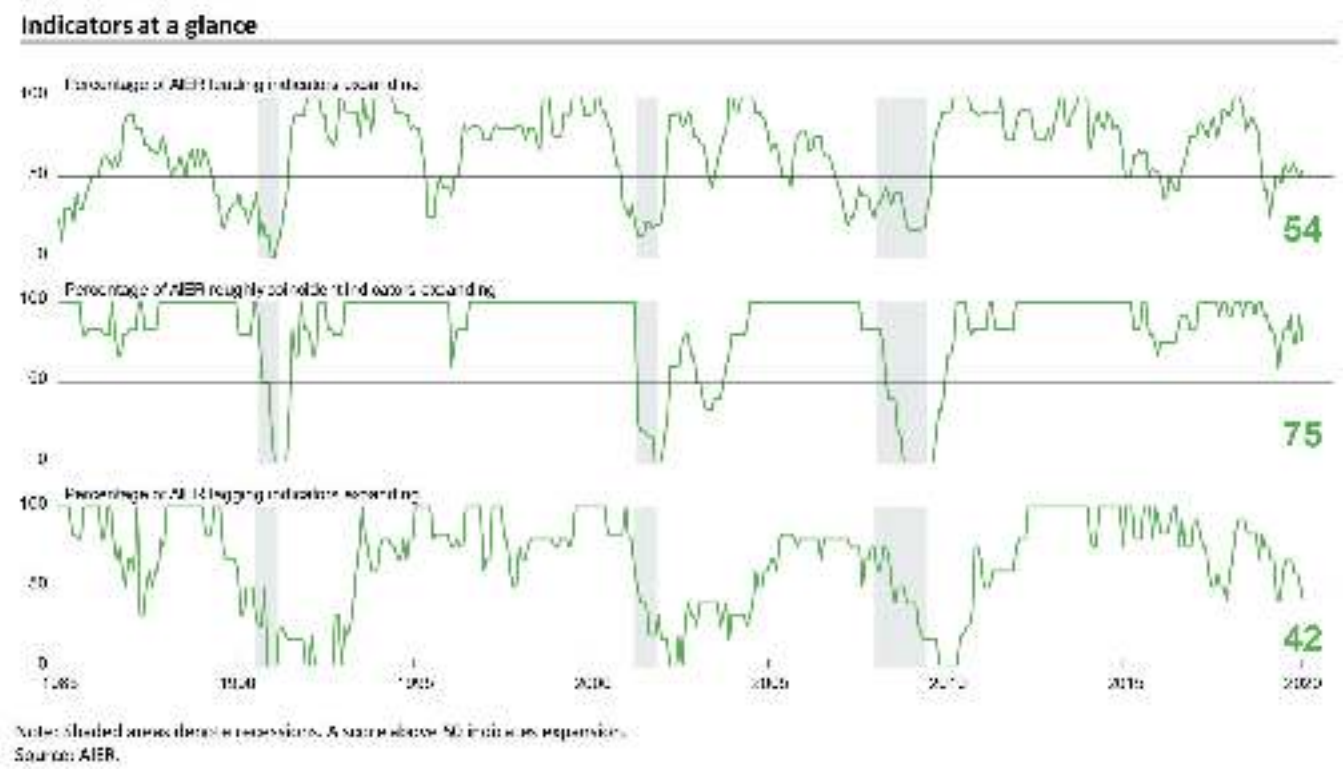
AIER's Leading Indicators Index remains close to neutral; coronavirus threatens outlook.

AIER's Leading Indicators Index rose 4 points to a reading of 54 in February, up from 50 in January. The Roughly Coincident Indicators Index and the Lagging Indicators Index both fell, to 75 and 42, respectively (see chart). February is the tenth consecutive month within the 46 to 54 range for the Leading Indicators Index. The continuing modest performance of the Leading Indicators Index reflects the varied performance among the major sectors of the economy and overall slow pace of growth.

The risks from the coronavirus (COVID-19) are still unknown but appear to be growing. The outbreak has already had wide-ranging, mostly negative, effects. The effects on economic activity will almost certainly be significant enough to be reflected in economic statistics, likely beginning with monthly reports released in April and covering the month of March. High frequency statistics such as initial claims for unemployment insurance and same-store retail sales have not shown a significant impact as yet. Many public companies have announced significant impacts on operations, and lowered sales and earnings expectations accordingly. Financial markets have reacted sharply, reflecting the role fear and emotions play in day-to-day market prices.

The emergency rate cut by the Federal Reserve acknowledges the extent of the current effects and potential for future disruptions to economic activity. Ultimately, the full effects of the outbreak will be determined by the degree to which the virus can be contained and the ability to develop a vaccine. Both of these remain unknown. Extreme caution is warranted.



Leading indicators were mostly unchanged in February

The AIER Leading Indicators index rose to 54 in February. February is the tenth consecutive month within the 46 to 54 range for the Leading Indicators Index following a four-month run below neutral that hit a low of 25 in March 2019. The average over the last 10 months is 52.9, just barely above neutral. The near-neutral results suggest continued slow growth with elevated downside risks.

Just one indicator changed direction in February as real new orders for nondefense capital goods excluding aircraft improved from a negative trend to neutral. Among the 12 leading indicators that make up the Leading Indicators Index, six are trending higher, five are trending lower and one is neutral. The nearly balanced results are indicative of the varied performance of the major sectors of the economy.

Across the broad categories of indicators, results are mixed. The two labor market indicators, initial claims for unemployment insurance and average workweek in manufacturing have offsetting trends with claims trending favorably but average workweek trending lower. Heavy-truck unit sales were trending lower, offsetting the neutral reading from new orders for core capital goods indicator. Among the financial indicators, debit balances in margin accounts and the Treasury yield spread indicator were unfavorable in February. However real stock prices were still trending favorably (though that is likely to change next month given recent stock price movements).

On an upbeat note, consumer-related indicators were tilted positively as real retail sales and food services, real new orders for consumer goods, and the University of Michigan Index of Consumer Expectations were all trending higher.

The Roughly Coincident Indicators index fell 17 points to 75 in February from 92 in January. Despite the significant decline, just one indicator changed signal in February. The Conference Board's consumer confidence in the present situation indicator weakened from a positive trend in January to a negative trend in February. That move left the index with four roughly coincident indicators in uptrends while one was neutral and one was in a downtrend.

The Lagging Indicators index fell 8 points in February to a reading of 42, the lowest result since June 2019. Among the six lagging indicators, just two were trending higher while three were trending lower and one was neutral. The core consumer prices indicator weakened from a favorable trend to a neutral trend in February.

Coronavirus Situation Report

Information about the outbreak of COVID-19 is changing continuously (officially, the virus has been named "SARS-CoV-2" and the disease it causes has been named "coronavirus disease 2019," abbreviated "COVID-19".) The World Health Organization (www.who.int) and the U.S. Center for Disease Control (www.cdc.gov) provide regular updates on the outbreak.

According to the World Health Organization, the first patients were reported to it by China on December 31, 2019. From sometime in mid-to-late December, COVID-19 has spread to approximately 90,000 people in 65 countries causing more than 3,000 deaths. The vast majority of confirmed cases and deaths are in China. Other hot spots include Republic of Korea (South Korea), Italy, and Iran, which account for a combined 7,000 confirmed cases and 111 deaths. In the U.S., there are 60 confirmed cases with 6 deaths across 12 states.

Significant efforts to contain the spread of COVID-19 are underway. Travel restrictions and quarantines are being implemented around the world. Those efforts are having direct effects on economic activity. Furthermore, reactions by people around the

world have altered daily routines including travel, work, and spending patterns.

Economic Implications

While it's too early to gauge the full impact of the outbreak, numerous public companies have already announced disruptions to supply chains, production, and sales. Financial markets have reacted sharply with equity markets falling 10 percent or more. Bond markets have seen yields on safe assets drop, including the U.S. 10-year Treasury note yield which fell below 1.0 percent for the first time ever following an emergency rate cut by the Federal Reserve. The Fed lowered the target range for the fed funds rate by 50 basis points to 1.00 percent to 1.25 percent.

For the most part, economic statistics in the U.S. have yet to reflect the outbreak. Monthly statistics for March will begin to be published in April, though the latest surveys from the Institute for Supply Management noted widespread comments about the unfolding outbreak, and the University of Michigan Survey of Consumer Sentiment will publish a preliminary estimate in mid-March. High frequency data such as initial claims for unemployment insurance and weekly same-store retail sales are holding at pre-outbreak levels.

Overall, the COVID-19 outbreak represents a major threat to the U.S. and global economies. There is an increasing likelihood that first-quarter growth in the U.S. and around the world will slow dramatically and could turn into a contraction – possibly a severe contraction. Extreme caution is warranted.

Manufacturing Sector Remains Fragile

The Institute for Supply Management's Manufacturing Purchasing Managers' Index fell to a 50.1 percent reading in February, down from 50.9 percent in January. The February result was the second month just barely above the neutral 50 threshold following five months below neutral.

Among the key components of the Purchasing Managers' Index, the New Orders Index came in at 49.8 percent, down from 52.0 percent in January. February returned to a below-neutral level after turning positive in January. January was the first month with a reading above 50 percent following five months below neutral. The results suggest production as measured by the Federal Reserve's industrial production for manufacturing index may continue to be weak in the coming months.

The production index was at 50.3 percent in February, down from 54.3 percent in January. The weaker performance for production contributed to an increase in the backlog-of-orders index. That index came in at 50.3 percent in February, up from 45.7 percent in January.

Consumer Price Increases Accelerate

The Consumer Price Index posted a 2.5 percent increase for the 12 months through January. The historically volatile food and energy categories had gains of 2.0 and 6.9 percent respectively while the core consumer price index, which excludes food and energy, increased 2.3 percent. These increases are a bit faster than the 5-year annualized gains of 2.0 percent for the consumer price index, 1.8 percent for food, and 1.9 percent for energy. The 5-year rate for the core consumer price index was 2.1 percent.

Key areas accounting for much of the persistent increases include owners' equivalent rent, tobacco, medical care (particularly hospitals), and food services. Owners' equivalent rent accounts for about 24 percent of the consumer price index and has posted a five-year annualized increase of 3.3 percent. A unique attribute of owners' equivalent rent is that there is no actual transaction. The number represents what a homeowner theoretically would

pay to rent their home to themselves. An argument can be made that including a category with such a significant weight yet no real underlying transaction inaccurately boosts the final index. If food, energy, and shelter were excluded from the Consumer Price Index, the 12-month gain would be just 1.5 percent, while the five-year annualized pace of increase is just 1.3 percent.

Among the other significant contributors, tobacco prices are up 5.4 percent for the year and 4.6 percent annually over the last five years; medical care is up 4.5 percent for the year and 3.0 percent over five years with hospital services up 3.8 percent and 4.0 percent, respectively; and food services are up 3.1 percent over the past 12 months and 2.7 percent annually over the past five years.

On the opposite end of the spectrum, the Consumer Price Index for all goods except for food and energy goods is down 0.3 percent for the past year and down 0.2 percent annually over the last five years. Overall, consumer prices have been increasing at a slightly faster pace. Energy continues to be volatile, but within the core consumer price index, goods prices are generally falling (except for tobacco) while services, particularly housing and medical services, are rising.

Commercial bank lending has been moderate

Commercial banking institutions in the U.S. increased total loans and credit outstanding by just 0.1 percent in January, resulting in a 12-month rise of 4.2 percent. That is less than half the pace of credit growth over the two years prior to the last recession. Excessive credit growth can be a significant problem during economic expansions; however, the current pace of expansion appears moderate.

Among the major segments, residential mortgages, consumer loans, and commercial real estate loans have been growing in a range of 2.5–6 percent over the past year, up from a range of 1.5–5 percent at the beginning of 2019. The notable exception is commercial and industrial loans which grew at a 1.2 percent pace over the past year, down from a 10.4 percent pace for the 12 months ended February 2019. The latest survey of senior loan officers at commercial banks suggests loan demand remains solid for residential mortgages but generally weak for commercial and industrial loans.

CAPITAL MARKET PERFORMANCE

(Percent change)

	February	Latest 3M	Latest 12M	Calendar Year 2019	Calendar Year 2018	Calendar Year 2017	Annualized 3-year	Annualized 5-year	Annualized 10-year
Equity Markets									
S&P 1500	-8.5	-6.3	4.9	28.3	-6.8	18.8	7.1	6.7	10.3
S&P 500 - total return	-8.2	-5.5	8.2	31.5	-4.4	21.8	9.9	9.2	12.7
S&P 500 - price only	-8.4	-6.0	6.1	28.9	-6.2	19.4	7.7	7.0	10.3
S&P 400	-9.6	-9.8	-5.0	24.1	-12.5	14.5	1.6	3.8	9.4
Russell 2000	-8.5	-9.1	-6.3	23.7	-12.2	13.1	2.1	3.7	8.9
Dow Jones Global Large-Cap Index	-8.0	-5.8	2.7	23.8	-10.4	42.9	13.0	3.7	5.8
Dow Jones Global Large-Cap ex-U.S. Index	-7.8	-6.6	-2.7	18.2	-15.7	41.0	8.1	-0.3	1.7
STOXX Europe 600 Index	-8.5	-7.8	-0.8	23.2	-13.2	7.7	0.5	-0.9	4.3
Bond Markets									
iShares 20-plus Year Treasury Bond ETF	6.4	10.6	29.4	11.5	-4.2	6.5	8.5	3.7	5.4
iShares AAA - A Corporate Bond Fund	1.1	2.8	10.4	9.1	-5.2	2.9	2.8	1.4	NA
Commodity Markets									
Gold	0.0	8.6	20.6	18.7	-1.7	12.6	8.1	5.5	3.7
Silver	-3.9	1.3	8.7	16.7	-8.3	3.8	-2.0	0.8	0.6
CRB all commodities	-2.1	2.4	-4.2	-1.9	-5.4	2.2	-2.9	-1.2	-0.8

Sources: Barrons, Commodity Research Bureau, Dow Jones, Frank Russell, iShares, Standard & Poor's, STOXX Europe 600, Refinitiv.

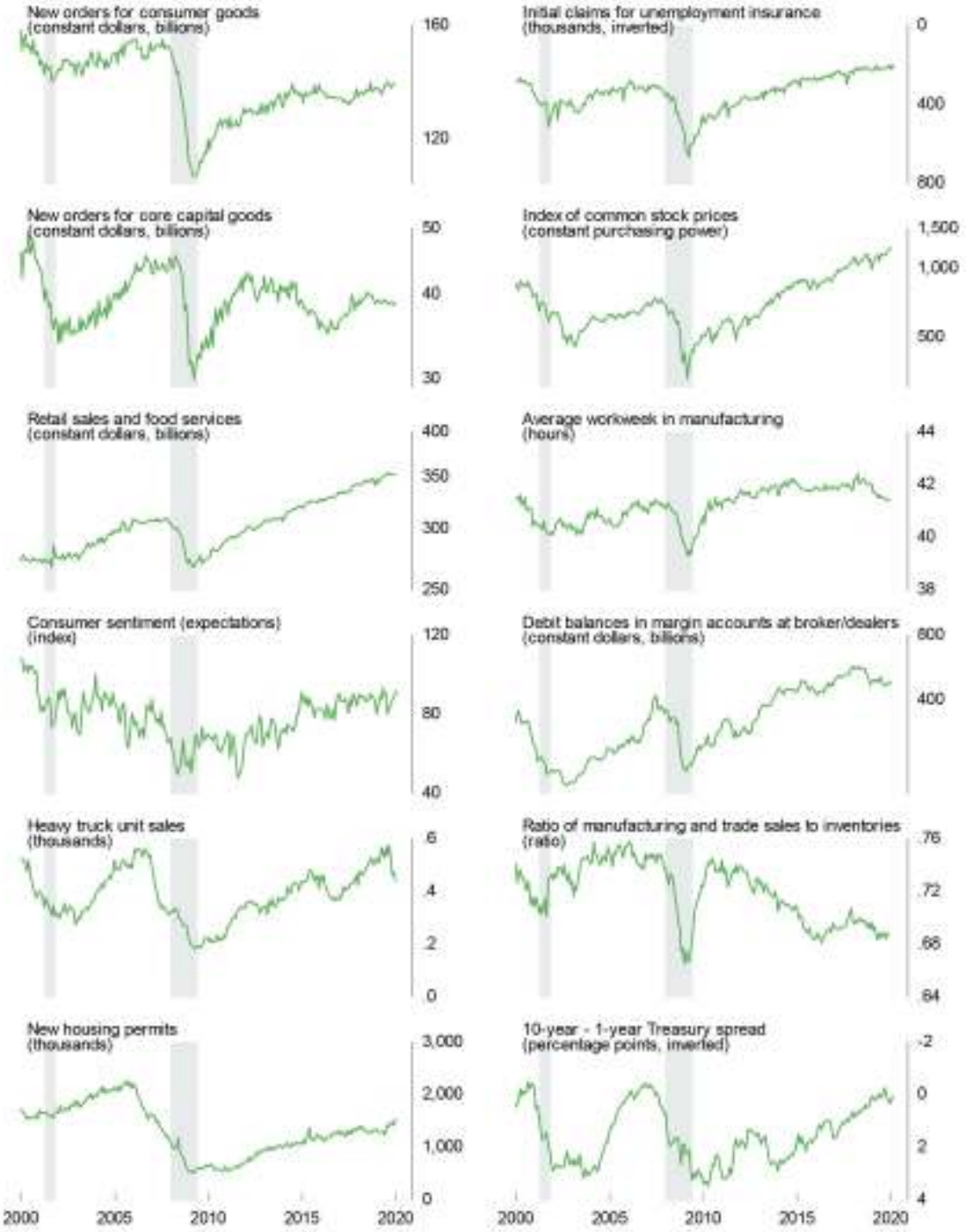
CONSUMER FINANCE RATES

(Percent)

	February	Latest 3M	Latest 12M	Average for Year 2019	Average for Year 2018	Average for Year 2017	Average over Period 3-year	Average over Period 5-year	Average over Period 10-year
30-yr. fixed mortgage	3.6	3.7	3.9	3.9	3.7	3.9	4.1	4.0	4.1
15-yr. fixed mortgage	3.1	3.1	3.3	3.4	2.9	3.1	3.5	3.3	3.4
5-yr. adjustable mortgage	3.3	3.4	3.5	3.6	2.9	2.9	3.5	3.3	3.2
48-month new car loan	NA	5.5	5.4	5.4	4.3	4.2	5.0	4.7	4.9

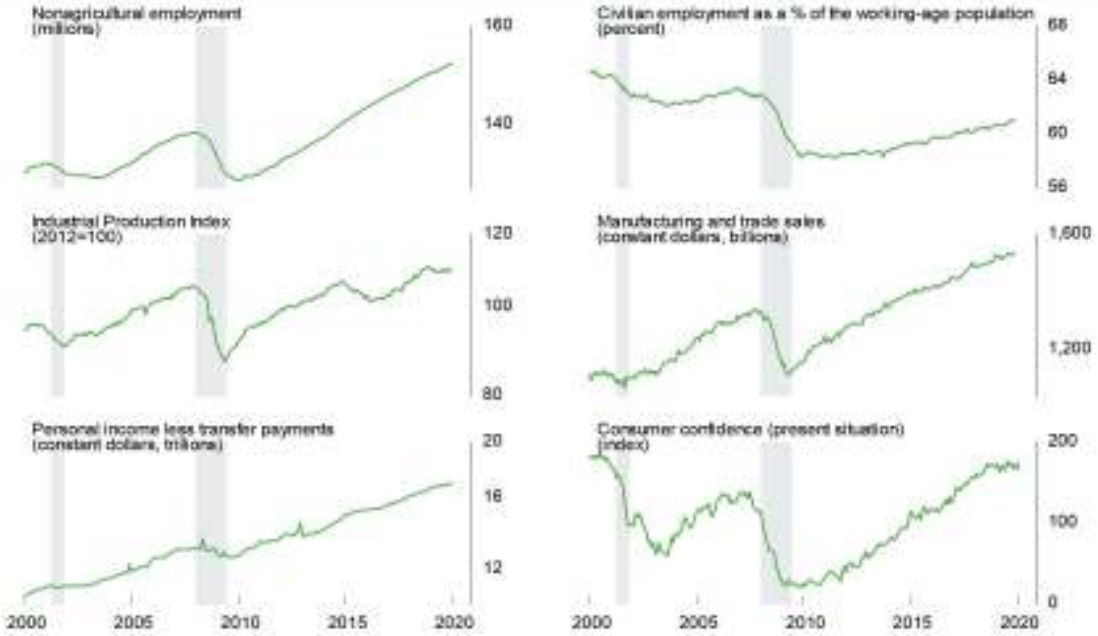
Sources: Bankrate, Federal Reserve.

LEADING INDICATORS (1950-2019)



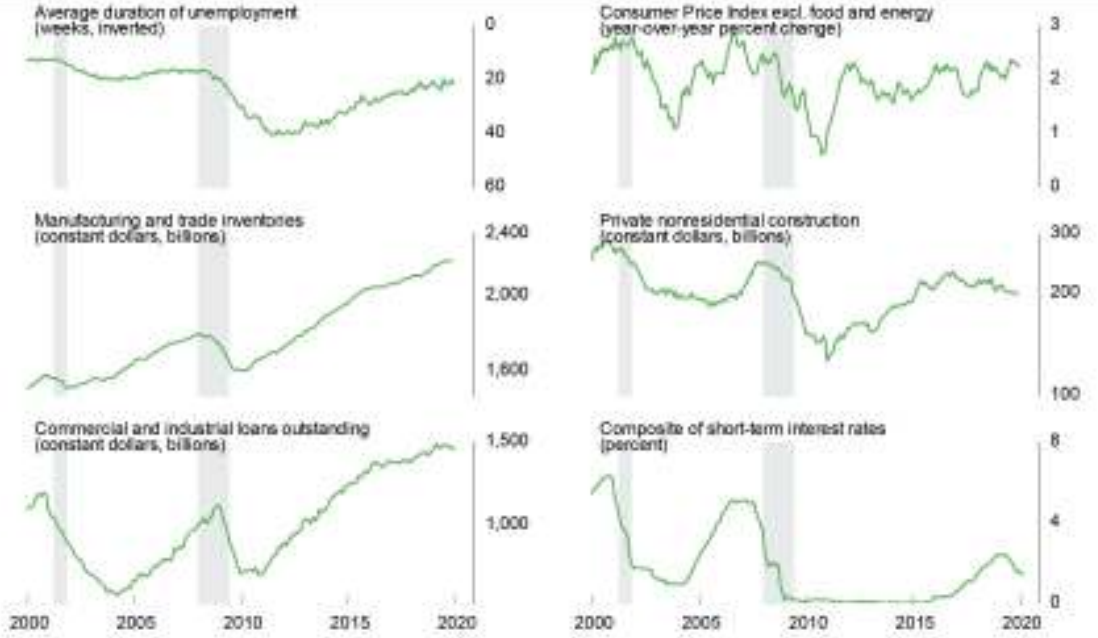
Note: Shaded areas denote recessions.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, The conference Board, Census Bureau, Department of Labor, Federal Reserve, Institute for Supply Management, Standard & Poor's, AIER (Refinitiv).

ROUGHLY COINCIDENT INDICATORS (1950-2019)



Note: Shaded areas denote recessions.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, The conference Board, Census Bureau, Department of Labor, Federal Reserve, Institute for Supply Management, Standard & Poor's, AIER (Refinitiv).

LAGGING INDICATORS (1950-2019)



Note: Shaded areas denote recessions.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, The conference Board, Census Bureau, Department of Labor, Federal Reserve, Institute for Supply Management, Standard & Poor's, AIER (Refinitiv).

The Overnight Lending Intervention That Wasn't

JAMES L. CATON

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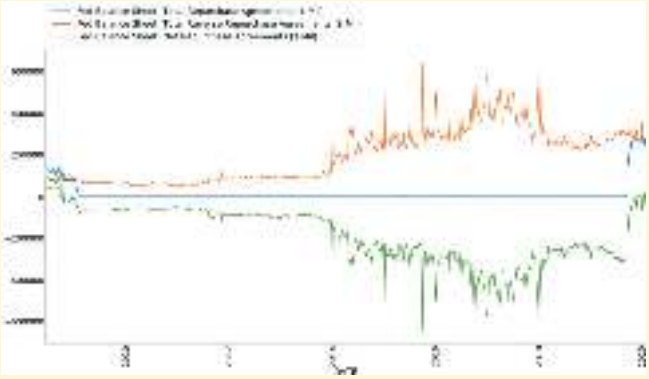
Recent intervention in the overnight lending market is not precisely an intervention. In some ways, it is a dis-intervention. Viewed in terms of the net effect of activity by the Federal Reserve, the recent accumulation of repurchase agreements has only just recently offset the contractionary effects on overnight lending exerted by its holdings of reverse repurchase agreements.

When the Federal Reserve increases its holdings of repurchase agreements, it provides a short-term loan to investors in the overnight lending market. Accumulation of reverse repurchase agreements accomplishes just the opposite. The Federal Reserve borrows from investors in the overnight lending market.

When the Federal Reserve acquires a repurchase agreement, it increases the quantity of funds in the overnight lending market. When it acquires a reverse repurchase agreement, it removes funds from the market. Accumulation of repurchase agreements by the Federal Reserve provides monetary stimulus to the overnight lending market. Accumulation of reverse repurchase agreements depresses private lending in that market.



Since the start of the crisis, the Federal Reserve's net effect on overnight lending has been negative. I was at first surprised by this finding. The common response in the media has been that the Federal Reserve has provided significant support for overnight lending. The reality is that Fed intervention has been a millstone for the overnight lending market, having removed as much as $536.6 billion.

Since early 2009, the Federal Reserve owned only reverse repurchase agreements. The Fed's accumulation of repurchase agreements in September was the first of its kind since that time. The overall influence of the Federal Reserve on the overnight lending market is represented as the difference between the value of its repurchase agreements and its reverse repurchase agreements. These include "overnight" agreements where the Federal Reserve purchases or sells U.S. Treasuries as part of a repurchase or reverse repurchase agreement. This value had hovered around -$250 billion for much of Powell's tenure and only became positive in November. At present, *the net effect* of Federal Reserve holdings of repurchase agreements and reverse repurchase agreements is approximately zero.

U.S. Treasuries and the Fed's Balance Sheet

After Powell took the helm as chair in early 2018, he consistently reduced the Fed's balance sheet. That was true until the recent intervention that began in September 2019. The initial expansion of the balance sheet that occurred in late September and into October owed largely to the increase in holdings of repurchase agreements. (In the plot, I have included overnight repurchase and reverse repurchase agreements as part of "Total Treasuries,"

not as part of "Repurchase Agreements." For "Total Treasuries," the difference between "Overnight Repurchase Agreements" and "Overnight Reverse Repurchase Agreements" is added to "Treasuries Held Outright.")

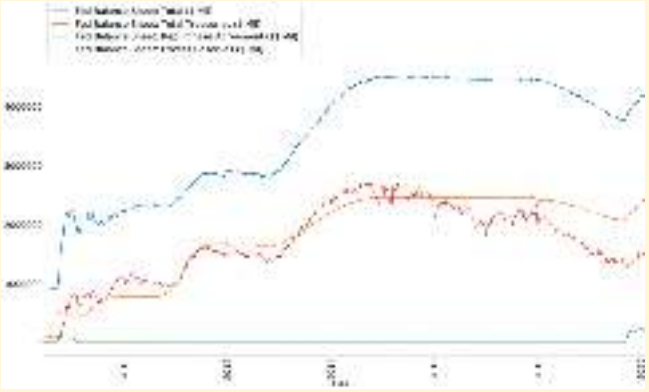
Since September, the Federal Reserve has consistently increased its holdings of U.S. Treasuries. This is responsible for the steady increase in the size of the balance sheet even after Fed holdings of repurchase agreements stabilized.

Interest rate volatility in the overnight lending market has provided the Federal Reserve a pretense for increased support of the Treasury market. The persistent growth of Treasury holdings by the Federal Reserve suggests this is the more significant effect of expansion. The initial volatility in the overnight lending market appears to have been the result of the maturation of U.S. Treasuries. The new offering of U.S. Treasuries pulled resources from the overnight lending market that were not offset by inflows from elsewhere.

Powell's approach was twofold: relieve the pressure placed on the overnight market by the Federal Reserve and provide support for federal borrowing.

While Powell has simultaneously solved these interdependent problems, the move has revealed difficulties faced by the current regime. A reduction of the Fed's balance sheet necessarily reduces support for federal borrowing. Without support, rates paid on U.S. Treasuries will rise, as will rates in other markets. This is particularly true for short-term borrowing, as we observed in September. The new intervention, however, moves the size of the balance sheet back above $4 trillion.

If Powell maintains this course, we will likely observe a sustained increase in the quantity of excess reserves held at the Federal Reserve. Since September, the path of excess reserves has begun to tick upward, suggesting that the preceding downward trend may reverse. If the Federal Reserve balance sheet continues to expand, the only way to prevent this would be for Powell to, once again, increase the discrepancy between the federal funds rate and the rate of interest paid on excess reserves. This would draw excess reserves into the market as the payoff of investments would increase relative to the rate paid on excess reserves. Powell has shown no indication that this is his intention as the rate paid on excess reserves remains 20 basis points below the federal funds rate.



There may be a silver lining in the recent changes. The Federal Reserve has somewhat decreased its level of repurchase and reverse repurchase agreements since November. This reduction has been relatively small compared to the recent expansion. Still, it would not be unreasonable for the Federal Reserve to continue reducing the value of holdings in sync with one another. This would be one means by which it can reduce the size of its balance sheet without exerting a net effect on the market.

At present, holdings of repurchase and reverse repurchase agreements have hovered from around $260 billion to $280 billion. Since these values are about equal, the Fed is essentially intermediating these funds, borrowing from and lending to investors in the overnight market. Thus, simultaneous reduction of these balances would not harm these markets.

The only reason for maintaining large balances

would be for the Federal Reserve to have a means of more swiftly influencing overnight lending by asymmetrically reducing holdings of either category of instrument. Thus, it could ease conditions by reducing holdings of reverse repurchase agreements or tighten conditions by reducing holdings of repurchase agreements.

Throughout his tenure, Powell has shown a willingness to reduce the weight that the Federal Reserve places on financial markets. He was the first chair since the 2008 crisis to reduce the rate of interest paid on excess reserves relative to the federal funds rate. He has increased this discrepancy twice now. He also consistently reduced the size of the balance sheet until September 2019.

Although Powell is the chair, he faces pressure from both inside the Federal Reserve board and Congress. To implement change, he must either withstand this pressure or accomplish his goals by a means that does not generate resistance from them. The current strategy seems to take the latter approach. Time will tell if he can reduce the Fed's footprint moving forward.

February 8, 2020

Employment and the Participation Rate Rose in January

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The labor market rebounded in January. U.S. nonfarm payrolls added 225,000 jobs after an increase of just 147,000 new jobs in December. The December gain was revised up 2,000 from an initial estimate of 145,000 jobs. Combining the last two months with a 5,000 upward revision to November, the three-month average gain in payrolls came in at 211,000 in January.

For the private sector, nonfarm payrolls added 206,000 in January following a gain of 142,000 in December. On a three-month average basis, private payrolls added 198,000. Over the last six months, the average gain is 206,000 for total nonfarm jobs and 190,000 for the private sector. The six-month average for private payrolls has been trending higher since hitting a relative low of 123,000 in July 2019 (see top chart).

Goods-producing industries added 32,000 in January, ahead of the monthly average gain of 11,000 over the past year. Construction led with the addition of 44,000 jobs while durable-goods manufacturing and nondurable-goods industries lost 11,000 and 1,000, respectively. Within private service-producing industries, which typically account for the lion's share of job creation, payrolls added 174,000 workers, led by gains of 47,000 in health care, 36,000 in leisure and hospitality, 28,000 in transportation, and 21,000 in professional and business services. Retail employment led on the downside, losing 8,000 for the month.

The unemployment rate ticked up to 3.6 percent from 3.5 percent in December but remains close to a five-decade low (see bottom chart). The labor force participation rate moved up to 63.4 percent in January, the highest since February 2013, as 50,000 people joined the labor force in January (see bottom chart). Over the past year, more than 1.4 million people have entered the labor force.

Average hourly earnings rose 0.2 percent in January, leaving the 12-month change at 3.1 percent, down from 3.5 percent for most of the first half of 2019 (see bottom chart). Average hourly earnings growth has been slow compared to previous cycles, especially given the low unemployment rate, but has now been above the three percent level for 18 consecutive months.

Average weekly hours were unchanged at 34.3. Combining payrolls with hourly earnings and hours worked, the index of aggregate weekly payrolls rose 0.4 percent in January and 4.0 percent from a year ago. This index is a good proxy for take-home pay and has posted relatively steady year-over-year gains in the 3.5 to 5.5 percent range since 2011 (see top chart). Continued gain in the aggregate-payrolls index is a positive sign for consumer income and spending, supporting continued economic expansion. The strong rebound in job creation in January allays some fears about the durability of the current expansion. However, the outlook remains highly

uncertain. Erratic trade policy, tariffs, deteriorating relations with major trading partners, slow global growth, and the recent outbreak of the coronavirus represent threats to the global economic expansion. Furthermore, the first estimate of fourth quarter real gross domestic product released on January 30th shows U.S. economic growth is highly dependent on the consumer. A strong labor market remains key for sustaining consumer incomes, sentiment and spending. Overall, the economy continues to grow but significant risks remain.

February 7, 2020

Fedophilia: The Intellectual Disease and Cure

GEORGE SELGIN
Contributor

Although the movement to "End the Fed" has a considerable popular following, only a very tiny number of economists—our illustrious contributors amongst them—take the possibility seriously. For the rest, the Federal Reserve System is, not an ideal currency system to be sure (for who would dare to call it that?), but, implicitly at least, the best of all possible systems. And while there's no shortage of proposals for reforming it almost all of them call only for mere tinkering. Tough though their love may be, the fact remains that most economists are stuck on the Fed.

This veneration of the Fed has long struck me as perverse. Its record can hardly be said, after all, to supply grounds for complacency, much less for the belief that no other system could possibly do better. (Indeed that record, as Bill Lastrapes, Larry White and I have shown, even makes it difficult to claim that the Fed has improved upon the evidently flawed National Currency system it replaced.) Further, as the Fed is both a monopoly and a central planning agency, one would expect economists' general opposition to monopolies and to central planning, as informed by their welfare theorems and by the general collapse of socialism, to prejudice them against it. Yet instead of ganging up to look into market-based alternatives to the Fed, the profession, for the most part, has relegated such inquiries to its fringe.

Why? The question warrants an answer from those of us who insist that exploring alternatives to the Fed is worthwhile, if only to counter people's natural but nevertheless mistaken inclination to assume that the rest of the profession isn't interested in such alternatives because it has already carefully considered—and rejected—them.

It's tempting to blame Fedophilia, and the more general phenomenon of what Larry White calls "status quo" bias in monetary research, on the Fed's direct influence upon the economics profession. According to White, in 2005 the Fed employed about 27 percent more full-time macro- and monetary (including banking) economists than the top 50 US academic economics departments combined, while disseminating much of their research gratis through various in-house publications or as working papers. Perhaps not surprisingly, despite a thorough review of such publications, White could not find "a single Fed-published article that calls for eliminating, privatizing, or even restructuring the Fed." That professional monetary economics journals are not much better may, in turn, reflect the fact, also documented by White, that Fed-affiliated economists also dominate those journals' editorial boards.

But I doubt that a reluctance to bite the hand that feeds them is the only, or even the most important, reason why most economists seldom question the Fed's desirability. Another reason, I suppose, is their desire to distance themselves from… kooks. Let's face it: more than a few persons who'd like to "End the Fed" want to do so because they think the Rothschilds run it, that it had JFK killed because he planned to revive the silver dollar, and that the basic plan for it was hatched not by the Congressional Committee in charge of monetary reform but by a cabal of Wall Street bankers at a top-secret meeting on Jekyll Island.

Oh, wait: the last claim is actually true. But claims like the others give reasonable and well-informed Fed critics a bad name, while giving others reason for wishing to put as much space as possible

between themselves and the anti-Fed fringe.

I'm convinced that imagination, or the lack of it, also plays a part. To some extent, the problem is too much rather than too little imagination. With fiat money, and a discretionary central bank, it's always theoretically possible to have the money stock (or some other nominal variable) behave just like it ought to, according to whichever macroeconomic theory or model one prefers. In other words, a modern central bank is always technically capable of doing the right thing, just as a chimpanzee jumping on a keyboard is technically capable of typing-out War and Peace.

Just as obviously, any conceivable alternative to a discretionary central bank, whether based on competition and a commodity standard or frozen fiat base or on some other "automatic" mechanisms, is bound to be imperfect, judged relative to some—indeed any—theoretical ideal. Consequently, an economist need only imagine that a central bank might somehow be managed according to his or her own particular monetary policy ideals to reckon it worthwhile to try and nudge it in that direction, but not to consider other conceivable arrangements.

That there's a fallacy of composition of sorts at play here should be obvious, for a dozen economists might hold as many completely different monetary policy ideals; yet every one might be a Fedophile simply because the Fed could cater to his or her beliefs. In actual fact, of course, the Fed's conduct can at most satisfy only one of them, and is indeed likely to satisfy none at all, and so might actually prove distinctly inferior to what some non-central bank alternative would achieve. So in letting their imaginations get the best of them, all twelve economists end up endorsing what's really the inferior option.

If you don't think economists are really capable of such naivete, I refer you to the literature on currency boards, in which one routinely encounters arguments to the effect that central banks are always better than currency boards because they might be better. Or how about those critics of the gold standard who, having first observed how, under such a standard, gold discoveries will cause inflation, go on to conclude, triumphantly, that a fiat-money issuing central-bank is better because it might keep prices stable?

But if economists let their imaginations run wild in having their ideal central banks stand in for the real McCoys, those same imaginations tend to run dry when it comes to contemplating radical alternatives to the monetary *status quo*. Regarding conventional beliefs concerning the need for government-run coin factories, which he (rightly) dismissed as so much poppycock, Herbert Spencer observed, "So much more does a realized fact influence us than an imagined one, that had the baking of bread been hitherto carried on by government agents, probably the supply of bread by private enterprise would scarcely be conceived possible, much less advantageous." Economists who haven't put any effort into imagining how non-central bank based monetary systems might work find it all too easy to simply suppose that they can't work, or at least that they can't work at all well. The workings of decentralized markets are often subtle; while such markets' ability to solve many difficult coordination problems is, not only mysterious to untrained observers, but often difficult if not impossible even for experts to fathom except by means of painstaking investigations. In comparison monetary central planning is duck soup—on paper, anyway.

Nor does the way monetary economics is taught help. In other subjects, the welfare theorems are taken seriously. In classes on international trade, for example, time is always spent, early on, on the implications of free trade: never mind that the world has never witnessed perfectly free trade, and probably never will; it's understood that the consequences

of tariffs and other sorts of state interference can only be properly assessed by comparing them to the free trade alternative, and no one who hasn't studied that alternative can expect to have his or her pronouncements about the virtues of protectionism taken seriously.

In classes in monetary economics, on the other hand, the presence of a central bank—a monetary central planner, that is—is assumed from the get-go, and no serious attention is given to the implications of "free trade in money and banking." Consequently, when most monetary economists talk about the virtues of this or that central bank, they're mostly talking through their hats, because they haven't a clue concerning what other institutions might be present, and what they might be up to if the central bank wasn't there.

Since monetary systems not managed by central banks, including some very successful ones, have in fact existed, economists' inability to envision such systems is also evidence of their ignorance of economic history. That ignorance in turn, among younger economists at least, is a predictable consequence of the now-orthodox view that history can be safely boiled down to a bunch of correlation coefficients, so that they need only gather enough numbers and run enough regressions to discover everything worth knowing about the past.

Those who've been spared such "training," on the other hand, often have a purblind view of the history of money and banks—one that brings to mind Saul Steinberg's famous *New Yorker* cover depicting a 9th-Avenuer's view of the world, with its almost uninhabited desert between the Hudson and the Pacific, and China, Japan, and Russia barely visible on the horizon. If he or she knows any monetary history at all, the typical (which is to say American) economist knows something about that history in the U.S., and perhaps considerably less about events in Great Britain. Theirs is, in short, just the right amount of knowledge to be very dangerous indeed.

And dangerous it has been. In particular, because the U.S. before 1914, and England before the Bank of England began acting as a lender of last resort, happened to suffer frequent financial crises, economists' historical nearsightedness has given rise to the conventional wisdom that any fractional-reserve banking system lacking a lender of last resort must be crisis-prone, and two clever (if utterly fantastic) formal models serving to illustrate the same view (or, according to economists' twisted rhetoric, to "prove" it "rigorously"). It has, correspondingly, led economists to ignore or at least to underestimate the extent to which legal restrictions, including unit banking laws in the U.S. and the six-partner rule in England, contributed to the deficiencies of those countries' banking systems. Finally, and most regrettably, it has caused economists to overlook altogether the possibility that the monopolization of paper currency has itself been more a cause of than a cure for financial instability.

The good news is that Fedophilia is curable. Milton Friedman, for one, was a recovering Fedophile: later in his career, he repudiated the mostly-conventional arguments he'd once put forward in defense of a currency monopoly. Friedman, of course, was a special case: a famous proponent of free markets, he had more reason than most economists do to view claims of market failure with skepticism, even if he'd once subscribed to them himself. Even so, his was only a half-hearted change of heart, in part (I believe) because he still hadn't drawn the lessons he might have from the banking experiences of countries other than the U.S. and England.

Friedman's case suggests that it will take some pretty intense therapy to deprogram other Fed inamoratos, including a regimen of required readings. Charles Conant's *History of Modern Banks* of Issue will help them to overcome their

historical parochialism. Vera Smith's *The Rationale of Central Banking* will do more of the same, while also exposing them to the lively debates that took place between advocates and opponents of currency monopolies before the former (supported by their governments' ravenous Treasuries) swept the field. *The Experience of Free Banking*, edited by Kevin Dowd (with contributions by several *Alt-M* contributors including yours truly) gathers studies of a number of past, decentralized currency systems, showing how they tended to be more stable than their more centralized counterparts, while another collection, Rondo Cameron's *Banking in the Early Stages of Industrialization*, shows that less centralized systems were also better at fostering economic development. Finally, instead of being allowed to merely pay lip service to Walter Bagehot's *Lombard Street*, Fedophile's should be forced, first to read it from cover to cover, and then to re-read out-loud those passages (there are several) in which Bagehot explains that there'd be no need for lenders of last resort had unwise legislation not created centralized ("one reserve") currency systems in the first place. The last step works especially well in group therapy.

Of course, even the most vigorous deprogramming regimen is unlikely to alter the habits of hard-core Fed enthusiasts. But it might at the very least make them more inclined to engage in serious debate with the Fed's critics, instead of allowing the Fed's apologists to go on believing that they answer those critics convincingly simply by rolling their eyes.

February 14, 2020

The Strangest Thing about the Debate

JEFFREY A. TUCKER

Editorial Director

It struck me about one hour into what Politico calls "the snarling incoherence of the latest Democratic presidential debate" that was "painfully hard to follow."

What precisely was so painful?

It was not what divided this gaggle of politicians vying for your affection. It was what united them. They all agree that their job is to have a plan for your life. This is the source of the pain.

How did it happen that all these candidates have come to believe that it is their job to plan the economy, manage your finances, fix your job, improve your wages, get you to the doctor, get your kids educated, keep you off drugs, make you equal to others, give you climate justice, grant you vacation time, and one thousand and ten other things?

That this is what they are supposed to do is not even questioned. And if you listened carefully, you will see that all of them agree that there is only one direction for government power: more. Everything without exception can be solved with more money, more power, more bureaucrats, more engagement, more plans, more intelligence, more focus.

No longer is the presidency the person who presides over the affairs of state. All of life has become an affair of state. The president is not just an administrator of things related to the federal government. He or she is the head of the whole country and everything and everyone in it, plus sizable parts of the rest of the world.

So they are all up there talking about what? They are talking about what they plan to do with your life and your money. That's what was so painful. They have no clue about any possible limit to their planning.

All the while, every single person watching this debate has his or her own plans for life. Real people are planning their futures, navigating the job market, dealing with the boss or trying to find good employees, watching their 401ks, talking with their financial planners, figuring out whether to get another degree or go to work, wondering about partners, thinking about children, worrying about their kids' education, considering whether to raise children in a religion and which one, when to take a vacation and where, what to do about an uncle's drinking problem, worrying about aging parents, wondering whether to rent or buy, and one million other things.

We are all trying to figure it out. It's called life planning. We all do it every day. The underlying institution that makes our plans realizable is that we have freedom and the right to manage our lives and resources. This is essential to what it means to live the good life.

The trouble with the 7 people on the stage last night is that they have little or no regard for our personal plans. It's their plans for us that matter. Our lives are mere abstractions to them.

We are there to be manipulated into granting them money and votes. Once they get the power via democratic means, they are done with us. Our only job is to cough up money and comply. That presumption is why the evening seemed so creepy.

They talk about clumps of voters, not real people. They talk of the "working classes," "African-American women," "minority populations," the "underemployed," the "underinsured," the "immigrants," ad infinitum but these are categories of voters, people being drafted against their will into voting blocs, not actual living, breathing, choosing individuals.

And with that comes a preposterous game of pretending that they know things that they cannot really know. The point was obvious in the question about what to do about pandemic disease should the US be hit. They all strutted and pronounced on the issue as if they knew precisely the right path.

Not one person said a normal thing like: "There is a lot we do not know about the Coronavirus, and we are all sifting through information as it becomes available. Each of us wants to stay safe and all of us have a strong interest in taking every precaution."

Such a statement would be a shock because it flies in the face of the ethos of this debate, which is that we are electing an all-knowing, all-powerful godlike brain rather than a mere head of state.

Where did this idea come from that the president is not just the head of the state but also the head of the whole of society and everything within it? It's been around a very long time but only recently has it been made so explicit, and become an open and conventional presumption behind all the political rhetoric.

The first time I experienced it so overtly was 2015, when I heard the second campaign speech by Donald Trump when he was first seeking the Republican nomination. He stood in front of an audience and talked as if he were running to become not a constitutional head of state in a republic governed by the rule of law. He was running to be the CEO of America. It was strange and alarming. It never occurred to him that there might be limits on his power that would be justified.

This speech rattled me. It struck me as the inauguration of a new era in politics.

Here we are almost five years later, and guess what? The Democrats speak exactly like him. They have learned from Trump as good students. They are all running to be the new CEO of the whole country, just with a different set of priorities.

They all have a plan for your life. Their plans naturally overrule your plans because they will have the power and might of government behind them. You merely have things like human rights that are, in a country that hosts the largest and most powerful government ever, rather vulnerable to rampant violation.

Why do we put up with it? If you had a co-worker who spoke to you about your life and your plans the way members of the political class do as a matter of habit, you would avoid him like the Coronavirus. You would plan your lunch hour to miss him, be on the phone when he walked by your desk, and maybe maneuver behind the scenes to get him pushed out. A person like that would be seen as threatening, even pathological.

And yet we somehow put up with it from politicians. We watch with bemusement and think: what the heck is wrong with these people? Why are they so lacking in the normal human grace of willing to live and let live? It's because they have all drunk the Kool-Aid of power. They want it desperately and will do anything to get it.

And truly, does anyone actually believe that this gang of political performers has access to some magic machine that will improve your life better than you can yourself? Some people do believe this. But fewer every day. If this political season has had any merit to it at all, it is that it has made the point that their presumption of omniscience and omnipotence is a dangerous path.

And yet, despite all their silly and potential dangerous antics, what can we do but live our lives as we always do, planning and struggling, sometimes achieving and often failing, grappling with uncertainty and opportunity, doing our best to cobble together a good life, raise our children well, and prepare for the future as best we can? In this sense, none of these people can help. The best all of them can do is get out of the way.

February 26, 2020

Harvard Finally Stands Up to Academic Duplicity

PHILLIP W. MAGNESS

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A new profile of Berkeley economists Emmanuel Saez and Gabriel Zucman in the *New York Times* contained a fascinating revelation about the ongoing academic reception of their work. Late last year, Zucman was being courted for a faculty appointment by Harvard University's Kennedy School of Government. Although the department voted to approve the hire, Harvard's president and provost vetoed the decision. According to the *Times*, this was "partly over fears that Mr. Zucman's research could not support the arguments he was making in the political arena."

A predictable assortment of critics seized upon this comment to charge Harvard with political bias. *Vice* cobbled together a column charging the institution with politically motivated hypocrisy. "Harvard's president intervened to deny tenure to a rising-star economist because he publicly supports a wealth tax," wrote J.W. Mason, a left-leaning economics professor at John Jay College. The Urban Institute's Daniel Kuehn called the decision "outrageous" and suggested Harvard's administration intruded on faculty hiring decisions. And Marshall Steinbaum suggested the incident revealed conspiratorial designs by the "economics establishment" to tell "the wealthy what they want to hear" and to suppress researchers who politically threaten their fortunes.

Zucman for his own part suggested a similar political motive was at play, telling reporter Jim Tankersley that his rejection from Harvard "should not discourage young scholars in the US to publicly defend new ideas."

Such claims fit with a growing tendency to depict Saez and Zucman as anti-establishment outsiders and victims of viewpoint discrimination against their work. Warren Gunnels, an economic adviser to the Bernie Sanders campaign, suggested as much to the *Times*, arguing that economists "that disagree with Saez and Zucman…are funded by the powers that be, the establishment, the billionaire class." Zucman has personally encouraged and cultivated a similar narrative on his Twitter feed, even though the evidence speaks to a very different reality.

As tenured professors making six-figure salaries at an elite department, the pair of UC Berkeley economists head an "inequality studies" research center with a multi-million dollar budget. The center was started with a gift from a left-leaning billionaire insurance executive. Far from beleaguered outsiders, Saez and Zucman are the epitome of academia's privileged "one percent."

As to the matter of their disputed statistics, a much simpler explanation than viewpoint discrimination lies at the heart of the matter. Rather, the vetoing of Zucman's hire by Harvard represented a rare display of academic integrity in a politicized academy that all too often elevates and celebrates subpar research on account of ideological agreement with its message.

The issue with Zucman's work revolves around a stunning statistical claim that he made last fall. According to his own proprietary calculations, the overall effective tax rate paid by the ultra-rich in the United States had dipped below that paid by the bottom 50 percent of earners for the first time in 2018.

Zucman released these statistics to journalists with much fanfare, where they were quickly trumpeted as "fact" by outlets including the *New York Times* and *Washington Post* to bolster Elizabeth

Warren's wealth-tax proposal. In reality, Zucman's numbers had not even undergone scholarly peer review, as is the norm for work in the economic arena.

The weeks that followed their release also revealed something far worse than failing to adequately vet this seemingly stunning empirical claim.

Instead of objectively reporting the latest findings from tax statistics, Zucman was placing his finger on the scale. He appeared to be bending his results to conform to the political narrative of Warren's campaign, which he was also advising at the time. Through a series of highly opaque and empirically suspect adjustments, Zucman had artificially inflated the tax rate paid by the poorest earners while simultaneously suppressing the tax rate paid by the rich.

I was among the first economists to notice and call attention to the problems with Zucman's new numbers. Shortly after his release to the *New York Times*, I noticed a strange discrepancy. The tax-rate estimates he provided for the ultra-rich – the top 0.001 percent of earners – did not match his own previously published academic work on the subject, including a 2018 article in the highly ranked *Quarterly Journal of Economics*.

Whereas Zucman now claimed to show the ultra-wealthy paid just slightly north of 20 percent of their earnings in taxes, the most recently available year of his previously published numbers (2014) places the rate at 41 percent. I called attention to this discrepancy with a tweet, as did Columbia's Wojtek Kopczuk and the University of Central Arkansas's Jeremy Horpedahl. Then the floodgates of scrutiny opened.

It turned out that Zucman was bending his empirical results through a series of highly suspect and unconventional data manipulations, affecting both the top and bottom ends of the tax-rate distribution.

At the bottom of the income ladder, he was artificially raising the depicted rate faced by the poorest earners. He did so by excluding federal tax programs that are intentionally designed to alleviate the tax burden on the poor, such as the Earned Income Tax Credit and the Child Tax Credit. By leaving out these programs, Zucman not only broke from decades of statistical conventions – he also created the illusion that the tax rate paid by the bottom quintile was nearly twice its actual level.

Later investigation revealed that Zucman further tilted the scales through unconventional assumptions about the burdens of state and local consumption taxes on the poor. To avoid the empirical impossibility of infinite sales-tax rates that arise from accounting discrepancies between pre- and post-transfer income, Zucman essentially excluded

the bottom decile of earners when assigning its tax incidence. This essentially causes him to misrepresent data from the second decile from the bottom as the poorest earners.

Zucman's handling of the very top of the distribution ventured even more aggressively into the territory of intentional data manipulation. The biggest discrepancy here came from his handling of how to assign corporate tax incidence across earnings. When economists examine corporate tax incidence, they usually distribute it across a variety of affected parties according to fairly standard assumptions about the portion that falls onto shareholders, onto other forms of capital, and onto the noncorporate sector of the economy due to various pass-through effects.

Indeed, Zucman followed these conventional assumptions in his aforementioned academic article from 2018, coauthored with Saez and Thomas Piketty. In his new statistics, however, he jettisoned all conventional literature on corporate tax incidence and adopted his own heterodox approach that effectively assigns 100 percent of actual incidence to its statutory incidence, namely shareholders.

This unconventional assumption not only conflicts with his prior work, but is sufficiently unrealistic to have caused a wave of jeers around the economics profession when it was discovered. In practical effect, however, it greatly augmented Zucman's depicted tax rate on the top 0.001 percent in the mid-20th century and greatly reduced the same in the last few decades, mapping with the recent downward trend in corporate tax rates.

Again, the overall effect of Zucman's fuzzy math is to severely understate the total effective tax rate on the rich compared to other estimates. Those estimates, like Zucman's earlier academic work, place that rate at almost twice the level he now claims.

To cap off his data-bending exercise, Zucman undertook a final suspicious step. He claimed to report tax rates for both groups in 2018, citing this as the first time in history that the rich paid a lower rate than the poor. Except there's one glaring problem: at the time Zucman released his headline-grabbing new stats to the press, the IRS had not yet published any statistical reports from its 2018 returns (these only become available in the early spring of 2020). Closer examination revealed that Zucman simply imputed his "new" numbers from 2016 stats based on his own highly imprecise assumptions about the effects of the 2017 Trump tax cut. While these figures are sure to be scrutinized when the actual numbers come out, suffice it to say that Zucman was presenting estimates for years where he does not actually possess data and, furthermore, staking one of the most audacious claims of his argument on the same.

Within a few weeks of the earliest scrutiny of Zucman's statistics, the wheels began to fall off of his narrative.

The skepticism even extended to economists on the center-left who are more sympathetic to progressive tax hikes than I am. In late October former Treasury Secretary Larry Summers debated Zucman's coauthor Emmanuel Saez in a public forum about wealth taxation. Summers indicated he had conducted a "very close study of the Twitter wars … surrounding the work of Saez and Zucman" and described himself as "about 98.5% persuaded by their critics that the data are substantially inaccurate."

Some four months later Zucman still retains a credulous following among journalists and political candidates, but he has struggled to find support from economists who work in the area of taxation and inequality.

There's a good reason that most of the profession has looked on his most recent work with a skeptical eye. It is the product of political advocacy, open

electioneering on behalf of Warren, and statistics that were constructed primarily to fit with the narratives of her campaign. In bending his data and eschewing the process of peer review, Zucman shed any pretense of doing social science – including his own previously published work where it contradicted his new political narrative.

Harvard's administration, to its credit, recognized this inappropriate breach of scholarly standards and exercised a rare but necessary check upon their ongoing erosion in the academy. Naturally, that has left other activist academics and journalists who support his claims for political rather than scientific reasons in a fit of rage.

February 25, 2020

Say's Law versus Keynesian Economics

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Say's Law, as explicated by the great liberal political economist Jean-Baptiste Say (1767-1832), is the principle that *supply constitutes demand*, with the corollary that aggregate supply always equals aggregate demand. There's no more important principle in political economy to get perfectly right – and assiduously avoid getting wrong – than Say's Law.

Say's Law is the most important first principle in economics, with innumerable important corollaries and implications; its logic is irrefutable, its empirics undeniable. Any economist who denies the Law is akin to a physicist who denies the Law of Gravity; an economist opposed to Say's Law isn't really an economist, any more than a gravity denier is a true physicist.

Among the many important implications of Say's Law is that prosperity and economic expansions are supply-side phenomena, a consequence of entrepreneurs, the profit motive, saving, investment and capital accumulation. Put negatively, "consumers" *per se* don't drive economies (least of all, today's largest consumer: government). Recessions, economic stagnation, unemployment, and crises occur not because of "over-production" (or "under-consumption") but because public policies undermine property rights, manipulate prices, prevent markets from clearing, impede trade, and punitively tax profits, income, and capital.

Tragically, Say's Law has been denied by John Maynard Keynes (1883-1946) and the Keynesians who dominated economics for at least four decades after World War II (and to some extent still influence economics and policymaking today). In his 1936 text, Keynes falsely attributed the Great Depression and mass unemployment to a prior period of "over-production" (in the 1920s). "Say's Law," he wrote, the principle "that the aggregate demand price of output as a whole is equal to its aggregate supply price for all volumes of output, is *equivalent to the proposition that there is no obstacle to full employment*." (emphasis added) It was a preposterous claim.

In fact, Say's Law reveals that while certain markets (say, the labor market) may be in disequilibrium, it's not possible that *all markets in aggregate* can be so – and if, as with unemployed labor, supply exceeds demand, it's due to policy barriers like minimum wage mandates, regulations and taxes on would-be employers and employees alike.

Although Keynesian economics dominated academia and policymaking from 1945 to 1980, beginning in the mid-1970s it was increasingly discredited as illogical in theory and harmful in practice; its macroeconomics was inherently contradictory, it had no foundation in microeconomics and it was harmful, precisely to the extent practiced, to economies in Britain, America, and India. Keynesian premises and policies ensured that the 1970s were marked by "stagflation – the worst of both worlds. Thankfully, this dire period was followed by New Classical Macroeconomics, "rational expectations" insights, and supply-side policy cures, all of which affirmed and built on the truth of Say's Law and its corollaries. The world thereafter was made better by Saysian economics displacing (at least partly) Keynesian economics.

But Keynesian economics persists today, partly because it satisfies unwarranted suspicions that capitalism is inherently unstable or unsustainable, and partly because it rationalizes government policy

intervention and activism. Many economists and policymakers, observing the financial-economic debacle of 2008-09, blithely assumed that Keynesian theory explained it while Keynesian policy could cure it.

Nothing was further from the truth. That debacle was caused not by capitalism (or "deregulation") but by its contravention – by government subsidies, guarantees, and regulations in housing, banking, and mortgages – and it was worsened and prolonged to the extent Keynesian policies were adopted (*e.g.*, massive new public spending and money issuance, plus a deliberate policy of near-zero interest rates).

The latest issue of the *Review of Keynesian Economics* is devoted entirely to a dozen Keynesian economists insisting strenuously that Keynesian economics is alive and well. No counterviews are entertained, but it seems the acolytes doth protest too much. Why the defensiveness? Because most Keynesian principles are false – always were, always will be. Yet today's defensive acolytes can take comfort in the fact that Keynesian premises, no matter how wrong, will always retain a sympathetic hearing to the extent people are suspicious of capitalism, while Keynesian policies, no matter how wrong, will always win ardent support from policymakers to the extent they seek to rationalize interventionism and activism.

Say's Law and Saysian economics go hand in hand with a political-economic-philosophical appreciation for *capitalism* – for rationality, the pursuit of self-interest, entrepreneurialism, profit-making, private property rights, the rule of law, and constitutionalism. Say's Law was largely unquestioned (but also not fully grasped) in the century or so before Keynes tried to slay it in the 1930s; before then, Malthus, Rodbertus, and Marx were its most prominent deniers. We should be grateful that in recent years many scholars have kept Say's political economy, his treatise, and his Law alive, well, and pertinent to contemporary debates – especially Steven Kates, James Ahiakpor, Alain Beraud, Richard Ebeling, Evelyn Forget, Steve Hanke, Steven Horwitz, Gilles Jacoud, Petur Jonsson, Guy Numa, Munir Quddus, Rashid Salim, Evert Schoorl, and Mark Skousen.

Given Say's Law's crucial importance to sound political economy and public policy, I offer the following concise account of it, together with its primary principles and propositions:

- Say's Law holds that *supply constitutes demand* (not "supply creates its own demand"), with the crucial corollary that *aggregate supply always equals aggregate demand*. There can never be a deficiency (or excess) of aggregate demand relative to aggregate supply; the two phenomena are the *same thing* (or "two sides of the same coin") viewed from *different sides.*
- It's misleading to define Say's Law as "supply creates its own demand" (or, so goes a typical ridicule, that supplying bikinis will create a demand for bikinis, even in Alaska). In truth, newly created bikinis entail a demand for things *other than* bikinis. There can be a "glut" (surplus) of goods (or money) in some markets (microeconomic), but no "general glut" in all markets (macroeconomic), and to deny this is to commit the fallacy of composition ("what's true of the parts is true of the whole").
- Production is the *creation* of wealth (utility) and spending is the *exchange* of wealth while questions about who earns wealth (and how much – and why) pertain to the *distribution* of wealth; the consumption of wealth is not equivalent to demand but to the destruction of wealth (utility), the opposite of creating it (production). Demand is not equivalent to consumption; it's a desire to purchase *plus* purchasing power (and the latter comes only

from the creation of supply, or from the income one is paid for doing so). One cannot demand unless one first *supplies* (produces) something of value for offer to others in exchange for their goods. *Markets are made by producers*, not by consumers *qua consumers* (because consumption is the destruction of wealth, or utility).

- Of course, we produce wealth, ultimately, to consume it, or save-invest it, but this doesn't mean consumption "causes" production (destruction is the opposite of creation). Obviously, some wealth is consumed in the process of creating wealth (see "cost of goods sold" in profit-loss statements), but no (net) wealth is truly created unless there's valued-added (sales exceeding costs = profit). Profit isn't a "deduction" from (labor) income but *net production*.
- Sound economics focuses on the production, exchange and distribution of wealth, not on its consumption; there is a "primacy of production" – because supply is a necessary precondition for prosperity, wealth creation, and demand. Given the importance and primacy of production in an advancing, progressing civilization, we must be concerned above all with the freedom, rights, incentives, and rewards of creative inventors, engineers, and entrepreneurs.
- Says' Law is as true in an advanced, *monetary* economy as it is in a barter economy, and as true in the *short term* as it is over the long term; in this way Say's Law doesn't differ from the law of gravity. These two aspects of Say's Law are often misunderstood even by adherents.
- When we produce things in exchange for money or income, we demand money (and income), for purposes of spending or saving; but saving is not a "leakage" from "the spending stream" (it is saved wealth and invested, which means: spending on capital goods instead of spending on consumer goods). If money is hoarded, no drop in total demand occurs; money itself is a type of good, and if hoarded, is itself demanded (intensely so). A "scarcity" of money by itself doesn't impede output growth; it merely entails a declining price level; but this should be welcomed as "a declining cost of living" (which implies a rising standard of living). Money hoarding isn't a normal part of a free economy but occurs when public policy is confiscatory and/or risk-promoting; to the extent a higher, intense demand for money (hoarding) accompanies economic stagnation it's due to bad policy, *not* to *relatively* less total demand.
- Economic recessions reflect not insufficient nominal demand (an alleged "money shortage") but less *real supply* due to counter-productive public policies (taxing, regulating, etc.) which seize or divert wealth and impede-punish its creation; government spending doesn't cure recessions by promoting consumption but only delays recovery; public spending is financed by taxes, borrowing, or money-printing, none of which is, *per se*, pro-production; no magical "public spending multiplier" arises from some increased "marginal propensity to consume."
- Keynes's claim that Say's Law is "equivalent to the proposition that there is no obstacle to full employment [of labor]" is patently false; many (non-macro) factors impede full employment, including above-market wage rates (whether imposed by coercive unions or public policies) and the punitive taxation and/or regulations inflicted on would-be employers and employees.
- Some Keynesians have acknowledged the importance of a debate about foundations and first principles, conceding that *if Say's Law is true, Keynesian economics necessarily cannot also be true* (since the latter says a differential can arise between aggregate demand and aggregate supply and that government policy can

> do something to close the differential). By the logic and reality of the matter, Say's Law *in fact* is true and valid, so Keynesian economics is not.

The great French liberal Frederic Bastiat (1801-1850) popularized much of Say's political economy and in his *Economic Harmonies* (1848) wrote of Say and Say's Law as follows:

> It is fortunate for society that men of genius like Say have patiently and tirelessly applied themselves to observing, classifying, and setting down methodically all the facts that constitute this excellent science [of political economy]. Henceforth the human mind can move forward from this firm base toward new horizons. . . You too might be able to take this same torch from the hands of your predecessors and turn its light upon some of the dark recesses of the social sciences, and particularly upon those that have recently been plunged into darkness by the dissemination of mad doctrines.

It's worth reiterating that there's no more important principle in political economy to get right – and avoid getting wrong – than Say's Law. As Bastiat knew, the Law is akin to a torch illuminating and facilitating the spread of knowledge, based on reason and reality. It also helps us avoid a deleterious dissent into the darkness of "mad doctrines."

February 9, 2020

The Huge Difference Between Boris Johnson and Donald Trump

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I have always thought that the comparison of United Kingdom Prime Minister Boris Johnson to US president Donald Trump was unfair to Johnson. And while admittedly I am no Boris Johnson expert, I do have his speech from February 3th to prove the injustice of the comparison. In fact, the more I read the speech, the more I think that, at least when it comes to trade, Johnson sounds more like one of the greatest defenders of free trade alive today, Donald Boudreaux.

I will let you be the judge.

Imagine the setting. The beautiful Painted Hall in the Old Royal Naval College in Greenwich. The place itself was the subject of the first part of the Prime Minister's speech. In a very Johnsonian way, he noted:

> "This painting above you was started in 1707, the very year when the union with Scotland was agreed – and does it not speak of supreme national self-confidence? Look at these well-fed nymphs and cupids and what have you. They are not just celebrating the Triumph of Liberty and Peace over Tyranny – the official title of the scene."

And with that he doesn't waste many words to tell us what this speech would be about: his terms in the next stage of Britain's negotiations with the European Union. But the way Johnson goes about it is brilliant, as he takes time to set his position in the intellectual tradition of Adam Smith and David Ricardo. He said:

> "We in the global community are in danger of forgetting the key insight of those great Scottish thinkers, the invisible hand of Adam Smith, and of course David Ricardo's more subtle but indispensable principle of comparative advantage, which teaches that if countries learn to specialise and exchange then overall wealth will increase and productivity will increase, leading Cobden to conclude that free trade is God's diplomacy – the only certain way of uniting people in the bonds of peace since the more freely goods cross borders the less likely it is that troops will ever cross borders. … And since these notions were born here in this country, it has been free trade that has done more than any other single economic idea to raise billions out of poverty and incredibly fast."

This discourse offers a stark contrast with what we hear about free trade in America these days.

Unfortunately, he tells us, politicians around the world – politicians whom he is not afraid to denounce – are trampling the benefits of trade.

> "The mercantilists are everywhere, the protectionists are gaining ground. …From Brussels to China to Washington tariffs are being waved around like cudgels even in debates on foreign policy where frankly they have no place – and there is an ever-growing proliferation of non-tariff barriers and the resulting tensions are letting the air out of the tyres of the world economy."

He goes on to promise that the British people can count on him to be the champion of "the right of the populations of the earth to buy and sell freely among each other" starting with Africa, and then "Japan and the other Trans-Pacific agreement countries, with

old friends and partners – Australia, New Zealand, Canada – on whom we deliberately turned our backs in the early 1970s."

Johnson wants to make a free-trade deal with America too. On that point he says, "We will get going with our friends in America." My colleague Dan Griswold is ready with a blueprint of what a UK-US free-trade deal should look like.

Once again, Johnson denounces the US for its protectionism when he notes "it is high time I think we all agree that they cut their punitive tariffs on Scotch whisky." To be sure, it is!

But the Prime Minister's main purpose was to lay out his opening position in talks about Britain's future relationship with the EU. And that part of the speech, too, is enjoyable. Johnson announces among other things that the era of bureaucrats in Brussels setting the tone for what the UK does is over, not because Johnson wants to engage in "dumping," destroy the environment, or undermine EU standards, but, rather, because other European countries are bad role models to follow, and not just because many of them are economic basket cases. Case in point:

> "France spends twice as much on state aid as the UK, and Germany three times as much, who is using subsidies to undercut? Not the UK. In fact, the EU has enforced state-aid rules against the UK only four times in the last 21 years, compared with 29 enforcement actions against France, 45 against Italy – and 67 against Germany."

"The same applies to social policies," Johnson notes.

Here I part company with him over his bragging about how much better the UK government is than the EU bureaucracy. Not least of the reasons for my belief that he has no good reason to brag is that he goes on to talk about how much more paid leave the UK government mandates, how much higher than other EU countries is Britain's minimum wage, how strict are the UK's ivory bans compared to the EU's bans, and how the country's ban on single-use plastics goes further and faster than anything proposed by the EU." Unfortunately, these well-meaning policies will inevitably backfire and hurt the people – and elephants – they are supposedly meant to help.

As problematic as this last section is, it nevertheless gives Johnson an opportunity to demonstrate his profound understanding of the benefits of free trade. He notes that these differences are no reason to demand that the EU match the UK on all these dimensions before accepting "a zero-tariff zero-quota deal with the EU." As he notes:

> "So I hope our friends will understand that what is sauce for the goose is sauce for the gander. … There is no need for a free trade agreement to involve accepting EU rules on competition policy, subsidies, social protection, the environment, or anything similar any more than the EU should be obliged to accept UK rules."

It looks like the Prime Minister understands the concept of sovereignty, the economic benefits of free trade, and even the value of competition between nations using different rules. These are concepts that, unfortunately, elude our president here in the US.

February 7, 2020

Your Pessimism Is Ridiculously Inaccurate

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Because its denial is incessantly repeated, the following truth must be incessantly restated: we ordinary Americans are fabulously rich and getting richer. The irony is that we are *so* very materially prosperous – with a prosperity that is shared by nearly all Americans – that we take our happy condition for granted.

Most of us don't see this prosperity, at least not for what it is. Our material prosperity, although historically unprecedented, is now so commonplace that, for us Americans in 2020, this prosperity appears to be the natural state of the world. It appears simply to exist – to happen like rainfall happens in the tropics. But of course widespread material prosperity doesn't just happen. It didn't happen for 99.9 percent – *literally* 99.9 percent – of human existence. The prosperity that we all today enjoy must be not only created but, also, continually *re*created.

Entrepreneurs must be inspired to innovate. Investors must be motivated to take risks. Countless individuals must have incentives to save, to work hard, to daily cooperate productively with people whom they do not know, and to avoid using scarce resources wastefully. Yet it is only in the past two or three centuries that most of us have been led most of the time to mostly act in these ways that generate the tremendous shared material bounty that most of us take for granted.

Be More Amazed…

The 'Wow!' factor of a tiny fraction of this bounty becomes obvious immediately when pointed out. In 2020 it's not difficult to inspire someone to marvel at relatively recent innovations such as smart-speakers, GPS, streaming music, and hip-replacement surgery. But these new marvels are hardly the whole story.

The real measure of our prosperity is in what, for us, is mundane: running drinkable water over a wide range of temperatures, hard roofs and floors, refrigeration, artificial lighting, inexpensive garments and bedding made with machine-woven cloth that withstands being cleaned with powerful inexpensive detergents in powerful affordable machines, widespread literacy, mastery at using the electromagnetic spectrum, liability insurance for drivers and for homeowners, well-stocked supermarkets, fresh blueberries in New York in January, ice cream in New Orleans in July, air travel, automobiles, air-conditioning, aspirin, antibiotics…. You, Mr. or Ms. Reader, will have no trouble extending this list for pages.

Each and every one of these seemingly humdrum features of our everyday lives will inspire you to exclaim "Wow!" if you ponder the almost incredible amount of human effort and undesigned coordination that takes place regularly to make these almost-miraculous goods and services so routine that they seem humdrum.

Accustomed to constant access to an abundance of such marvels, we fail to recognize them for the marvels that they are. Instead, we focus only on the failure of this marvelous reality of ours to be even more marvelous. With our glass 99 percent full – and with this fullness seemingly produced and guaranteed by some mysterious laws of nature – many of us are apoplectic both that the "distribution" of this bounty isn't as ideal as we can imagine, and that our glass has yet to be filled even further.

Such complaints would be more tolerable if those who issue them were to reveal some appreciation

for just how minor are today's economic problems relative to the enormous good that economic growth has already brought about and *continues* to bring about. But no such appreciation is apparent.

Just once, I want to hear someone who worries about climate change acknowledge that we today are *fortunate* to be able to worry about climate change. Just once, I'd love to encounter a politician or professor who wags his finger angrily at the "uneven distribution" of income or wealth note that any randomly chosen ordinary person in the United States today is likely to be materially far *richer* – in very many ways – than was the richest American of a mere century ago.

And just once, I long to be surprised by a "social-justice warrior" conceding that at least some of today's alleged problems might actually be mirages conjured by the market economy's successes.

… But Don't Be Shocked

Consider, for example, the much-noted reduction over recent decades in Americans' geographic mobility. This reduced mobility is said to be a major reason why increased trade with China inflicted on Americans what is now known as the "China shock" – namely, a slower than expected adjustment of American workers to increased imports of goods from China. (There is, by the way, some confusion about exactly what the "China shock" finding is. Some people interpret this finding in the manner in which I describe it in the previous sentence. Yet other people interpret it to be a finding that increased trade with China caused a *permanent* reduction in *net* American employment. The "China shock" researchers themselves are unclear on this matter. For purposes of my essay here, however, nothing much turns on which interpretation is correct.)

While Americans' reduced geographic mobility might reflect real problems – such as housing costs in booming cities made artificially high by land-use restrictions – it might also, at least in part, reflect increased *prosperity*.

Most people prefer to live in some locations over other locations, but to satisfy such 'locational preferences' is costly. And so just as when we become richer we are more likely to satisfy our preferences for nicer automobiles and larger homes, as we become richer we also are more likely to satisfy our preferences for living in our favorite locations.

A blue-collar resident 50 years ago of Allentown, PA, might have had a strong attachment to that locale but, having lost his job, couldn't afford to keep living there. His best economic option was to move. But suppose that today we see a blue-collar worker remain in Allentown despite being unemployed. What should we conclude? The conclusion leapt to by many pundits is that today's unemployed worker is so much less likely than was the typical worker in the past of finding a new job elsewhere that today's unemployed worker sees no point in moving. Out of despair, today's unemployed worker simply stays put.

Perhaps. But given that there's been no long-term uptick in the national rate of unemployment, this pessimistic conclusion is likely mistaken. A more plausible conclusion is that unemployed Americans today can better afford to stay put in their preferred locales and wait for new jobs to come to them rather than them move to different locales in search of new jobs.

This increased affordability of staying put might come in the form of greater purchasing power of workers' savings, or in the form of more generous family, private, and public assistance for unemployed workers. Regardless of the source of this increased affordability of locational preferences, such increased satisfaction of locational preferences is evidence that ordinary Americans are today richer than were ordinary Americans in the past.

No sensible observer argues that the American economy is free of problems and flaws, or that ordinary Americans face no real economic challenges, some of which are daunting. But the incessant drumbeat of negativity about the U.S. economy and about globalization – and the blinkered focus on problems (real and only apparent) divorced from the larger context of the economy's successes and of Americans' stupendous prosperity – gives us a dangerously inaccurate sense of the state of the economy and of ordinary men's and women's relationship to it. And this inaccurate sense, in turn, will fuel policies that destroy rather than promote our ability to continue to prosper.

February 17, 2020

The Effect of the Coronavirus on Financial Markets

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The 1,031 point drop in the Dow Jones Industrial Average yesterday came as a surprise to many investors and even regular market watchers, especially given the recent record close above 29,000. Yet while the drop was the third largest ever in absolute (point) terms, it only registers tenth by the more relevant, meaningful measure: percentage change for the day – just over -3.5%. By comparison, the October 22, 1987 stock market crash saw the index decline 508 points, nearly 23% in percentage terms.

Another way of gauging the relative severity of a decline in stock prices is to compare them against the regulatory criteria which triggers a halt in trading ("trading curbs" or "circuit breakers"). Although they have changed throughout the years, at present there are three tiers that would trigger a trading halt; they are calculated based upon changes in the S&P 500 index. The first is triggered at a 7% drop (generating a 15-minute pause); the second, at a 13% drop (causing a second 15-minute pause; and the last, at a 20% drop, which would halt trading for the rest of the day (unless the declines occur after 3:25pm EST).

Comparing the magnitude of today's decline to what the New York Stock Exchange itself views as justifying a brief halt in trading, it registered barely half of the decline to cause the first, 15-minute trading pause.

We should take a sober, dispassionate look at forces acting upon the U.S. financial markets. Headlines indicating a "panic" are vastly overwrought. The futures, which begin to trade outside of cash (regular) market hours, were already deeply negative as American traders began to arrive at their desks. On Monday morning when U.S. equity markets open, Asian markets have already closed (at roughly 2am EST) and various European equity markets have either just closed or are close to closing.

Thus on Monday mornings, the U.S. market is the last to start trading in the new week and takes cues on the "size" of the down move (a three to four percent decrease, on average, in stock prices) from foreign market indices. Certainly individual companies – airlines, for example – see more severe and sometimes company-specific declines, but a look at the decline in foreign markets is usually instructive.

From the perspective of the weekend news about the coronavirus, Asian and European markets provide strong indications of both price direction and magnitude of decline (gain) owing both to (a) their proximity to the unfolding crisis, and (b) the highly, indeed inextricably, intertwined nature of global markets.

U.S. Treasury yields at various points came close to record lows – bond yields move in the opposite direction of their prices – as investors exiting equity markets sought liquid, low-risk assets to park funds in for awhile. (Gold, additionally, hit a seven-year high.)

Some of the market commentary hinted at an apocalyptic sentiment, reminiscent of the opening of apocalyptic horror films – the zombie and pandemic genres, specifically. It is a wholly irresponsible, indeed juvenile, perspective. We have seen this before, and came out none the worse for wear.

The sell-off has nothing whatsoever to do with concerns (much less, expectations) of an extinction-level event or some other such cataclysm, however entertaining those are to consider. Stocks – equities – are fundamentally *units of title to aggregates of capital goods*, and financial markets

are the social machinery which serves to discount future earnings generated by those aggregates of capital goods. Thus in the most immediate, hysteric-free economic sense, equities were repriced today based upon a consensus expectation of lower earnings in the coming quarters.

Among other valuation methods, one way (a "back-of-envelope" calculation) of determining how fairly priced a stock is has to do with a ratio between the equities price and per-share earnings for the most recent twelve months: the P/E ratio. Increasingly bad news regarding the spread of the coronavirus over the weekend (more cases, in more countries, despite quarantines and other restrictions) led to a swift repricing of Asian and European stocks late Sunday night and early Monday morning, respectively, and in turn to U.S.-listed companies.

That is to say: investors sold stocks, lowering the numerator ("Price") in anticipation – speculating – that the recent news about the coronavirus may give rise to more quarantines; more restrictive measures applied to the international movement of individuals, goods, and services; and most of all: additional uncertainty.

And those changes, they believe, will negatively impact corporate earnings. Stock markets, they say, climb a wall of worry; "up a ladder, but down a slide (chute)." Declines in stock prices typically occur faster and deeper than the upward trudge, for several reasons which behavioral finance and other aspects of psychology touch upon. (Suffice it to say: to any investor, and even to corporate insiders, the body of all relevant information regarding a stock's value is at every moment incomplete, unevenly distributed, and subject to instantaneous revision.)

As information trickles out regarding what China knew about the coronavirus, and as speculation about the aggravating effect of ongoing U.S.-China tariffs take shape, more volatility – repricings of stocks all over the world, reflective of both higher and lower expectations where future earnings and growth is concerned – is likely. The interconnected world in which we live, where today I can eat sweet potatoes, tomorrow I can read any of tens of millions of books from around the world, and all the while I'm buying more computer power for less money, works in no small part because of the financial markets' ceaseless weighing and processing of new information.

Via individual traders, large financial institutions, hedge funds, pension funds, and a host of other market participants, world equities markets are "saying:" the newest information we have makes the likelihood of the coronavirus negatively impacting corporate earnings greater. In anticipation of that, prices should come down such that valuations reflect lower earnings. It's not guaranteed, and the next bits of information may result in a complete reversal of that perspective (with a subsequent rise in prices), but this is how it works.

Various legendary investors (Benjamin Graham, Ron McEachern, Warren Buffett) have been credited with saying that in the short term equity markets are a voting machine, but in the long term they act as weighing machines (scales): in every moment of every trading session, the herd effects of a million fears and hopes are at work. But over the long term – years, decades, and generations – how the firm fares under various economic conditions, with changes of management, new technologies, and the like present an incrementally clearer view of the value of the firm and its prospects.

An appreciation of markets, in particular free markets in financial instruments which on a tick-by-tick basis marshal and allocate capital on a global scale, requires respect for both the voting machine and the scale.

February 25, 2020

Are We Seriously Debating Capitalism vs. Socialism Again?

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The answer is yes, we are seriously debating capitalism vs. socialism again. As it should be. And herein lies the silver lining in one of the most alarming trends in public life: a self-described socialist is leading in the polls to win the Democratic nomination.

For nearly 100 years, public figures in America have dabbled in socialist ideology, learned from it, practiced it on a limited scale, imposed policies rooted in its logic, and been inspired by its conflict ethos that imagines markets to be inherently exploitative, unfair, and unjust. It makes some kind of weird sense that finally at the highest (?) levels of American public life, they would just finally come out and say it: we are all kind of socialist now.

To contradict that claim requires that you see the problem with socialism, and to see that problem leads one to think through the logic of markets and economics, which in turn leads one to see the virtues of commercial freedom. But doing that, taking those hard steps to understand scarcity, creativity, prices, and exchange threatens to undermine the ideological infrastructure of the Democratic Party itself. What has emerged instead is a "no enemies to the left" ethos that allows the extremists to control the messaging.

David Brooks, writing for the New York Times, makes the very compelling point that the reason Bernie Sanders is coming out on top is that he offers a clear (if utterly unrealistic) worldview that the others tacitly accept, so therefore they are not really in a position to shatter his presumptions:

> Over the past five years Sanders and his fellow progressives have induced large parts of the Democratic Party to see through the Bernie lens. You can tell because every candidate on that stage has the categories and mental equipment to carve up a billionaire like Bloomberg. None have the categories or mental equipment to take down a socialist like Sanders.
>
> Sanders goes untouched in these debates because the other candidates don't have a mythic platform from which to launch an attack. Saying his plans cost too much is a pathetic response to a successful myth.

Myth is right, and it was too much for Michael Bloomberg, who called him out for favoring socialism in a country in which the most famous socialist owns three homes. To be sure, to someone like Sanders, there is nothing contradictory here. The dictatorship of the proletariat always needs a vanguard elite to channel the interests and energies of the working classes; it stands to reason that they should live well, in this way of thinking. Such has it always been.

Socialism is a movement not of the working classes but of the elites, born of arrogance, snobbery, and preposterous pretense, kept alive not from lived experience but the astonishing capacity of an ideologically soaked brain to live in denial of reality.

But what about this term capitalism? The case against it as a description of the market economy is that it was an invention of the Marxists, and for a reason: it was supposed to describe an economy ruled by the capitalists. In fact, capitalism is nothing more than the working out of the advanced stage of a society that respects private property, peace, and freedom of association and trade. It is not an

imposition or even a system; it is a description of what happens when violent actors bow out of the process of social evolution.

For this reason, many of my classically liberal friends would just as soon get rid of the term.

On the other hand, the term does zero in on the main debate: whether and to what extent should the produced means of production (capital) be unmolested by public authority and accumulated by successful companies. The non-capitalists of the political class want to bust up and pillage businesses just because they are big and tax the rich just because they are rich. The problem is that this is the path to impoverishment.

Capital, on the other hand, is institutionally essential for complex production structures and the division of labor. There is no doing without, though many societies have tried.

What's more, socialists will tell you that they aren't against private property as such, just private ownership in the means of production. So there is a sense in which framing the debate over the future of freedom really is an argument about capitalism vs. socialism. The logic of this demand trends toward finding a stable truth: there is freedom and private property or there is not. We need to have this debate. Probably it should never stop.

I personally recall that after 1989, I was pretty sure that the argument had been settled for all time and eternity. Part of me was disappointed because I had cut my teeth on this issue during the Cold War. Maybe all my knowledge would now be of historical interest only. Not so: the very next issue of a Marxian academic periodical headlined "the collapse of Stalinism" – announcing this only 40 years too late.

So yes, the intellectual battle continues. Watch the movie and buy the two books: The Best of Marx and the Best of Mises.

February 22, 2020

How Negativity Wrecks Relationships and Businesses

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A good friend who is one of the founders of an enormously successful global investment company once explained to me one of the secrets to the success of the business: "we have a no a-hole policy." This came up while we discussed a world-renowned investor; this individual having offered to migrate his own investment firm into the aforementioned partnership several years ago.

It all seemed like a great idea, except for the rather evident personality defects of this prominent investor. To bring him into the fold would most certainly violate the firm's explicit policy. As a consequence, the invite wasn't extended. The partnership made an investment in the personality-challenged investor, sourced for him office space and infrastructure, and ultimately the partners made a lot of money off of their investment. But they did so at arm's length. Culture, and in particular a culture of harmony within the firm, wasn't worth allowing inside the tent someone who, though preternaturally talented as a capital allocator, might upset the proverbial apple cart.

This story came to mind while reading John Tierney and Roy Baumeister's fabulous new book, *The Power of Bad: How the Negativity Effect Rules Us and How We Can Rule It.* About halfway through, Tierney and Baumeister discussed why successful companies are so eager to root out the "bad apples" as quickly as possible. Just a few can quite literally wreck a corporation's trajectory.

The authors found that within food service companies alone, "It was the deviant behaviors that made the difference to profitability" far more than did good workers. The bad ones, those "who showed up late, slacked off, or made fun of their colleagues" took down successful operations far more than the good lifted operations and profitability up.

Interesting is that Tierney and Baumeister found that bigger, theoretically more white-collar businesses happened on the same truth about the bad. They report that Men's Wearhouse ultimately fired a top salesman whose sales dwarfed those of his fellow colleagues. As they put it, "impressive as his numbers were, he had repeatedly antagonized the other salespeople by refusing to help them with their customers – and sometimes trying to steal them away." Interesting is that after the challenging employee was fired, the numbers of his relieved colleagues never rose to his. It didn't matter. The work atmosphere was quite a bit more collegial such that "the store's overall sales rose by almost 30 percent."

At Stanford's engineering school, the authors write of the department heads talking about hiring someone "who was known for his research (good) as well as his personality (bad)." One professor quickly objected to the hire in a way that will now be familiar to readers: "Listen, I don't care if that guy won the Nobel Prize. I just don't want any a-holes ruining our group." There's a pattern here, and it's one that defines this excellent book. Bad has a tendency to overwhelm the good in all manner of situations, so the goal should be to root out what is bad whenever possible.

The problem is that "Bad is stronger" than good according to Tierney and Baumeister, so they're trying to arm the reader with ways to counter what pushes around good. They aim to help the reader "deploy the rational brain to keep bad at bay in both private and public life," and to even "learn how to

stop fights before they can begin." Easier said than done? Perhaps, but as they make plain, it's usually small, seemingly (at least to you) innocuous affronts that set the stage for much worse. Since it is, they're striving to help the reader detect ahead of time the small things that have the potential to be big, and by extension, bad.

All of this is crucial in consideration of their striking assertion that there "is no opposite of trauma, because no single good event has such a lasting impact." With the latter in mind, it's only fitting to focus on the good until it's remembered how we've evolved as humans. As the authors so pithily put it, "To survive, life has to win every day. Death has to win just once." All hope is lost to bad? Not so fast.

Indeed, it's not unreasonable to rethink how we as humans think. Though we're wired to focus on the unfortunate, the authors remind us throughout *The Power of Bad* just how good things have become. In 1950, most people in the world got by on less than $1/day. The world has never been more peaceful than it is now, people are living longer amid this peace, plus they're living much better. The examples are endless, but the authors remind us how in 19th century Great Britain, which at the time was the world's most prosperous country, the average citizen "worked more than sixty hours a week, with no annual vacation, from age ten until he died in his fifties." Contrast this brutal existence with today, when "workers enjoy three times as much leisure over the course of their lives," and food is so plentiful that the "biggest nutritional problem in many places is now obesity."

What's with all the negativity amid all this plenty? Per Tierney and Baumeister, "The healthier and wealthier we become, the gloomier the worldview." So change the worldview.

When a friend lets you down, think of all the times that friend has come through for you. With a husband, wife or significant other, try to achieve a high frequency of intimate relations relative to arguments, plus lay off the whiney lament so commonly uttered sotto voce (or noisily) about the "other" along the lines of "Why doesn't she appreciate me?" About this frequent complaint, the authors make the simple point that we all have a tendency to overstate just how special we are, or, in their words, our tendency to focus on the bad "magnifies their faults, real or imagined," just as it "magnifies" our "own strengths." So relax. Recognize that you're not exactly an endless thrill ride, and then focus on the good.

In particular, keep in mind the power of bad while doing so. Though you may think yourself expert at giving compliments, or asking the right questions, or existing as a willing ear when the other just needs you to listen, the bad invariably overwhelms. Applied to relationships, all the good things are drowned by hostile tones, eye rolls, denials of responsibility, along with insults.

As the authors put it, "Being able to hold your tongue rather than say something nasty or spiteful will do much more for your relationship than a good word or deed." Easier said than done? For sure, but then there's an art to being successfully partnered in all walks of life. Tierney and Baumeister quote Supreme Court Justice Ruth Bader Ginsburg's wedding day advice from her mother-in-law: "In every good marriage it helps to sometimes be a little deaf."

In life more broadly, recognize how much the bad criticism overwhelms praise. In making this case, the authors quote a champion optimist in Ronald Reagan's tendency to magnify the disdain of his detractors. In Reagan's words, Nancy "says I only see the guy with the finger." The authors quote movie and television director/producer Lee Daniels (movies including *The Butler,* and tv shows including *Empire*) as saying that even the rave reviews with but one critical sentence within them

are for him "like taking a knife and stabbing you in the heart over and over." Be careful with criticism in public or private.

Which brings up the one critique, if that's what it can be called, of this excellent book. About it, it's possible that a lack of clarity that will drive this point could be erased with a second read. This review, though written with the just-completed book very fresh in mind, is also being written after one read of *The Power of Bad*. In it, Tierney and Baumeister routinely make a case about how much the bad and hurtful overwhelms the good and uplifting, they quote Daniels as finding even one sentence of criticism as rather brutal, yet they assert that the "self-esteem movement is one of the sorrier mistakes of modern psychology," that the proverbial sticks work better than carrots, that kids aren't improved by easy promotion to the next grade, etc. Their explicit point is that penalties are good, that in a figurative sense "death concentrates the mind wonderfully."

All of the above makes perfect sense, or seems to, only for there to be a pivot by the authors to Frito-Lay, and the successful doings of Dick Grote to improve factory performance there. Rather than use the stick, Grote very much dialed back the punishment. With errant factory workers he ceased having them suspended without pay, and instead sought to induce guilt with paid days off that he referred to as "Decision Making Leave" during which workers would "contemplate" their future. Not feeling attacked, and sensing management was really trying to work with them to improve the quality of their work, Frito-Lay employees would strive to improve. And it worked.

About the critique, this is one of not understanding where the authors stand: bad is powerful, but fear of bad doesn't work. Or does the stick work? In this part of the book the authors' viewpoint became a little bit opaque given their approving analysis of Grote, but maybe would be cleared up with another read.

It would also be interesting to ask the authors their opinion of B.F. Skinner. Skinner is briefly mentioned in the book, and is famous for making a case for "reinforcers." Along these lines, a great friend who long owned a successful banking company once told me how very much he hated firing people. It was just awful. Thank goodness for Skinner.

A disciple of the man, my friend designed very specific, but also in a sense very vague, work structures. He hated office politics, so his rule was that those in his employ didn't have set work hours. If they could complete very specific work requirements on a daily basis, he didn't care if they departed midday, or earlier. Of course those who didn't respond to these productivity incentives would see it in their pay, and they would clearly see their failure.

Essentially those who didn't respond productively to the incentive structure would fire themselves, thus saving my friend the agony of letting people go. Skinner's teachings led him to create very positive reinforcers and the banking company ultimately achieved more than impressive profitability. This is mentioned not as a critique of Tierney and Baumeister, but more as a yearning to know what they think of Skinner.

Arguably most fascinating about *The Power of Bad* is when Tierney and Baumeister report about social media. Maybe opinion writers have a skewed view of it as a source of endless negativity, but it sure seems as though Twitter is a place for one to fulfill a need to confirm that all is wrong with the world. Except that it's not. The authors write that "The old mass-media dictum 'If it bleeds, it leads' doesn't govern social media." A study of *New York Times* articles posted on Twitter revealed that "negative articles were less likely to be shared than positive ones," not to mention that among Twitter users, they "use more positive words than negative words" even on the worst days of the terrorist attack

kind. If only our optimism could extend to work and relationships.

Which brings us to this excellent book's best chapter. It's Chapter Nine, which is the second to last. Here's hoping every pundit, left, right, libertarian, anarchist, socialist and communist reads it. In it, Tierney and Baumeister critique the "Crisis Crisis" whereby everything is just that. They so correctly assert that "the greatest obstacle to freedom and prosperity, is the exploitation of people's negativity bias by crisismongers." Amen, thousands and thousands of times over.

Those on the left routinely write and talk of climate, obesity, and poverty crises among many other looming tragedies, while all too many on the right warn us daily of birthrate, debt, and entitlement crises among many other looming disasters. At least with those on the left, they *want* to expand the size and scope of government such that they regularly aim to foment immense fear. Members of the right, who at least talk a good game about limited government, have no excuses.

Funny is that both sides have lamented the "opioid crisis" of modern times. Funnier is that both point to too much economic freedom, and markets that are too open to foreign plenty, as one of the sources of this alleged problem. Thankfully Tierney and Baumeister aren't so alarmist. They remind readers that opioids have given comfort to tens of millions suffering chronic pain, with the rate of addiction somewhere in the neighborhood of 1 to 2 percent.

The problem with Chapter Nine from a review perspective is that nearly every line was worth underlining, and discussing. Rather than do that, it should just be said that an already excellent book is made *spectacular* by the chapter on alarmism.

Ahead of hopefully reading this great book, it's worth keeping in mind an essential interpersonal theme that permeates it: "It's not so much what you do unto others. It's what you don't do." *The Power of Bad* is a truly excellent read that will surprise you, make you smarter, and crucially improve you. Run, don't walk.

February 13, 2020

The New Totalitarians

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Senior Fellow

This year marks the 75th anniversary of the end of the Second World War. The defeat of Nazism in Europe was seen as not only a victory over tyranny, terror, and mass murder, but a triumph for the preservation of many of the most cherished human freedoms, including freedom of speech and the press, and free association. Such freedoms seem to be under attack again, and often on American college and university campuses.

A new tyranny over the mind has arisen at some institutions of higher learning where open, diverse, and competing ideas across the spectrum of human interest is supposed to be the ideal. The last several years have been filled with numerous instances in which mobs of students and groups of professors have pressured university administrators to either prevent or revoke an invitation for an outside speaker to come to that campus because the vocal critics oppose the proposed speaker's social, political or economic views.

When such an outside speaker has still appeared on such a campus, they have been greeted with crowds condemning their viewpoint even before the visitor has had the opportunity to express it, or has been drowned out by derogatory chants and slogans, or in a few cases they have been physically threatened and even assaulted.

Identity Politics and the Closing of the Academic Mind

Virtually all of these attempts to prevent, harass, or violently respond to the visitor's words have been made by those on the political "left." A new spirit of intellectual intolerance has emerged and congealed in American academia. Their proponents are the new totalitarians who brook neither dissent, debate, nor disagreement. (See my articles, "The Tyranny of Trigger Words and College Safe Spaces" and "Campus Collectivism and the Counter-Revolution Against Liberty.")

Theirs is a collectivism of social class, race, and gender. They are the ideological offspring of the communists and fascists of the 20th century. They blend together a synthesis of Marxism and Nazism into the new world of political correctness and identity politics. They view themselves as radical "progressives," determined to overthrow and abolish the capitalist, racist and sexist sins of the past, and put in its place an amorphous "democratic socialism" that is premised on a new tribalism of group identity and belonging. (See my articles, "Tyrants of the Mind and the New Collectivism" and "Collectivism's Progress: From Marxism to Race and Gender Intersectionality" and "An 'Identity Politics' Victory Would Mean the End to Liberty.")

Like their Marxian and Nazi forbearers, these new totalitarians look at the world with a fanatical self-righteousness that they have the clear and correct vision of the "true" bases of society's ills and the only answer for its healing. The Marxists saw nothing but a two-dimensional world of exploiting capitalists who were abusing the "workers of the world." The Nazis were certain that all the evil in human history was due to a worldwide Jewish conspiracy to dominate and defile mankind's purer "races."

Our modern-day identity politics warriors are absolutely certain that all of history is the story of white, male domination of women and "people of color" through the institutional means of private

property and capitalist methods of production and control. Everything else is a "false consciousness" created by white men determined to maintain their power over all others on the planet.

All the talk about individual liberty, free enterprise, freedom of speech and the press, or freedom of association are ruses and rationales, they say, to hide from view the underlying "real" relationships of domination and oppression that cover over what actually binds people together and represents their "objective" identities.

Submerging the Individual in the Politics of Race and Gender

Submerged in this latest tidal wave of collectivist fanaticism is that smallest of all minorities, the individual human being. How the individual views and thinks of himself; what goals and purposes he or she considers possibly best for the peaceful improvement of their own life; the forms of voluntary and mutually beneficial associations and relationships that the individual might consider most desirable for happiness, fulfillment, and betterment.

These are all shunted aside under the presumption and hubris that the politically correct, identity politics warriors know the "true" connections that define and bind people together. This is determined by your race and ethnicity, by your gender and sexual orientation. You are "white," or you are "black," or you are "Hispanic," or you are "Asian," or you are . . . Plus, you are any one or more of the Heinz 57 ketchup-like categories and classifications of gender and intersectionality.

They talk about "social justice," but it really means the injustice of force through coercively determining what for and how individual human beings may go about thinking, acting and interacting with others. They refer to dignity and diversity, but in their lexicon of meaning this really means demeaning anyone who thinks and acts differently than their tribal ideologies dictate, and homogenizing human uniqueness and difference into political group pigeonholes for purposes of paternalism and power-lusting.

The new totalitarian tribalists, like their Marxist and Nazi intellectual ancestors, reject the ideas and achievements of the 18th and 19th centuries, achievements that cultivated and created a social, economic and political climate and institutional setting respectful for individual human beings, compared to the degradations and indignities and cruelties for most of human history before then.

The Western Ideals of Freedom and Reason

The classical liberal historian, Hans Kohn (1891-1971), summarized some of these achievements in his insightful work, *The Twentieth Century, A Mid-Way Account of the Western World* (1949):

> "The one world which the 18th century in its intellectual curiosity visualized seemed assured in the 19th century through the magic of universal commerce and free trade. The benevolent merchant offering goods and happiness replaced the warrior hero carrying glory and death . . .
>
> "For the first time mankind became an open society . . . More important, however, was the spread of the new humane attitude based upon the growing recognition of the value and dignity of each individual life: the end of slavery and serfdom, the unprecedented feeling of social responsibility, the reform of penal laws . . .
>
> "At the end of the 19th century, in practically all civilized countries, the legal equality of all men was established, and in the backward countries the fight for civilization included the fight for the equality of all. This has never been known in history before.
>
> "Constitutional safeguards protected the rights of individuals against the state – arbitrariness by

the powerful or by the police and censorship of beliefs seemed to belong to a dead past . . .

"The 19th century movement has its shortcomings, its hypocrisies, its absurdities; but it was a great and serious effort to make life more humane and more reasonable. It brought to the countries of modern middle-class civilization such an increase in liberty, welfare, and happiness as no century before had done."

All of this arose, Hans Kohn argued, from man's renewed confidence in and understanding of the relevance of human reason and freedom of thought. This was emphasized by him in his earlier work, *Force or Reason: Issues of the Twentieth Century* (1937), a response to the totalitarian threats of that time:

"A new self-confidence was awakened in man, a new dignity given to him. On the strength of his reason man rose to the position from which he was able to understand the world . . . Reason, natural light in man, made superfluous all supernatural and superhuman light. Natural law, law founded upon reason, which is the same for all men, and not law founded upon divine authority, guided man's steps from philosophical rationalism to political and social rationalism, which found its expression in the American and French Revolutions . . .

Out of the right and duty of man to think for himself grew a new toleration, a feeling of respect for the rights and opinions of one's fellow men, for his freedom of thought, an effort to arrive at a mutually satisfactory settlement of disputes and discrepancies by discussion and compromise. . .

We are sometimes inclined today to forget what the 19th century really meant in human history . . . A greater progress was achieved than in all the centuries before. This progress did not express itself solely or mainly in the domain of science and technology . . . The essential progress of the last one hundred and fifty years lies, in my opinion in three other directions – toward the equality of man, towards a more general participation of everybody in the fullness and opportunities of life, and towards a refinement and humanization of our mores."

Identity Politics in the Footsteps of Marxism and Nazism

All of this is ridiculed and rejected by our new tribal collectivists, just as it had been by their Marxist and Nazi predecessors. Marxism spoke of your raised "class consciousness." Nazism urged you to discover yourself in your "blood" and primitive racial emotions. The Identity Politics Warriors insist that you self-identify based on the color of your skin, the cultural roots expressed in your ancestor's clothing, customs, and cuisine, and how you "feel" about your self-designating gender today that might be different tomorrow and which no one else may judge or fail to recognize.

Doctrinaire Marxists often asserted that capitalist and proletarian interests were so inescapably in conflict with each other that no common ground could be found through attempts to "reason together." Your social class molded the way you thought. "Reason," therefore, was a servant of class interests. Nazis insisted that each race possessed its own "logic," and even insisted that there was a distinct German science from Jewish science; no common ground for reasoning together existed between German and Jew, the Nazis said. These different logics were tools in the battle between races for survival and domination.

Our Identity Politics Warriors declare that any disagreement or dissent from their conceptions of human beings in terms of declared group definitions and designations are to be discounted and condemned as "proof" of racism, sexism and power

for the white one percent. Even trying to understand another ethnicity's experiences of life are instances of condemnable "cultural appropriation." Each ethnic and racial group, and one presumes every one of the dozens of different genders as well, lives in its own unique hermetically sealed world, with no common humanity of shared knowledge and experience.

Finally, just as any real world events could be twisted and turned to be made to fit within the Marxist and Nazi interpretive templates to assure that nothing could challenge or refute their a priori world views, so too nothing is to be allowed to undermine or question the illusive premises behind any and all positions declared to be "politically correct" and part of the prevailing elements of current Identity Politics.

Freeing Young Minds by Prohibiting Open Discussion

When you know you know the "truth" and the liberation of humanity depends upon the triumph of that truth throughout society, then it becomes self-evident that "evil," falsehoods, and lies cannot be allowed to undermine the crusade for the better world that is just ahead of us.

Restricting and prohibiting false speech, therefore, is essential for success of "the truth." Otherwise, utopia may be delayed or even derailed, as well as being "harmful" and "hurtful" to the oppressed victims of white, male, capitalist exploitation.

Thus, closing colleges and universities to those disagreeing or questioning Identity Politics and "progressive" social and economic policies is in fact the way to set young minds free from the dangerous and degenerate and still dominating Enlightenment ideas of individual liberty, private property and enterprise, and limited government under rule of law. After all, they are merely intellectual tools for white male domination.

The Conservative Response: Mandated Speaker Diversity

So, what is to be done? Last year a "conservative" answer was proposed to end the academic tyranny of the politically correct. Stanley Kurtz, a senior fellow at the Ethics and Public Policy Center in Washington, D. C., proposed that institutions of higher learning be required by state legislatures to have an Office of Public Policy Events (OPPE) to assure a more fair and balanced representation of views during public debates and discussions on campus by arranging invitations and participation of those offering alternative perspectives.

Kurtz's Campus Intellectual Diversity Act (CIDA) was endorsed by the National Association of Scholars (NAS), which monitors the degree to which political correctness narrows the knowledge offered at colleges and universities, and challenges instances of denials of freedom of speech.

In Mr. Kurtz's template for such an Act, university administrators are tasked and commanded:

> "Inviting speakers who hold a wide diversity of perspectives, from within and outside the campus community, to participate in debates, group forums, and individual lectures, with particular attention to inviting participants from outside the institution who hold perspectives on widely debated public policy issues otherwise poorly represented on campus.
>
> "Providing, where necessary, honoraria, travel, and lodging expenses to participants in debates, group forums, and individual lectures organized by the Office of Public Policy Events, from outside the campus community."

If the state legislature does not specify how many and what types of public debates, forums and lectures the academic institutions will have during an academic year, then the respective Offices of

Public Policy will:

"Organize a substantial number of all three event-types: debates, group forums, and individual lectures. Obtain the participation of speakers who represent widely held views on opposing sides of the most widely discussed public policy issues of the day. Invite and host speakers who can ably articulate widely held perspectives on public policy issues otherwise poorly represented on campus."

In addition, these campus Offices for Public Policy Events would be required to keep public records of upcoming and past programs and make available an archive of video recordings of all such public events.

Conservative Speakers' Planning and Unintended Consequences

Recently, Mr. Kurtz wrote in *National Review* (February 3, 2020) that Arizona State Representative, Anthony Kern, has introduced a bill in the Arizona legislature to implement the CIDA, with its mandates on university and colleges funded by taxpayers.

Mr. Kurtz responded to critics who had expressed concerns that weird or extreme speakers might be required to be brought to a campus, such as a Holocaust denier. He argued that that would not be expected or mandated, but merely a "spectrum" of reasonable and public perspectives should be offered to students and others attending such events.

From a classical liberal perspective, may I suggest, Mr. Kurtz's proposal is another too frequent instance of conservatives searching for responses to the "leftward" drift in American society by merely offering their own version of the planning mentality with all of its intended and possibly unintended consequences.

Or, stated even more bluntly, here is an instance of a conservative GOSPLAN for academia. Either the legislature or a built-in mandate into the Act directs a certain number of targeted events. The appointed managers of the campus programs, the Office of Public Policy Events, will determine the content, the format, the number of programs, and the alternative points-of-view to be offered by the participants.

Who will decide the relevant topics or issues? Once such an Office of Public Policy Events is in place and up and running, political cover for the campus administration will be to see to it that little or no such public events operate outside of the legislated framework. Otherwise, before you know it, all hell breaks loose with critics from either "the left" or "the right" complaining and threatening legal action due to some "underrepresentation" at a debate, discussion or forum outside of or not directed by the university's OPPE.

Once the OPPE becomes the gatekeeper and the monitor for all such campus events, there would soon be campus pressure group jockeying to see that every political and ideological viewpoint that has any clout has participation in or a voice heard on the committee. It would likely evolve into a hothouse of political power-playing in an attempt to influence what gets publicly discussed on campus and who gets offered the outsider invitations to speak.

The Act's proponents are hoping that it will see to it that "conservative" voices are regularly heard on campus. Just wait until every variation of gender intersectionality, race identity, and radical revolutionary niche clique and "cause" insists on being put on the program, otherwise it will not be "fair and balanced." A conservative or even libertarian voice will soon be drowned out in the torrent of mandated and tax-funded leftist "diversity" points-of-view.

Campus debates, forums and lectures will become a bedlam of the very types of things people like Stanley Kurtz are frustrated and angry about. A conservative version of central planning for diversity discourse on America's colleges and universities

will not, I fear, solve the problem of intellectual closed mindedness in modern-day higher education.

The Answer Lies in the Privatization of Higher Education

At the end of the day, in my view, the only long-term answer is an end to educational socialism, which is what government-mandated and/or funded schooling is really all about. Higher education in America has become taxpayer- funded islands of collectivist thought in too many fields of study, especially in the humanities and the social sciences. The "progressives," socialists, and Marxists who comprise the ideological foundations for political correctness and Identity Politics in colleges and universities, and who set the tone and culture for those attending these institutions, can only be unseated by withdrawing their secure source of funds.

The privatization of colleges and universities that are state-owned and operated, and the ending of various types of tax-based support for other nominally "private" institutions of higher learning, would do more to change the form and content of what is taught at these places over time than anything else imaginable. (See my article, "Educational Socialism versus the Free Market.")

Anything else, in my view, is either merely reinforcing what is already the problem in colleges and universities or simply adds another layer of planning bureaucracy that fails to solve the problem.

Make colleges and universities completely answerable to students, parents, and charitable benefactors, with no financial support, subsidies or guarantees from government. In other words, make those offering higher education answerable to the buying public, the consumers, for what they are offering in terms of content and pedagogy.

It will soon become clear whether there really is a market for all the "politically correct" subjects and course offerings currently filling up the college and university catalogues in terms of what many students and parents actually want, without the financial underpinnings of compulsory tax dollars to make it presently possible.

February 10, 2020

Trump Cutting the Budget? Don't Believe It

DANIEL J. MITCHELL
Contributor

I would prefer not to write about President Trump's new budget, largely because I know it's not a serious proposal.

Even before he was elected, I pointed out that Trump was a big-government Republican who had no intention of dealing with serious fiscal issues such as the rising burden of entitlement spending.

So I wasn't surprised that he capitulated to swamp-friendly budget deals in 2017, 2018, and 2019. And I'm depressingly confident that the same thing will happen this year.

That being said, I want to comment on how the media is covering his latest budget.

Take a look at some of the headlines that are dominating the news this morning.

All of these headlines make is seem like Trump is proposing a Reagan-style budget with lots of cuts, especially with regards to domestic programs.

From Reuters.

Trump slashes foreign aid, cuts safety net programs in new budget proposal

From New York magazine

Trump Proposes Massive Cuts to Safety Net Once Again

From the Washington Times.

'Shrink' government: Trump's budget reduces spending by $4.4 trillion, makes 2017 tax cuts permanent

From NBC

Trump to propose sweeping cuts to foreign aid, safety net programs in latest budget

From the Associated Press.

Trump's $4.8 billion budget proposal revisits rejected cuts

From Bloomberg.

Trump to propose $4.8 trillion budget, big safety-net cuts

From International Business Times.

Trump Budget Cuts Funding Of Medicaid, Food Stamps

From Fox

Trump's budget plan runs $1T deficit, cuts $4.4T in spending over 10 years

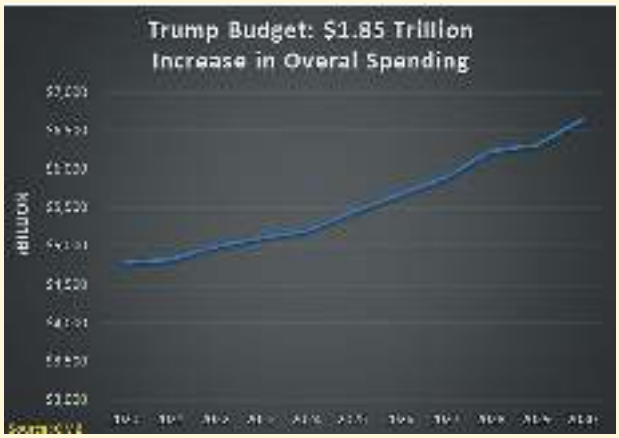
From the Wall Street Journal.

Trump to Propose $4.8 Trillion Budget With Big Safety-Net Cuts

All of that would be great news…if it was true.

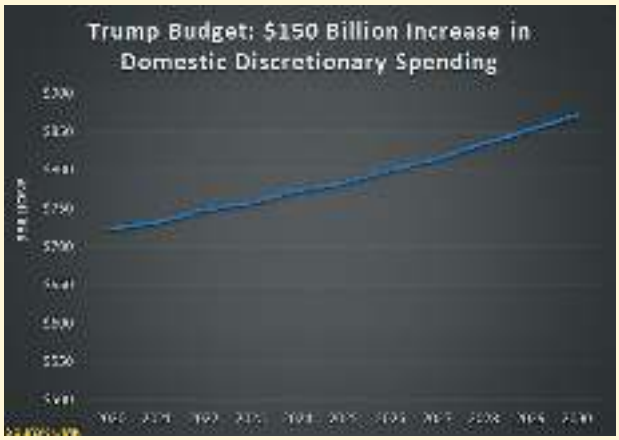
In reality, here's what Trump is projecting for total spending over the next 10 years.

Can you find the spending cuts?



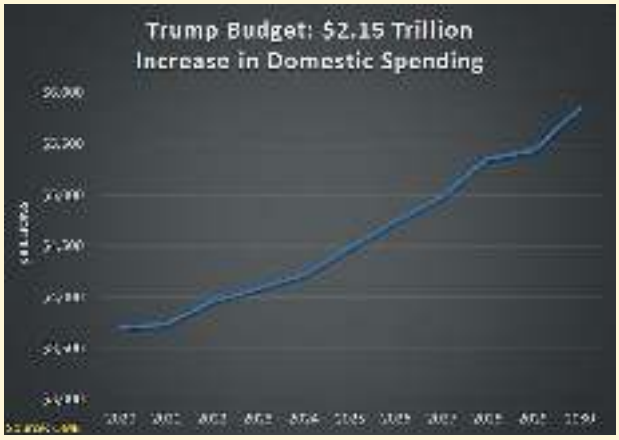
And here's what's happening with domestic spending (mandatory outlays plus domestic discretionary) according to Trump's budget.

Can you find the spending cuts?



Last but not least, here's Trump's plan for domestic discretionary spending.

Can you find the spending cuts?



So why is there such a big disconnect in the media? Why are there headlines about cutting and slashing when government is growing by every possible measure?

For the simple reason that the budget process in Washington is pervasively dishonest, as I've explained in interviews with John Stossel and Judge Napolitano. Here are the three things you need to know.

1. The politicians created a system that automatically assumes big increases in annual spending, called a baseline.
2. When there's a proposal to have spending grow slower than the baseline, the gap between the proposal and the baseline is called a cut.
3. It's like being on a diet and claiming progress because you're gaining two pounds each month rather than five pounds.

Defenders of this system argue that programs should get built-in increases because of things such as inflation, or because of more old people, which leads to more spending for programs such as Social Security and Medicare.

It's certainly reasonable for them to argue that budgets should increase for these reasons.

But they should be honest. Be forthright and assert that "Spending should climb X percent because…"

Needless to say, that won't happen. The pro-spending politicians and interest groups like the current approach because it allows them to scare voters by warning about "savage" and "draconian" spending cuts.

Remember how Obama said the sequester would wreak havoc because of massive cuts? Except there weren't any cuts, massive or otherwise. As Thomas Sowell pointed out, Obama was trying to deceive voters.

P.S. The British also use dishonest budgeting.

February 11, 2020

How the Coase Theorem Solves the Problem of Wolves

MICHAEL MUNGER

Senior Fellow

The "Coase Theorem" is hard to understand because it's so simple.

Ronald Coase was working on the "problem" of allocating frequencies in the 1950s. The U.S. Federal Communications Commission was dithering about how to ensure that frequencies being sold to private companies would go to the "best" uses.

Coase thought this was dumb; just auction them off, and allow resale. Then, either the company that owns the rights values them, or another company values the rights more and will buy them. So long as it is possible to buy and sell property rights, the rights will always be in the hands of the user who values them most. It's true by definition.

Coase recognized an important qualification, "transaction costs." He never defined transaction costs, on principle, because there is no all-inclusive definition. In the years since Coase wrote his famous article in 1960, analysts have realized the most important considerations are rules and property rights.

I'll admit I'm a transaction costs nut, because I'm a student of Douglass North. North believed that most interesting problems in political economy come down to attempts to control or reduce transaction costs. One of the most important institutions, as has been recognized at least back to David Hume, is property rights.

If property rights are diffuse, hard to enforce, or expensive to exchange, it's difficult for people to cooperate. In the frequency auction, if the government has regulatory restrictions, or otherwise makes it hard to buy and sell frequency use rights, then less socially useful stations and programs get on the radio and the new, better station that more people would enjoy never gets a chance to be heard.

In the past 30 years there have been some remarkable achievements applying the insights of the Coase Theorem to problems in the environment. Many people have a visceral objection to using "market" logic in environmental settings, but it's hard to argue with the results. (If you are interested in those results, take a look at the descriptions given here.) The problem is that the favored solution of many environmentalists on the left is the use of commands, regulations that dictate certain behaviors that are seen as good and outlawing behaviors seen as bad. Combined with enforcement, that amounts to increasing the transaction costs of acting badly.

Coase, of course, was proposing a different solution: reduce the transaction costs of acting in accordance with the public interest. Now, defining the public interest is hard, but the point is that given some political determination about what is good for the environment, we still usually have two choices: use commands and regulation, or else use incentives and property rights. Let's consider an example.

Wolves are a naturally evolved, and well-adapted, species of predator that were once common in the Central and Western portions of the northern U.S. They played an important role in limiting the size of elk herds. But wolves were hunted to near-extinction, and nearly driven out of this enormous land area by the 1930s. The reason was understandable: wolves found cattle, sheep, goats, and almost any other kind of domesticated animal to be quite tasty, and usually slower than elk to boot. An adult wolf can be three feet high at the shoulder, and weigh more than 120 pounds. Plus, they hunt in organized packs; wolves are formidable.

Removing wolves meant a lot fewer cows and

sheep were lost to predators. But it also meant that elk herds burgeoned, often tearing up the tender shoots and other vegetation growing on stream banks. Rivers and creeks throughout the region eroded, tore up their banks, and in many cases took out the cottonwood trees that had once stabilized the flow of the streams. Water ran off rather than percolating into the soil, and the face of the land began to change rapidly.

Starting in the 1990s, the U.S. Fish and Wildlife Service began to reintroduce wolves into several parts of the northern states, in Idaho, Montana, and Wyoming. The results were better, occurred faster, and have had more wide-reaching effects than almost anyone expected: hungry wolves ate elk, there was much less pressure on river systems, and the previous ecosystem of plants and animals such as beavers were quickly reestablished. As a recent article in Ecohydrology notes:

Recent increases in tall willow heights, greater canopy cover, well–vegetated streambanks, and the recent development of an inset floodplain all pointed towards a riparian/aquatic ecosystem beginning to recover. Overall, results were consistent with a landscape–scale trophic cascade, whereby reintroduced wolves, operating in concert with other large carnivores, appear to have sufficiently reduced elk herbivory in riparian areas to initiate the recovery of Blacktail Deer Creek's riparian plant communities and stream channels.

Of course, the reintroduction of wolves for a "public interest" policy of restoring damaged streams, wetlands, and habitat for native plants and animals had what economists call an "externality:" the wolves still had a nice breakfast of beef or mutton, taken from land of the thousands of privately owned ranches in the wolves' new territory.

Now, in the legalistic mind of many in the environmental movement, the solution to this "conflict" is obvious: make it illegal to shoot wolves. But there are two problems with this approach. First, there is a problem of basic fairness: it may be true that there are enormous benefits to the society, through the environmental improvements of huge areas of wildland, that result from a healthy and diverse "guild" of large predators, as scientists call the populations of wolves, bear, mountain lions, and so on. But we are asking a small number of people—ranchers and their families—to bear those costs, almost alone.

In effect, the policy itself imposes an externality on ranchers: wolves are good, but the side effect on ranchers is bad. If the benefits are large and extend to the entire nation, why must ranchers be the only ones to pay the costs?

Second, the idea that "protecting" wolves by listing them as "Endangered" is nonsense. Having grown up on a rural farm myself, I can assure you that it may be 20 miles or more to the nearest law enforcement office, the sound of gunfire is not cause for alarm, and in any case if a rancher's neighbors, likely ranchers themselves learn that a cattle-killing wolf has been shot they are not likely to report it to the authorities. They might bring over a nice warm pie, though, in gratitude.

What this problem needs is the environmental Coase Theorem.

Let us grant that it's really true that "we" value the presence of wolves in the West, partly for the inherent value of a balanced ecosystem in which wolves have long played a role, and partly for the substantial benefits of restoring plants and wildlife in river systems.That might not be true, of course, but it's the premise of the current policy. In that case, it must be possible (that's why it's called a "Theorem"!) for the gainers to negotiate with and compensate the losers, because the total gains exceed the total losses. All that is necessary is to find a way to assign tradable property rights that make wolves assets rather than liabilities.

To date, the environmental Coase Theorem has been applied in two ways: compensation for ranchers who lose cattle to wolves, and payments to ranchers who also "raise" wolves on their land. Let's consider each in turn.

Compensation for loss: The logic of the Coase Theorem is that if the losses that result from introducing wolves are less than the value of having the wolves around, then it should be possible to arrange a property rights system that makes that result universally agreed upon. In other words, all parties should agree that it's better to have wolves than not to have them. The basis for this claim is that the presence of wolves creates such large societal benefits that it should be possible to hold harmless anyone who loses out in the new system. In the case of the sales of radio frequency sales, the seller is willing to give up the rights to the frequency because he is paid an amount at least equal to how much he values that frequency. And the new owner values the frequency more, so the total value of the allocated use right is increased. But the seller would not give the rights away for free; his consent must be obtained voluntarily, by paying for rights he is giving up.

If I'm a rancher, I might agree that wolves are good for the ecosystem. But it costs me $500 if the wolves bring down a calf. So I'm opposed to wolves, and will shoot them if I can. However, if the state or some other organization agrees to pay me the value of the lost cattle, I am at worst indifferent and may actually support the policy. Instead of imposing the policy and forcing the rancher to absorb the costs, the Coasian policy compensates the rancher for his loss.

The "Wolf Compensation Trust" is an organization that takes donations and compensates ranchers for lost livestock. Their web site is straightforward about the problem, and the solution:

> Our goal is to shift economic responsibility for wolf recovery away from the individual rancher and toward the millions of people who want to see wolf populations restored. When ranchers alone are forced to bear the cost of wolf recovery, it creates animosity and ill will toward the wolf. Such negative attitudes can result in illegal killing.

States can also sponsor such programs, though of course there are problems with fraud and misuse of funds, as with any attempt to offer state payments.

Paying to Raise Wolves: An even more interesting, and entirely private, application of the environmental Coase Theorem is the example of "Wild Sky Beef." WSB buys beef from licensed producers, and sells the product at a premium to people who support the reintroduction of wolves, or maybe who just like excellent beef. Todd Wilkinson of PERC describes the company this way:

> [WSB's] goal is to promote wildlife-friendly ranching and it follows a for-profit, market-driven model. Not only are ranchers paid more for their cows, but they are rewarded for providing proof if bears, cougars, or other animals pass through their pastures. But how?

Scientists with APR install remote, motion-sensing cameras and if the animals are documented on their land, ranchers are paid a bonus. Produce a picture of a black bear: collect $300; a cougar: $200. If grizzlies or wolves arrive in the area, the non-lethal visual bounty will rise even higher.

A rancher can make an extra $12,000 a year for having a pack of wolves," says Sean Gerrity, APR's president. With payments such as this, wolves become worth more alive than dead. If ranchers can find a way for wolves to co-exist with their cattle, they could come out much further ahead.

If people really do value wolves sharing habitat

with cattle, they are willing to pay more for beef that such ranches produce. And private donations change nearby wolves from threats to income-producing assets. True, the rancher has to find ways to manage the problems that wolves cause. But on net the rancher is an ally rather than an enemy in the drive to establish wolves in the northwest and north central U.S.

As I said at the outset, the problem with the Coase Theorem is that it's simple. The question of finding the highest-valued use for a resource should not depend on who has to pay the cost. But high transaction costs can be a problem; making it possible to imagine creative ways to compensate the losers in policy initiatives can make policies more effective, more fair, and more politically viable.

February 10, 2020

The Case for Retracting Matthew Desmond's 1619 Project Essay

PHILLIP W. MAGNESS

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Since the outset of the 1619 Project controversy, I have consistently argued that the overwhelming majority of the project's problems derive from a single featured essay: Matthew Desmond's piece on capitalism and slavery.

This essay advances an explicit anti-capitalist political message that's rooted in a fundamental misreading of economic history. Although he repurposes the concept with an antislavery message, Desmond essentially attempts to rehabilitate King Cotton ideology, a long-discredited piece of proslavery propaganda from the Confederate era. He also ignores the intellectual history of capitalism, including the strong historical association between laissez-faire theorists and abolitionism.

Today I'd like to take a look at another dimension of the problems in Desmond's essay: its errors of historical fact and its misuse of historical sources.

In doing so, it is important to recognize that there are still other faults with other contributions to the 1619 Project. Its lead essay still exaggerates British antislavery elements during the American Revolution, repurposing independence as a proslavery movement. But these faults are not irremediable. They could be addressed by relaxing the claim or injecting greater nuance into the discussion, should the *Times* exhibit an inclination to place historical accuracy above politics.

Desmond's argument, however, is riddled with factual error and dubious scholarly interpretations that warrant severely discounting the piece as a whole.

Let's consider those problems.

A Faulty Genealogy

Desmond begins his argument by asserting a direct lineal descent from the violent and coercive operations of the plantation system to the business practices of the modern economy. As he contends, "Recently, historians have pointed persuasively to the gnatty fields of Georgia and Alabama, to the cotton houses and slave auction blocks, as the birthplace of America's low-road approach to capitalism." The historians he refers to here are almost exclusively drawn from the highly contested "New History of Capitalism" (NHC) school, and many of its leading contributors are featured in his essay.

Desmond's reliance on such a narrow historiographical echo chamber is itself problematic, given how many scholars outside of the NHC reject its claims and given the documentation of errors affecting its core claims. We may nonetheless follow his claimed genealogical progression from the plantation to the modern economy. The effect of this alleged infusion, Desmond therefore contends, is to instill modern capitalism with a foundational "brutality" that can only be rectified by adopting a litany of economic policy interventions that bear striking resemblance to the progressive wing of the Democratic Party today.

The stated genealogy is presented as a matter of fact. Desmond invokes the imagery of a modern corporation where "everything is tracked, recorded and analyzed, via vertical reporting systems, double-entry record-keeping and precise quantification," then asserts that "many of these techniques that we now take for granted were developed by and for large plantations."

"When an accountant depreciates an asset to save

on taxes or when a midlevel manager spends an afternoon filling in rows and columns on an Excel spreadsheet," he continues, "they are repeating business procedures whose roots twist back to slave-labor camps." By direct implication, modern capitalism carries that same moral stain with it.

There are immediate problems with Desmond's historical narrative. The history of double-entry bookkeeping and business measurement predates plantation slavery by several centuries, with origins that are directly traceable to the banking families of late medieval Italy. Desmond seems not to understand the accounting function of depreciation, which arose mainly in the railroad industry as a mechanism for distributing the distortive effects of large replacement purchases on machinery that underwent constant wear and tear.

Nor are the tools of measurement and finance distinctly capitalistic, as their attempted adaptation to the centralized planning of the Soviet Union and other 20th-century communist states attests. Most attempts to operationalize socialist economic planning depend by necessity on the complex quantification of resource allocation, or attempts at input-output modeling of inter-industry relationships, usually adopted as an alternative to the obviated role of the price mechanism in decentralized allocation.

But even more problematically, Desmond's claim does not match his own stated source, Caitlin Rosenthal's 2018 book *Accounting for Slavery.* While Rosenthal does investigate the historical use of accounting practices on the plantation with informative insights into how slave owners made their institution profitable, she attaches a substantial caveat at the outset of her book:

> This is not an origins story. I did not find a simple path where slaveholders' paper spreadsheets evolved into Microsoft Excel. (p. xii)

The plain language of this caveat expressly disavows the genealogical interpretation that Desmond assigns to her work, even using the very same example of Microsoft Excel to convey her rejection. In short, the 1619 Project inverts its source's claimed purpose.

When I recently pointed this contradiction out to the *Times*, the newspaper's editors indicated that they were standing by Desmond's claim nonetheless and suggested that doing so now meets with Rosenthal's own post hoc concurrence. Given that her publisher is also now touting Desmond's passage as an endorsement of this book, one is left to wonder why this caveat was included if it is going to be abandoned with such nonchalance.

The alteration carries substantial implications for Rosenthal's thesis. As presented in its original form, *Accounting for Slavery* documents the unsurprising but historically interesting fact that slave owners managed their plantations by adapting then-modern accounting and financial practices found elsewhere in the business community to their own horrid institution.

When repurposed as a genealogy, however, this thesis falls apart for want of evidence. Rosenthal's work does not show that the specific accounting practices of the plantations were transmitted to modern Wall Street, or that later businessmen learned their trades specifically from slavery's financial innovations, as opposed to common financial and accounting practices that long predate the American plantation system. If accepted, Desmond's rendering of *Accounting for Slavery* would damage its own scholarly contribution as a work of history by stretching its evidence far beyond what the book's contents and documentation either claim or support. Yet that's the reading the Times appears to be sticking with.

Even in this simple presentation, Desmond's spin on Rosenthal's work exhibits the telltale characteristics of the genetic fallacy, wherein an unsavory

origin is said to be a discrediting of a position in the present. But Desmond's origin story is also wrong.

Illustrative of this fallacy, he quotes NHC historians Sven Beckert and Seth Rockman to assert that "American slavery is necessarily imprinted on the DNA of American capitalism." Beckert and Rockman's genetic claim would have come as a great surprise, if not a source of outrage, to the slaveholders of the late antebellum period. Leading proslavery theorist George Fitzhugh wrote in 1854 that the tenets of free market capitalism were "at war with all kinds of slavery, for they in fact assert that individuals and peoples prosper most when governed least." The depiction of slavery as capitalistic also chafes with the most developed ideological justifications that Southern radicals made for their economic system — a system built upon a coerced hierarchy of laborers forced to do menial tasks under the paternalistic direction of quasi-feudal plantation owners.

This leaves his historical account fraught through with factual and interpretive errors. Desmond's attempt to tie slavery to modern accounting misses the latter's known and separate origins, misrepresents accounting and measurement as uniquely capitalistic, and directly inverts the disavowal of an origin story in its own cited source. It's safe to say that his thesis is off to a poor start.

A Misrepresented Statistical Claim

Taking his own false genealogy of modern accounting as a given, Desmond next turns to its claimed economic implications for the plantation system. To illustrate the effect, he points to a stunning statistic:

> During the 60 years leading up to the Civil War, the daily amount of cotton picked per enslaved worker increased 2.3 percent a year. That means that in 1862, the average enslaved fieldworker picked not 25 percent or 50 percent as much but 400 percent as much cotton than his or her counterpart did in 1801.

The implication is clear. Desmond seeks to convey that "capitalist" business practices allowed plantation masters to forcibly extract the maximum amount of productivity from their enslaved workforce to such a degree that it causally drove the rapid expansion of the American cotton industry in the early 19th century. Cotton output, he contends, arose directly from a symbiotic convergence of capitalism and the whip.

The underlying statistic is nominally accurate insofar as American cotton production grew almost fourfold between 1800 and the Civil War. But Desmond has also repeated a severe misrepresentation of this statistic's source.

The 400 percent increase estimate comes from a 2008 article by economists Alan Olmstead and Paul Rhode, and reflects their calculation of yearly cotton picking rates from almost 150 sets of plantation records. Yet Olmstead and Rhode do not attribute this production increase to a devil's bargain between double-entry bookkeeping and systematized beatings of the slaves. Instead, they present clear evidence of a very different explanation. American planters improved their crop through biological innovation, such as creating hybrid seed strains that yielded more cotton, were easier to pick, and were more resistant to disease. As Olmstead and Rhode conclude:

> Technological changes revolutionized southern cotton production in the 60 years preceding the Civil War. The amount of cotton a typical slave picked per day increased about 2.3 percent per year due, primarily, to the introduction and perfection of superior cotton varieties.

Although the two economists support this technological explanation with extensive statistical evidence, Desmond and the NHC scholars he relies on ignore it and append their own alternative spin to Olmstead and Rhode's data. Instead of seed improvements, they contend that the 400 percent increase arose from a systematized and quantified process of whipping meant to extract greater labor from the slaves.

Desmond gets this alternative interpretation directly from NHC historian Ed Baptist. According to Baptist, the Olmstead and Rhode statistics attest to "an economy whose bottom gear was torture." By tracking individual slave production, he contends, slave drivers were essentially able to calibrate their torture to maximize and increase cotton picking rates over time. As Desmond describes it, "The violence [of slavery] was neither arbitrary nor gratuitous. It was rational, capitalistic, all part of the plantation's design."

The "calibrated torture" thesis is a central claim of Baptist's 2015 book *The Half Has Never Been Told*, itself one of the foundational texts of the NHC genre. Turning to Baptist's book, we find clearly that he too enlisted Olmstead and Rhode's 2008 paper for his evidence of the fourfold increase in cotton output before the Civil War, even reprinting one of their main graphs on page 127 of his book and another of their tables on page 129.

Baptist's book is an unscholarly mess of misinterpreted data, misrepresented sources, and empirical incompetence. In proclaiming the novelty of its own "never told" story, he also constructs a bizarre strawman of the scholarly literature on the economics of slavery before his own work. As Baptist writes on page 129 of his book, the claim that slavery was less efficient than free labor is "a point of dogma that most historians and economists have accepted."

In reality, most economic historians have associated economic efficiency as well as profitability with slavery since a landmark article by Alfred Conrad and John R. Meyer argued this position in 1958. The relationship between slavery, efficiency, and profitability is the subject of a vast subsequent literature that Baptist almost entirely ignores. As we can already see, his book is essentially arguing against a phantasm of his own imagination.

The problems similarly extend to Baptist's treatment of the Olmstead and Rhode data. Although Baptist uses the economists' statistics, he conveniently omits their evidence that cotton production growth arose from biological innovation in seed strains. Instead he supplants it with his own explanation, the "calibrated torture" thesis that Desmond then repeats. In the NHC telling, the 400 percent growth in cotton output arose from "ratcheting" production rates upward through tracked and mathematized beatings of the slaves who picked the crop.

Baptist's sleight of hand was not lost upon the economists. In 2018 Olmstead and Rhode published a withering rebuttal of Baptist's book, using additional records from plantations to empirically debunk his "calibrated torture" argument. Rather than corresponding to mathematized whipping — a claim that Baptist also makes by altering and distorting the text of historical slave narratives to make them fit his thesis — actual cotton picking rates from the Olmstead and Rhode data clearly follow a seasonal pattern corresponding to the annual crop cycle. As the economists write:

> Recall that Baptist has embraced our data showing a roughly four fold increase in average cotton picking rates over the antebellum years. These data only reported plantation yearly averages. If we turn up the power of our microscope and look at the daily data for individual slaves that we used to construct the plantation averages, a whole new world appears that allows us to investigate empirically the effect of current picking on

future picking. There is no evidence of ratcheting. Over the course of a year picking rates formed an inverted "U" going up to a peak period and then falling significantly.

In short, Baptist's thesis not only misrepresents the evidence from Olmstead and Rhode, his own cited data source — it also misunderstands the numbers behind that source.

Baptist, much to the discredit of his professionalism, has subsequently adopted a strategy of refusing to engage with Olmstead and Rhode's rebuttal. Instead he brushes it aside and persists as if his own thesis is uninterrupted and unaltered in the face of clear contradictory evidence.

Although the 1619 Project's editors have been circumspect about revealing the scholars they consulted on the project, it is becoming increasingly clear that Baptist heavily influenced and likely advised Desmond's essay. Desmond essentially adopts *The Half Has Never Been Told* as the basis of his economic interpretation, and of the aforementioned statistic. It therefore casually repeats Baptist's errors and misrepresentations of Olmstead and Rhode's work.

Olmstead and Rhode's critique of Baptist falls squarely among the highest-profile academic debates of the last decade. In 2016 it broke away from the confines of academic journals and into mainstream journalism, with even the *Washington Post* running an essay on the dispute.

Curiously, the 1619 Project's editors appear to have completely missed this dispute. When I asked her about Desmond's overreliance on Ed Baptist's debunked claims, project editor Nikole Hannah-Jones responded, "Economists dispute a few of Baptist's calculations but not the book itself nor its thesis."

Olmstead offers a very different assessment: "Edward Baptist's study of capitalism and slavery is flawed beyond repair." And as we've now seen, Desmond's 1619 Project essay lifted its main empirical argument from Baptist and grafted it onto a false genealogy that purports to derive modern accounting practices from lineal "roots" in the plantation system.

It would seem, too, that Desmond's essay is flawed beyond repair.

As the *New York Times* often presents itself as a stickler for corrections in the name of ensuring factual and interpretive accuracy, substantial portions of Desmond's essay warrant retraction — including its main thesis linking modern capitalism to slavery.

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