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RESEARCH REPORTS

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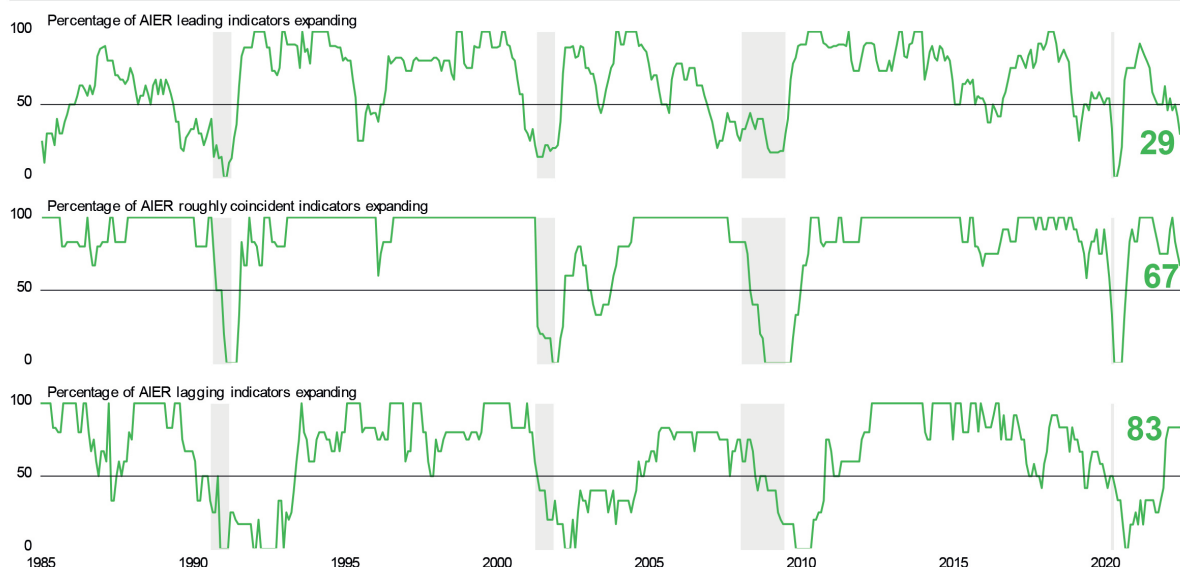
BUSINESS CONDITIONS MONTHLY

Robert Hughes

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AIER Leading Indicators Index Falls to 29, Signals Broadening Weakness

Indicators at a glance



Note: Shaded areas denote recessions. A score above 50 indicates expansion.
Source: AIER.

Summary

AIER's Leading Indicators Index fell thirteen points to a reading of 29, the lowest level since August 2020. The latest reading is well below the neutral 50 threshold and is consistent with broadening weakness in the economy and significantly elevated risks for the outlook. The results underscore the recent advance estimate of second quarter real Gross Domestic Product, which showed a second consecutive, albeit small, quarterly decline. It should be noted that the advance estimate is based on preliminary and incomplete data and will likely be revised. Even if the estimate for second quarter real GDP is revised to show growth, there is substantial and growing evidence of broadening weakness in the U.S. economy.

Persistently elevated rates of price increases and an intensifying Fed tightening cycle are impacting economic activity. Consumer attitudes and real consumer spending are weakening, and higher mortgage rates are weighing on housing. While the strong labor market continues to provide some support for consumer incomes, there are also some signs of softening for the labor market. Overall, the outlook remains highly uncertain. Caution is warranted.

AIER Leading Indicators Index Falls to 29 in July, Signaling Major Risks

The AIER Leading Indicators index posted a decline in July, dropping thirteen points to 29. The July result is down 62 points from the March 2021 high of 92 and is the lowest level since August 2020 during the recovery from the lockdown recession. In recent business cycles, the Leading Indicators Index has fallen

into the twenties-range five times since 1985. In four of those instances, a recession followed within about 12 months. The exception was in 1995 when no recession was declared but real GDP growth slowed significantly. With the latest reading now well below the neutral 50 threshold, the AIER Leading Indicators Index is signaling broadening weakness in the economy and significantly elevated risks for the outlook.

Three leading indicators changed signal in July. The trend in the real retail sales indicator reversed course, falling to neutral following improvements over the first six months of 2022. Over the first six months of the year, the real retail sales indicator was trending lower in January and February, trending flat in March and April, and trending higher in May and June. However, actual real total retail sales have fallen in three of the last four months, including drops of 0.3 percent (adjusted using the CPI) in June and 1.1 percent in May. With consumer spending being such a large part of the U.S. economy, future developments in this indicator will be critically important.

The housing permits indicator weakened for a second consecutive month, falling to a negative trend in July from a neutral trend in June and a positive trend in May. Given the sharp rise in mortgage rates and elevated home prices, this is not a surprising development. New home sales, existing home sales, and homebuilder sentiment data point to softening activity as well.

The average workweek in manufacturing fell to a negative trend in July from a neutral trend in June. The length of the average workweek for production and nonsupervisory employees fell to 40.9 hours in June, down from 41.2 hours in May. The workweek had been as high as 41.6 hours in February 2022 and 41.7 in March 2021 but is now at the lowest level since September 2020. During the last economic expansion, the workweek averaged 41.8 hours from 2011 through 2019.

Among the 12 leading indicators, three were in a positive trend in July while eight were trending lower and one was trending flat or neutral.

The Roughly Coincident Indicators index posted a third consecutive decline in July, dropping to a reading of 67 from 75 in May, 83 in May, and a perfect 100 in April. One indicator weakened in July. The Conference Board Consumer Confidence in the Present Situation fell from a neutral trend to a negative trend. Most measures of consumer attitudes are weakening, primarily a result of persistent, elevated rates of price increase.

In total, four roughly coincident indicators – nonfarm payrolls, employment-to-population ratio, industrial production, and real personal income excluding transfers were trending higher in July while two – the real manufacturing and trade sales indicator and the Conference Board Consumer Confidence in the Present Situation indicator – were in negative trends; none were in a flat or neutral trend. Given the weakening in the AIER Leading Indicators Index, it would not be surprising to see further declines in the Roughly Coincident Index in coming months.

AIER's Lagging Indicators index was unchanged for the sixth consecutive month, holding at 83 in July. February through July was the best five-month run since June through October 2018. No individual indicators changed trend for the month. In total, five indicators were in favorable trends, one indicator had an unfavorable trend, and none had a neutral trend.

Overall, the AIER Leading Indicators Index is well below neutral, signaling broadening weakness in the economy and sharply elevated levels of risk for the outlook. Consumer spending is facing strengthening headwinds from elevated rates of price increases and declining confidence while housing is showing signs of fatigue as record home prices and higher mortgage rates temper demand. Businesses may be losing confidence in the economic outlook as well given the pullback in capital spending, and

there are growing indications of deteriorating global economic activity. Furthermore, the Fed has intensified the current policy tightening cycle, raising the risk of a policy mistake, and the fallout from the Russian invasion of Ukraine continues to disrupt global supply chains. Caution is warranted.

U.S. Posts Second Consecutive Drop in Real GDP

Real gross domestic product fell at a 0.9 percent annualized rate in the second quarter versus a 1.6 percent rate of decline in the first quarter. Over the past four quarters, real gross domestic product is up 1.6 percent.

Real final sales to private domestic purchasers, a key measure of private domestic demand, has shown greater resilience. It was unchanged in the second quarter following a 3.0 percent pace of increase in the first quarter. Over the last four quarters, real final sales to private domestic purchasers are up 1.7 percent. Note that the data shown in the current report are based on incomplete information and will likely be revised in subsequent releases.

Declines were widespread in the second quarter. Among the components, real consumer spending overall rose at a 1.0 percent annualized rate, the slowest pace since the lockdown recession, and contributed a total of 0.7 percentage points to real GDP growth. Consumer services led the growth in overall consumer spending, posting a 4.1 percent annualized rate, adding 1.78 percentage points to total growth. Durable-goods spending fell at a 2.6 percent pace, subtracting 0.22 percentage points while nondurable-goods spending fell at a -5.5 percent pace, subtracting 0.85 percentage points. Within consumer services, growth was broadly strong, led by food services and accommodation (13.5 percent), recreation (7.4 percent), and other services (6.6 percent growth rate).

Business fixed investment decreased at a 0.1 percent annualized rate in the second quarter of

2022, subtracting 0.01 percentage points from final growth. Intellectual-property investment rose at a 9.2 percent pace, adding 0.47 points to growth while business equipment investment fell at a -2.7 percent pace, subtracting 0.16 percentage points, and spending on business structures fell at an 11.8 percent rate, the fifth decline in a row, and subtracting 0.32 percentage points from final growth.

Residential investment, or housing, fell at a 14.0 percent annual rate in the second quarter compared to a 0.4 annualized gain in the prior quarter. The drop in the second quarter subtracted 0.71 percentage points.

Businesses added to inventory at an \$81.6 billion annual rate (in real terms) in the second quarter versus accumulation at a \$188.5 billion rate in the second quarter. The slower accumulation reduced second-quarter growth by a very sizable 2.01 percentage points. The inventory accumulation helped boost the real nonfarm inventory to real final sales of goods and structures ratio to 4.07 from 4.0 in the first quarter; the ratio hit a low of 3.75 in the second quarter of 2021. The latest result is still below the 4.3 average for the 16 years through 2019 but suggests further progress towards a more favorable supply/demand balance.

Exports rose at an 18.0 percent pace while imports rose at a 3.1 percent rate. Since imports count as a negative in the calculation of gross domestic product, a gain in imports is a negative for GDP growth, subtracting 0.49 percentage points in the second quarter. The rise in exports added 1.92 percentage points. Net trade, as used in the calculation of gross domestic product, contributed 1.43 percentage points to overall growth.

Government spending fell at a 1.9 percent annualized rate in the second quarter compared to a 2.9 percent pace of decline in the first quarter, subtracting 0.33 percentage points from growth.

Consumer price measures showed another rise in the second quarter. The personal-consumption price

index rose at a 7.1 percent annualized rate, matching the first quarter. From a year ago, the index is up 6.5 percent. However, excluding the volatile food and energy categories, the core PCE (personal consumption expenditures) index rose at a 4.4 percent pace versus a 5.2 percent increase in the first quarter and is the slowest pace of rise since the first quarter of 2021. From a year ago, the core PCE index is up 4.8 percent.

Real Retail Sales Decline for the Third Time in Four Months

Retail sales and food-services spending rose 1.0 percent in June following a 0.1 percent decline in May. From a year ago, retail sales are up 8.4 percent. Total nominal retail sales remain well above the pre-pandemic trend.

However, these data are not adjusted for price changes. In real terms, total retail sales were down 0.3 percent (adjusted using the CPI) in June following a 1.1 percent decrease in May. Real retail sales have declined in three of the last four months. From a year ago, real total retail sales are down 0.5 percent. As with nominal retail sales, real retail sales remain well above trend but since March 2021, real retail sales have been trending essentially flat.

Core retail sales, which exclude motor vehicle dealers and gasoline retailers, rose 0.7 percent for the month following a 0.1 percent drop in May. Those leave that measure with a 6.6 percent increase from a year ago.

After adjusting for price changes, real core retail sales remained unchanged in June after a 0.7 percent decline in May. From a year ago, real core retail sales are up a meager 0.6 percent and have also been trending essentially flat since March 2021.

Categories were generally higher in nominal terms for the month with nine up and four down in June. The gains were led by gasoline spending, up 3.6 percent for the month. However, the average

price for a gallon of gasoline was \$5.15, up 9.7 percent from \$4.70 in May, suggesting price changes more than accounted for the rise. Nonstore retailers (2.2 percent), furniture and home furnishings (1.4 percent), and miscellaneous retailers (1.4 percent) also posted strong nominal-dollar gains. Building materials, gardening equipment and supplies led the declining group with a 0.9 percent drop followed by clothing and accessory stores with a 0.4 percent drop.

Overall, retail sales rose 1.0 percent for the month in nominal terms and remain well above trend. Excluding autos and gas, nominal core retail sales posted a 0.7 percent gain. However, rising prices are still providing a significant boost to the numbers. In real terms, total retail sales fell, and core retail sales were essentially flat for the month with both trending essentially flat since March 2021.

New Single-Family Home Sales Fall for the Fifth Time in Six Months

Sales of new single-family homes declined in June, falling 8.1 percent to 590,000 at a seasonally-adjusted annual rate from a 642,000 pace in May. The June fall was the fifth drop in the last six months, leaving sales down 29.7 percent from the December 2021 level, and down 43 percent from the August 2020 post-recession peak.

Sales of new single-family homes were down in three of the country's four regions in June. Sales in the South, the largest by volume, fell 2.0 percent, while sales in the Northeast, the smallest region by volume, fell 5.3 percent, and sales in the West decreased 36.7 percent. Sales in the Midwest jumped 42.3 percent for the month. Over the last 12 months, sales were down across all four regions, led by a 37.9 percent fall in the Northeast, followed by a 32.9 percent drop in the West, a 22.1 percent decrease in the Midwest, and an 8.7 percent retreat in the South.

The median sales price of a new single-family home was \$402,400, down from \$444,500 in May

and a record high \$457,000 in April (not seasonally adjusted). Meanwhile, 30-year fixed rate mortgages were 5.51 percent in late July, up sharply from a low of 2.65 percent in January 2021. The combination of high prices and rising mortgage rates is reducing affordability and squeezing some buyers out of the market.

The total inventory of new single-family homes for sale rose 2.2 percent to 457,000 in June, the highest since April 2008. That puts the months' supply (inventory times 12 divided by the annual selling rate) at 9.3, up 10.7 percent from May, 60.3 percent above the year-ago level, and the highest since May 2010. The months' supply is very high by historical comparison. The high level of prices, elevated months' supply, and surge in mortgage rates should weigh on housing activity in the coming months and quarters. However, the median time on the market for a new home remained very low in June, coming in at 2.5 months versus 2.7 in May.

Single-Family Home Construction Retreat Continued in June

Total housing starts fell to a 1.559 million annual rate in June from a 1.591 million pace in May, a 2.0 percent drop. From a year ago, total starts are down 6.3 percent. Total housing permits also fell in June, posting a 0.6 percent drop to 1.685 million versus 1.695 million in May. Total permits are still up 1.4 percent from the June 2021 level.

Starts in the dominant single-family segment posted a rate of 982,000 in June versus 1.068 million in May, a drop of 8.1 percent. That is the slowest pace and first month under one million since June 2020. Starts are down 15.7 percent from a year ago. Single-family permits fell 8.0 percent to 967,000 versus 1.051 million in May, also the slowest pace and first month under one million since June 2020.

However, starts of multifamily structures with five or more units increased 15.0 percent to 568,000 and are up 16.4 percent over the past year while

starts for the two- to four-family-unit segment plunged 69.0 percent to a 9,000-unit pace versus 29,000 in May. Total multifamily starts were up 10.3 percent to 577,000 in June, showing a gain of 15.6 percent from a year ago.

Multifamily permits for the 5-or-more group rose 13.1 percent to 666,000 while permits for the two-to-four-unit category decreased 5.5 percent to 52,000. Total multifamily permits were 718,000, up 11.5 percent for the month and up 26.0 percent from a year ago.

Meanwhile, the National Association of Home Builders' Housing Market Index, a measure of homebuilder sentiment, fell again in July, coming in at 55 versus 67 in June. That is the seventh consecutive drop and the second-largest monthly decline in the index's history, putting the result at the lowest reading since May 2020. The index is down sharply from recent highs of 84 in December 2021 and 90 in November 2020.

According to the report, "Builder confidence plunged in July as high inflation and increased interest rates stalled the housing market by dramatically slowing sales and buyer traffic." The report adds, "In another sign of a softening market, 13% of builders in the HMI survey reported reducing home prices in the past month to bolster sales and/or limit cancellations."

All three components of the Housing Market Index fell again in July. The expected single-family sales index dropped to 50 from 61 in the prior month, the current single-family sales index was down to 64 from 76 in June, and the traffic of prospective buyers index sank again, hitting 37 from 48 in the prior month.

Input costs are still a concern for builders though lumber and copper prices have declined from recent highs. Lumber recently traded around \$650 per 1,000 board feet in mid-July, down from peaks around \$1,700 in May 2021 and \$1,500 in early

March 2022. Copper prices were down to \$7,400 per metric ton.

While the implementation of permanent remote working arrangements for some employees may have been providing continued support for housing demand, record-high home prices combined with the surge in mortgage rates and falling consumer attitudes are working to weaken demand. Pressure on housing demand combined with elevated input costs is sending homebuilder sentiment plunging. The outlook for housing is deteriorating rapidly.

Weekly Initial Claims Continue to Trend Higher

Initial claims for regular state unemployment insurance fell 5,000 for the week ending July 23rd, coming in at 256,000. The previous week's 261,000 was revised up from the initial tally. However, by long-term historical comparison, initial claims remain very low.

The four-week average rose for the fifteenth time in the last sixteen weeks (the four-week average was unchanged in one week), coming in at 249,250, up 6,250 from the prior week and at the highest level since December. Weekly initial claims data continue to suggest a tight labor market, though the recent sustained upward trend indicates some easing.

The number of ongoing claims for state unemployment programs totaled 1.448 million for the week ending July 9th, a rise of 122,465 from the prior week. State continuing claims are also trending higher over the last several weeks.

The latest results for the combined Federal and state programs put the total number of people claiming benefits in all unemployment programs at 1.476 million for the week ended July 9th, an increase of 123,430 from the prior week. The latest result is the twenty-second week in a row below 2 million.

Initial claims remain at a very low level by historical comparison, but a clear upward trend has emerged, suggesting that, on the margin, the labor market has begun to loosen. Weekly initial claims

for unemployment insurance is an AIER leading indicator, and remained a favorable contributor in the July update. However, given the upward trajectory, it will likely turn to a neutral position in coming updates. Furthermore, the number of open jobs in the country has receded for three consecutive months, though the level remains very high by historical comparison.

While the overall low level of claims combined with the high number of open jobs suggests the labor market remains solid, both measures are showing signs of softening. The tight labor market is a crucial component of the economy, providing support for consumer spending. However, persistently elevated rates of price increases already weigh on consumer attitudes, and if consumers lose confidence in the labor market, they may significantly reduce spending.

Private-Sector Job Openings and Quits Fall for a Third Consecutive Month

The latest Job Openings and Labor Turnover Survey from the Bureau of Labor Statistics shows the total number of job openings in the economy decreased to 10.698 million in June, down from 11.303 million in May; openings were a record-high 11.855 million in March.

The number of open positions in the private sector decreased to 9.766 million in June, down from 10.275 million in May and a record-high 10.812 million in March. June was also the first month below 10 million since November 2021 and the lowest level since September 2021.

The total job openings rate, openings divided by the sum of jobs plus openings, fell to 6.6 percent in June from 6.9 percent in May while the private-sector job-openings rate fell to 7.0 percent from 7.4 percent in the previous month. The June result for the private sector is the lowest since June 2021.

Two industry categories still have more than 2.0 million openings each: education and health

care (2.246 million) and professional and business services (2.009 million). Trade, transportation, and utilities (1.651 million) and leisure and hospitality (1.451 million) are above 1 million.

The highest openings rates were in leisure and hospitality (8.5 percent), education and health care (8.4 percent), professional and business services (8.3 percent). Manufacturing (5.8 percent) and transportation, and utilities, trade (5.4 percent) also remain elevated.

The number of private-sector quits fell in June, coming in at 3.999 million, down from 4.048 million in May. Trade, transportation, and utilities led with 950,000 quits, followed by leisure and hospitality with 848,000 quits, and professional and business services with 738,000.

The total quits rate was unchanged at 2.8 percent for the month while the private-sector quits rate held at 3.1 percent. The current private-sector quits rate is the lowest since October 2021 and 0.3 percentage points below the record high 3.4 percent in November 2021.

The quits rates among the private-sector industry groups are still dominated by leisure and hospitality with a rate of 5.4 percent, well ahead of professional and business services and trade transportation, and utilities, both with a 3.3 percent quits rate.

The number of job seekers (unemployed plus those not in the labor force but who want a job) per opening ticked up slightly again in June, rising to 1.092 in June from 1.028 in May and a record low 0.957 in April. Before the lockdown recession, the low was 1.409 in October 2019.

The job openings data add to the significant range of evidence that suggest the economy is weakening. While the still-large number of openings suggest the labor market remains tight, the deterioration at the margin is warning sign.

CAPITAL MARKET PERFORMANCE

(Percent change)

	July	Latest 3M	Latest 12M	2021	Calendar Year 2020	2019	3-year	Annualized 5-year	10-year
Equity Markets									
S&P 1500	9.2	0.0	-6.1	26.7	15.8	28.3	11.2	10.5	11.5
S&P 500 - total return	9.2	0.4	-4.6	28.7	18.4	31.5	13.4	12.8	13.8
S&P 500 - price only	9.1	0.0	-6.0	26.9	16.3	28.9	11.5	10.8	11.6
S&P 400	10.8	0.5	-7.1	23.2	11.8	24.1	8.5	7.4	10.3
Russell 2000	10.4	1.1	-15.3	13.7	18.4	23.7	6.2	5.8	9.1
Dow Jones Global Large-Cap Index	6.5	-2.4	-11.7	16.2	14.7	23.8	6.8	6.0	7.2
Dow Jones Global Large-Cap ex-U.S. Index	3.0	-5.4	-16.8	4.9	8.8	18.2	0.7	0.2	2.5
STOXX Europe 600 Index	7.6	-2.7	-5.1	22.2	-4.0	23.2	4.3	3.0	5.3
Bond Markets									
iShares 20-plus Year Treasury Bond ETF	2.2	-1.7	-21.5	-6.0	16.4	11.5	-4.0	-1.1	-1.0
iShares AAA - A Corporate Bond Fund	3.3	1.8	-13.2	-4.2	7.1	9.1	-2.5	-1.1	NA
Commodity Markets									
Gold	-2.4	-7.6	-3.2	-4.0	24.8	18.7	7.3	6.8	0.9
Silver	-1.7	-14.4	-21.3	-12.8	46.8	16.7	6.8	3.7	-3.3
Refinitiv CoreCommodities CRB total return index	0.5	-4.9	34.7	38.5	-9.3	11.8	18.5	11.1	0.4

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

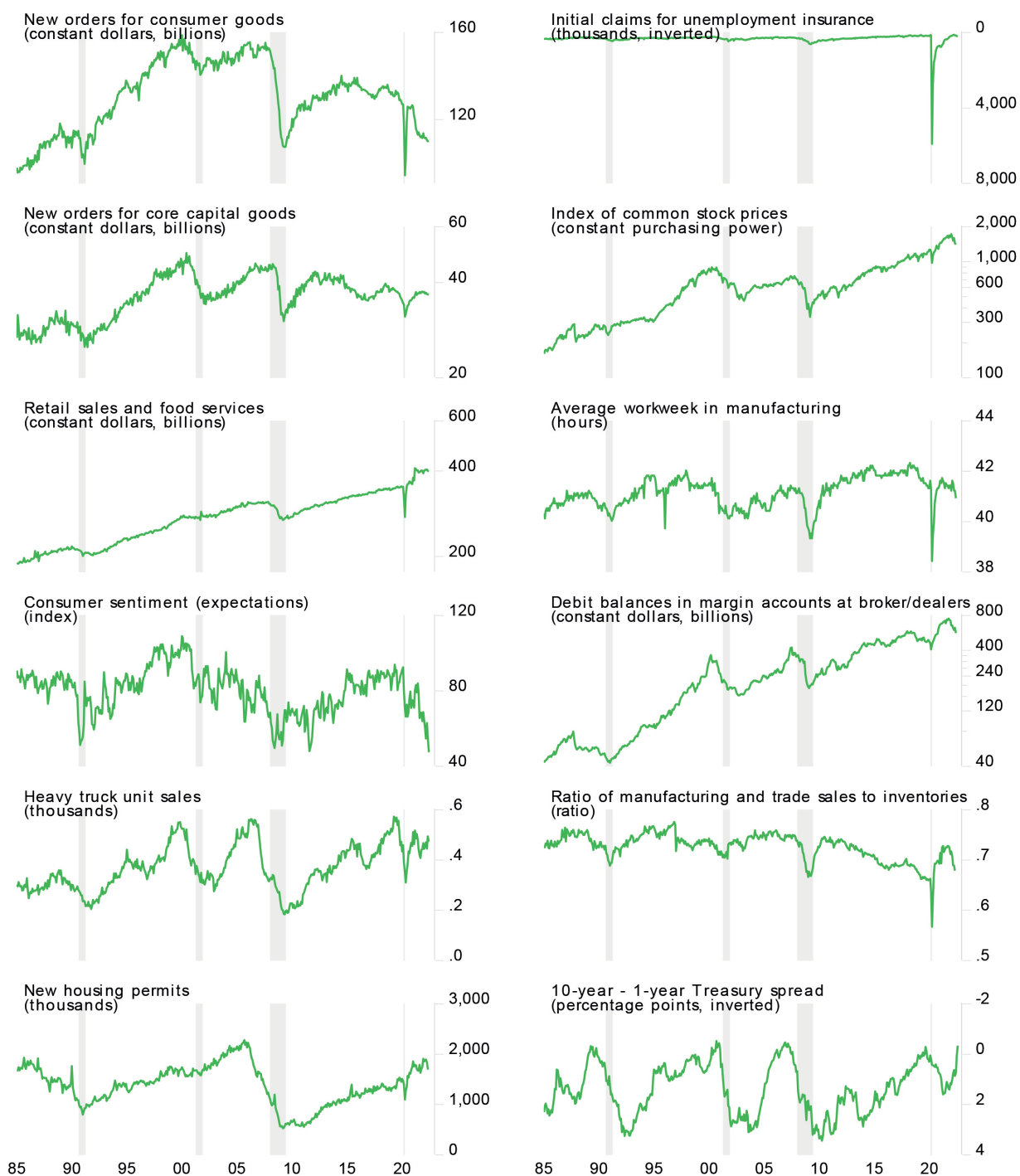
CONSUMER FINANCE RATES

(Percent)

	July	Latest 3M	Latest 12M	Average for Year			Average over Period		
	July	3M	12M	2021	2020	2019	3-year	5-year	10-year
30-yr. fixed mortgage	5.5	5.2	3.8	3.0	3.1	3.9	3.4	3.8	3.8
15-yr. fixed mortgage	4.7	4.4	3.0	2.3	2.6	3.4	2.8	3.2	3.1
5-yr. adjustable mortgage	4.3	4.0	3.0	2.6	3.1	3.6	3.0	3.3	3.1
48-month new car loan	5.2	5.2	4.9	5.1	5.1	5.4	5.1	5.1	4.7

Sources: Bankrate, Federal Reserve.

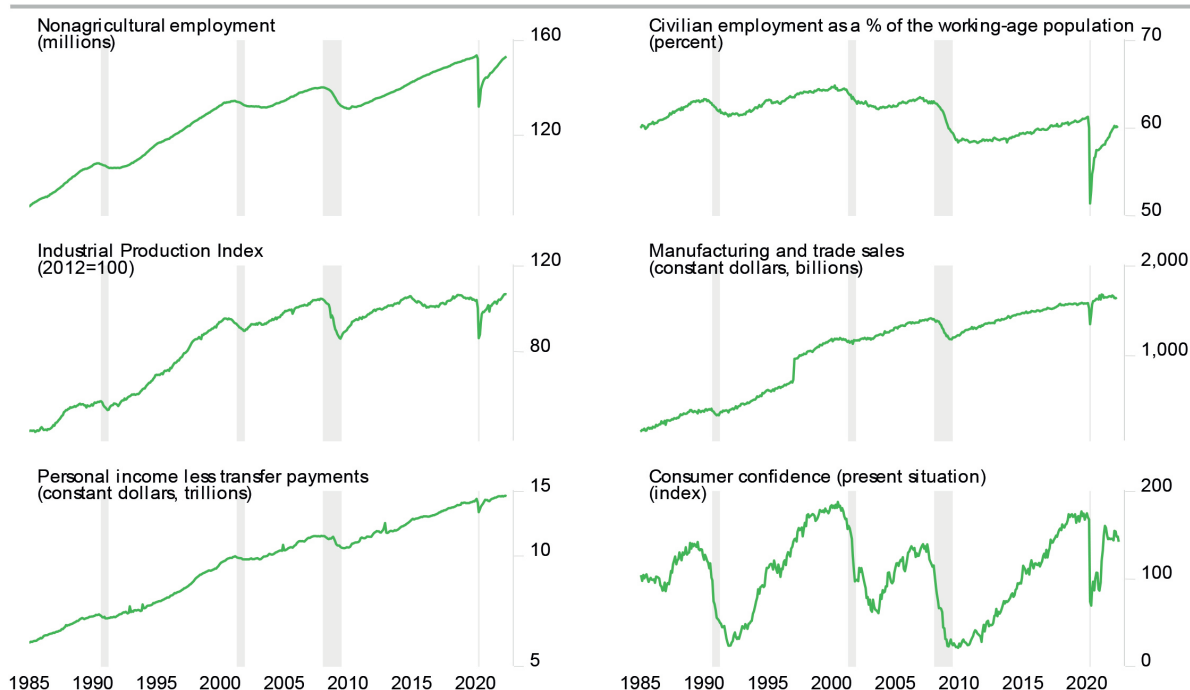
LEADING INDICATORS (1985 - 2022)



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).

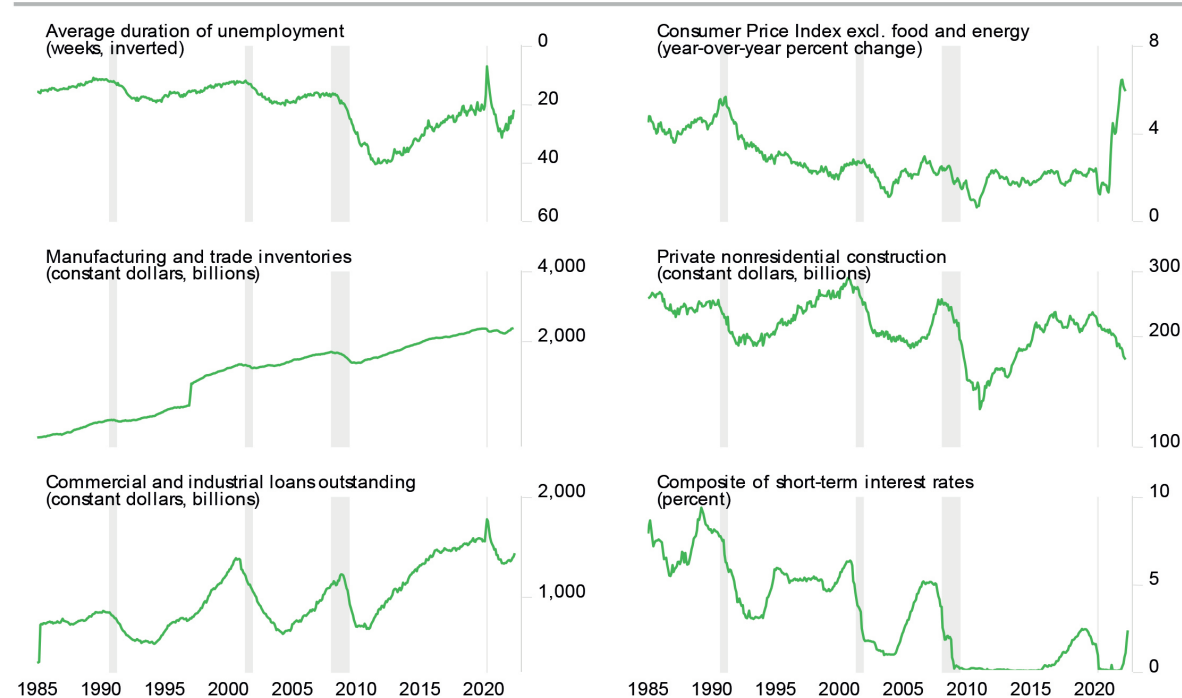
ROUGHLY COINCIDENT INDICATORS (1985 - 2022)



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 (1985 - 2022)



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 Recession is Here. Will Stagflation Follow?

PETER C. EARLE

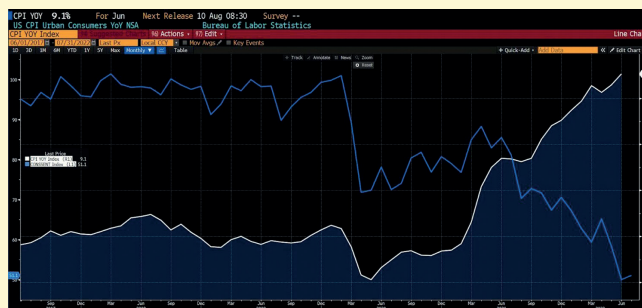
Research Faculty

With Thursday's abysmal 2nd quarter GDP number, the US is officially in a recession. The path to a soft landing for the US economy has virtually closed. The US economy shrank 0.9 percent in the second quarter, on top of a 1.6 percent contraction in the first quarter of 2022. The hangover of ruinous pandemic policies like lockdowns, in addition to fiscal, monetary, and regulatory policies animated by ideology rather than sound economic principles, are bearing their sordid fruit.

Inflation continues to rise, reaching levels not seen in two generations. A Census Bureau survey taken between June 29th and July 11th reports that 48 million US consumers are having a "somewhat difficult" time contending with household expenses, 43 million report having a "very difficult" time, and 58 million a "little difficult[y]" making ends meet. It's not surprising that Walmart, whose entire business is based upon offering essential consumer retail goods at the most deeply discounted prices possible, announced a profit warning early this week. When rising prices drive consumers to adjust their consumption patterns radically enough that Walmart's business suffers, the outlook is considerably gloomy.

That news ties to recent releases of the University of Michigan Surveys of Consumers, where the composite, current economic conditions, and consumer expectations subindices are consistent with prior recessions. The third of those, consumer expectations, is at its lowest level since May 1980. The Consumer Sentiment Indicator, struck hard by pandemic mitigation measures, has moved inversely with the rising general price level, starting in March 2021.

CPI YOY vs. UMich Consumer Sentiment Index, 5 years (2017 – 2022)



(Source: Bloomberg Finance, LP)

Despite the constant attempts to pin the rise in the general price level on Putin's invasion of Ukraine in February 2022, it's readily apparent that prices, far and wide, began rising in early 2021. The graph below depicts the five year trend of gasoline (white), retail electricity (yellow), meats, poultry, and fish (purple), used cars and trucks (aqua), and veterinary services (orange). The trend in these disparate groups and services makes clear that the general price level began rising over one year ago, early in 2021. Bear in mind when looking at this chart that the Fed was still calling inflation "transitory" until November of 2021

Average US gasoline price; CPI meat, poultry, and fish; CPI retail electricity; CPI used cars and trucks; CPI veterinary services, 5 years (2017 – present)



(Source: Bloomberg Finance, LP)

We've had two consecutive quarters of negative GDP growth, but what's happening under the hood? What about industrial production? Mining has been strong. But many sectors remain stubbornly below pre-pandemic levels, and the post-pandemic recovery seems to be stalling. Manufacturing output has fallen for two months in a row, and motor vehicle parts and vehicle assembly are below 2020 levels. Industrial output is now down for two months in a row with few clear prospects for improvement. Rising costs are creating drag here as well as in consumption—yes, inflation hurts producers as well as consumers.

Also contributing to the growing slack are shipping problems, now approaching a year since they made headlines. As the prices to ship a 40-foot container over these benchmark Pacific (white) and Atlantic (orange) sea routes show, conditions have improved but remain elevated.

**WCI Freight Benchmark Rates per 40 Foot Box,
Shanghai to Los Angeles and Rotterdam to New York,
5 years (2017 – present)**



(Source: Bloomberg Finance, LP)

For over a year employment numbers have presented a mysterious augury, but are now becoming clear. In historical terms, initial unemployment claims remain low, and the US unemployment rate stands at 3.6 percent. But over the last two months labor markets have softened. Initial claims have been ticking higher, recently hitting an eight month high. The number of open jobs, meanwhile, has fallen.

There are now three million fewer people in the US workforce than there were before the pandemic. The labor participation rate is over 1 percent lower than it was in January 2020. Pandemic mitigation policies drove several million Americans into early retirement, and school closures drove women out of the workforce in droves – down to levels not seen since the early 1970s. On top of that, enhanced unemployment benefits and Federal stimulus checks have fattened savings accounts by \$4 trillion in two years. Nearly 70 percent of unemployment claimants say they earned more out of work than they did employed.

**BLS Job Openings vs. US Unemployed Workers Total,
5 years (2017 – present)**



(Source: Bloomberg Finance, LP)

The Federal Reserve should have started hiking rates in 2021 when prices began rising. Instead, it seems to have been preoccupied with fielding inquiries and reporting on the possibilities of applying monetary policy in the service of climate change, equity, and other wokist baubles. So, America is in a recession. A mild recession, presently, but a recession nonetheless.

In a Bloomberg Radio interview early this year I was asked what I thought about the likelihood of stagflation. I commented at that time (January 2022) that while the “[in]flation” part of the ugliest portmanteau in economics was clearly occurring, the “stag[nation]” element wasn’t. Half a year later, an ugly picture is coming into focus: rising inflation,

slowing growth, and a job market that looks poised to deteriorate. Bearing in mind the lag associated with employment, it is no longer unthinkable that stagflation may be ahead.

– July 30, 2022

Stocks and Bonds Hurt Alike Under Stagflation

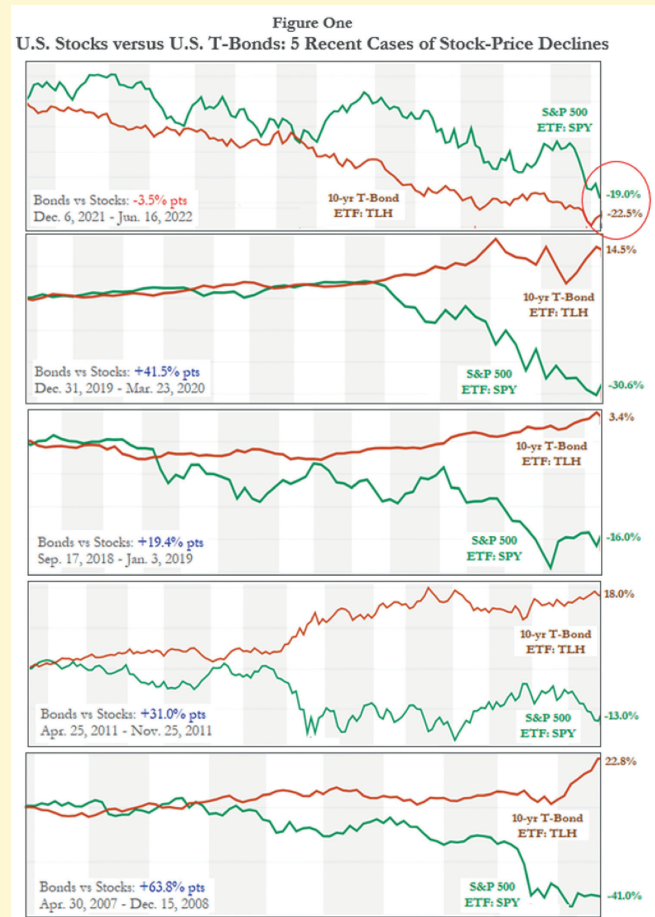
RICHARD M. SALSMAN

Senior Fellow

Returns on U.S. stocks and Treasury bonds have been materially and *simultaneously* negative so far this year, recording losses of 19.0 percent and 22.5 percent, respectively. This is an anomaly worth examining. Typically, sharp declines in risky equities coincide with solid gains in safe bonds.

A diversified portfolio – part stocks, part bonds – immunizes investors, to some extent, in bad economic times. If stocks plunge, at least bonds boom. But not this time. Why might this be?

Figure One illustrates how different recent investment performance has been compared to four prior episodes between 2007 and 2021. The S&P 500 is down 19.0 percent since last December's peak, but the return on the benchmark U.S. T-Bond has been even worse (-22.5 percent). Bond prices move inversely with bond yields; the 10-year T-Bond yield has more than doubled over the past half year, from an average of 1.47 percent last December to an average of 3.15 percent so far this month.



Also notice in Figure One that in the prior four episodes (2019-20, 2018-19, 2011, and 2007-08), while the S&P 500 plunged (by an average of -25.2 percent), T-Bonds gained rapidly (with an average return of +14.7 percent). In these four episodes bonds always gained and *outperformed* stocks by an average of nearly 40 percentage points; in contrast, bonds over the past half year have lost value and have *underperformed* stocks by -3.5 percentage points.

The benchmark U.S. T-Bond yield has doubled over the past half year largely because the Federal Reserve has shifted its policy to rate-hiking. But

the shift was a reaction to the higher rates of price inflation which the Fed itself substantially caused by instituting previously large increases in the money supply. The CPI rate is now 8.6 percent (the past year's change through May), up from 4.9 percent over the prior year and a mere 0.2 during the previous year (through May 2020). Prior to the inflation acceleration, the Fed had increased the monetary base by 87 percent from the end of 2019 to the end of 2021 (after having reduced it by 11 percent over the prior two years); the Fed also increased M-2 by 40 percent in the two years ending 2021 (versus a rise of only 10 percent over the prior two years).

Radically excessive money supply expansion has provided fuel for recent accelerating price inflation in the U.S. Initially, when money demand also increased a lot (akin to cash hoarding) money supply expansion didn't manifest itself immediately in a materially higher general price level. But in recent quarters money demand stopped growing and even declined a bit – a common phenomenon when people begin to see materially higher inflation and expect more of it; they try to spend money balances more quickly, to “beat” faster-rising prices. Lesser demand for money (higher money velocity) only further boosts price inflation (or prevents it from subsiding quickly).

When bonds and stocks decline a lot and simultaneously it suggests inflation is rising rapidly *even as the economy is stagnating or contracting* (or will soon do so). For most economists today, that combination is near-impossible. Trained in Keynesian demand-side models – and taught to ignore or ridicule supply-side models – they deny that higher inflation is likely to accompany a weakening, let alone stagnating or contracting economy. That's why they didn't predict the recent inflation boom. First, they denied it would happen. Next, when it happened, they dismissed it as “transitory.” Now

that it has persisted, they finger countless, irrelevant factors – leaving the Fed blameless. As inflation has risen lately, real GDP has contracted; it was down 1.5 percent in 1Q2022 and is flat so far in 2Q2022. Yet the Biden policy mix also *does not prioritize* economic growth.

We now have “stagflation,” which last appeared in the U.S. in the late 1960s and the 1970s, before the supply-side cures of “Reaganomics.” Keynesian policies remained dominant in the 1960s and 1970s. If any group today should know about stagflation – how to cause and predict it – it would be a group of Keynesians. They were flummoxed by the earlier stagflation and demanded price controls. Monetarists were also confused. Like Keynesians, they had long opposed the gold standard, preferring fluctuating to fixed exchange rates. The monetarists got their wish in 1971 – and conditions only worsened over the subsequent decade. Both “sides” caused that stagflation.

The term “stagflation” was coined in 1965 by U.K. conservative politician Iain Macleod. He sought to describe a rare condition in which inflation was high even though the economy wasn't growing (or worse, was in recession). Keynesian modelers – who denied that inflation was a debasement of money and rejected the principle that inflation is solely a monetary phenomenon – attributed universally fast-rising prices to real factors: “supply shocks,” and/or an economy that “grew too fast,” and/or a jobless rate that was “too low.” After its coinage in 1965, the use of “stagflation” spread far beyond the U.K. to the U.S. and spread far into the 1970s, due mainly to the abandonment of the gold exchange standard (in August 1971). Stagflation was eradicated for more than two decades only after supply-side policies were adopted, beginning in the early 1980s.

Table One illustrates the vast difference in economic-financial results attributable to demand-side Keynesian policies (1970s) versus supply-side Saysian policies (1980s). In real terms both stocks

and bonds lost ground in the 1970s, but both gained ground in the 1980s; in the latter case it helped that inflation *decelerated* from the prior decade. Economic growth rates weren't so different between the two decades (due to the recessions of 1981-1982), but growth rates *accelerated* throughout the 1980s, after *decelerating* during the 1970s. Vigor displaced malaise.

Table One		
A Tale of Two Decades - and Two Models		
<i>compounded annual real total returns and real growth rates</i>		
<i>December 1969 - December 1979 - December 1989</i>		
	Demand-Side Keynesian 1970s	Supply-Side Sayesian 1980s
S&P 500	-1.43%	11.86%
U.S. T-Bonds	-1.74%	7.16%
CPI	7.39%	5.09%
Real GDP	3.26%	3.11%

Today we're again seeing a diminution of economic vigor, not unlike the 1970s. Ample evidence over the years proves that as the U.S. government grows, prosperity necessarily slows. But it's also true that by now many intellectuals, policymakers, politicians, and voters *prefer* less economic growth, a lesser "human footprint," to the extent that growth coincides with unequal rewards and climate change. These have always been with us, but many people now prefer that they be curbed.

Beyond disdain for economic growth and its unavoidable, innocuous byproducts (income inequality, climate change), we observe in recent years a fringe bloc of economists pushing "Modern Monetary Theory" and convincing gullible policymakers, and pundits that governments can spend without limit (or reliance on higher taxes), that central banks can create money without limit (or higher inflation rates), and that finance ministers can issue public without limit (or higher interest rates). Only lately

have such myths been doubted, albeit only a little bit.

Table Two provides a broader and longer-term perspective on the phenomenon of stocks and bonds performing badly together – and it's due to *stagflation*. I partition the history since 1952 into three periods: 1) when both stocks and bonds recorded losses (9 cases), 2) when both stocks and bonds recorded gains (30 cases), and 3) when stocks and bonds recorded mixed results (30 cases). The first combination is rare, as inflation is much higher and economic growth much slower compared to the other two periods. The setting, of course, is the essence of stagflation.

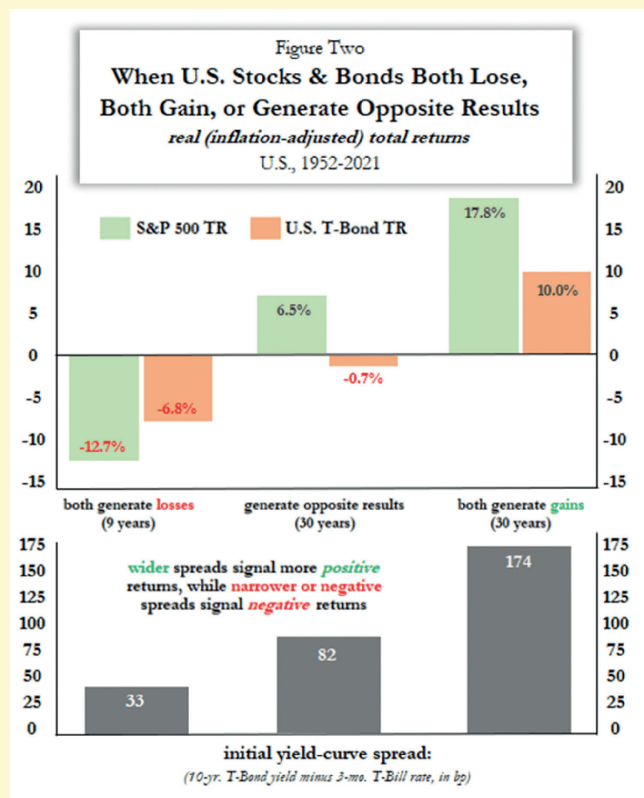
Table Two			
Rare Cases When U.S. Stocks and U.S. T-Bonds Have Generated Losses Simultaneously			
<i>1952 - 2021</i>			
same-year performance			
period averages	years when both lose	years of mixed results	years when both gain
# of years:	9	30	30
initial yield-curve spread (bp):	33	82	174
real return, S&P 500:	-12.7%	6.5%	17.8%
real returns, US T-Bond:	-6.8%	-0.7%	10.0%
U.S. inflation (CPI):	6.4%	3.0%	3.0%
change in CPI (% pts):	1.3%	0.5%	-1.0%
U.S. econ. growth (GDP):	2.7%	2.9%	3.2%
change in GDP (% pts):	-1.0%	-0.2%	0.3%
U.S. unemployment rate:	5.6%	5.5%	6.2%
change in jobless rate (% pts):	0.2%	0.2%	-0.1%
following-year performance			
period averages	years when both lose	years of mixed results	years when both gain
# of years:	9	30	30
initial yield-curve spread (bp):	51	97	153
real return, S&P 500:	11.2%	9.5%	7.6%
real returns, US T-Bond:	7.4%	1.5%	3.2%
U.S. inflation (CPI):	6.7%	3.0%	2.9%
change in CPI (% pts):	-0.4%	-0.1%	0.4%
U.S. econ. growth (GDP):	1.4%	2.9%	3.5%
change in GDP (% pts):	-1.3%	0.1%	0.3%
U.S. unemployment rate:	6.3%	5.7%	5.9%
change in jobless rate (% pts):	0.9%	0.1%	-0.4%

Figure Two further makes clear that the initial yield curve spread is a good forecaster of the joint performance of stocks and bonds. The yield spread is *narrower* (averaging only 33 basis points) prior to cases when both assets register losses; in contrast, the spread is wider (averaging 174 basis points) prior

to cases when both assets register gains. Historically, the yield curve spread has been narrowest after the Fed has been raising its short-term policy rate (to “fight inflation”); and a *negative* spread (inversion of the yield curve) has preceded all eight recessions since 1968.

I don’t expect Modern Monetary Theorists to apologize for having given such bad advice in recent years. They’re not necessarily done with advising. Their standard prescription for higher inflation is higher tax rates, a Hoover-like policy mix which, if adopted, could easily transform a mild and brief recession into a prolonged and deep depression.

– July 30, 2022



By flooding the system in recent years with excessive government spending, fiat money, and public debt, U.S policymakers made higher subsequent inflation almost inevitable. Now, as the Fed tries to “fix” what it broke, it seeks to put a *brake* on the economy’s growth rate; so far, it has “succeeded,” as the U.S. economy has stalled. In time, the Fed’s rate-hiking could again invert the Treasury yield curve and trigger recession. This is the only way a Keynes-driven Fed knows how to “fight inflation.” It’s futile, because relatively less production alone cannot reduce product prices.

Is the Fed Finally Serious About Inflation?

THOMAS L. HOGAN

Senior Research Faculty

Until recently, the Federal Reserve wasn't taking inflation seriously. Fed officials claimed to be serious about inflation. Fed Chair Jerome Powell said that price stability was essential and the Fed would do everything it could to restore it. Their actions, however, showed that Fed officials were not serious about solving this problem.

At their June meeting, the Federal Open Market Committee (FOMC) raised short-term interest rates by 0.75 percentage points and are expected to raise another 0.75 percent in late July. Are they finally getting serious about inflation?

The Fed's views on inflation have evolved since the recovery from the coronavirus pandemic. In early 2021, the FOMC was focused on supply-side problems. After all, price-level increases in the early part of the year were driven mostly by used cars and related services, a side effect of the automotive computer chip shortage.

By summer's end, the FOMC saw signs of sustained inflation. In March of 2021, their mean projection of inflation in core personal consumption expenditures (PCE) inflation was 2.2 percent for the year. By September, they increased that projection to 3.7 percent.

In the face of such inflation, the FOMC continued their expansionary monetary policy. Since March 2020, the FOMC had set short-term interest rates near zero, targeting a range from zero to 0.25 percent. They were also expanding the money supply by purchasing hundreds of billions of dollars per month in U.S. Treasury bonds and mortgage-backed securities.

By fall of 2021, FOMC members realized they had underestimated the extent of inflation and that action was needed to curtail it. In November, Powell

promised they would "use our tools to make sure that higher inflation does not become entrenched."

Despite this promise, the FOMC did not raise interest rates at its December meeting. They did not even end their asset purchase program as many speculated, but simply reduced the rate of purchases to a rate that would end the program in March rather than May.

On January 11, 2022, Powell testified that the Fed would get inflation under control and that price stability was necessary to achieve maximum employment. Yet two weeks later, the FOMC again kept interest rates near zero and continued the pace of its asset purchase program.

By early February, it was clear that the high inflation of 2021 would last into 2022. St. Louis Federal Reserve Bank President James Bullard argued the Fed should begin raising interest rates by half of a percent at its meeting in March.

But prior to the meeting, Powell said he would recommend an increase of only a quarter of one percent, a recommendation the FOMC accepted. Again, Powell refused to act aggressively to address inflation, even with the vocal support of another member of the FOMC.

On March 21, Powell said the FOMC needed "to move expeditiously to return the stance of monetary policy to a more neutral level." But less than a week earlier, he had a clear opportunity to "move expeditiously" and refused to do so!

In May, the FOMC finally raised interest rates by half of a percent to a target range of 0.75 to 1.0 percent. They raised another 0.75 percent at their recent meeting in June. Some FOMC members expect another 0.75 raise in their upcoming meeting

in late July. But will these actions be enough to turn the tide of surging prices?

Inflation is far above the Fed's long-run target of two percent and is expected to remain so. Over the past 12 months, PCE inflation is at 6.3 percent and CPI inflation is above 9 percent. The FOMC's June rate increase dampened expectations somewhat, but the market's pricing of average inflation over the next five years is still above 2.5 percent. Even the FOMC's own projections show means of 4.3 percent core PCE inflation in 2022 and 2.7 percent in 2023.

The FOMC's expectations of short-term interest rates are higher than a few months ago but still low by historical standards. Their mean projection is just 3.4 percent by the end of 2022. By comparison, Fed Chair Paul Volcker raised interest rates above 20 percent to stamp out inflation in the early 1980s.

Chair Powell has repeatedly claimed that the Fed will use its tools to create price stability. Will he and other Fed officials finally bring inflation back toward their stated two percent target? We'll see if there are any surprises in the FOMC policy statement on July 27th. But so far, the FOMC's actions as well as their own projections show that they are still not serious about fighting inflation.

– July 21, 2022

The Race to Tame Inflation Expectations

JAMES L. CATON

Fellow, Sound Money Project

In June, the Federal Open Market Committee (FOMC) raised the federal funds rate target by 75 basis points, moving the target range to 1.5-1.75 percent. This was the biggest single increase in the federal funds rate target since 1994. Why has the Fed so quickly shifted its stance? And how are investors responding to this financial tightening?

As noted in the Federal Reserve's Statement on Longer-Run Goals and Monetary Policy Strategy, the FOMC "seeks to achieve inflation that averages 2 percent over time" as measured by the personal consumption expenditures price index (PCEPI). PCEPI inflation is measured using a price level that weights prices in light of consumer expenditures. The Fed also monitors Core PCEPI inflation, which excludes food and energy, since this measure tends to be a better predictor of the PCEPI over longer periods of time.

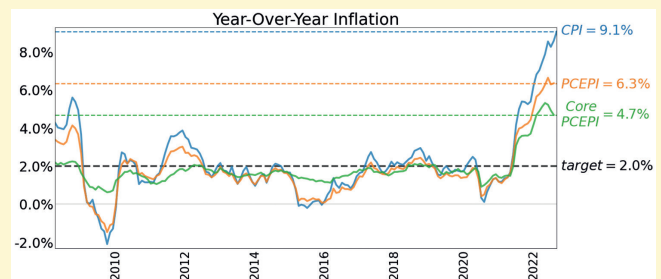
Some complain when the Fed officials or economists refer to Core PCEPI, on the grounds that food and energy prices matter a lot to American consumers. But such complaints are misguided. The Federal Reserve does not deny the importance of food and energy prices, which are included in the PCEPI it targets. The attention paid to Core PCEPI (and other variables) is merely intended to reduce the odds that the Fed overreacts to short term swings in food and energy prices, which lead PCEPI inflation to fluctuate around Core PCEPI inflation.

Year-over-year Core PCE inflation has been trending downward over the last few months. It reached a high of 5.3 percent in February. In May, it was just 4.7 percent.

PCEPI inflation, in contrast, has surged. Higher energy prices, which are largely due to Russia's

invasion of Ukraine and the corresponding economic sanctions, have lifted gas prices to new highs. In many states, the price of gas is higher than \$5.00 per gallon, with the price of diesel often pushing above \$6.00 per gallon. This has played a role in lifting PCEPI and CPI inflation.

The more important effect of higher energy prices is their constraint they put on economic growth. At the moment, the FOMC wants to prevent a significant takeoff in PCEPI inflation. Aggressive policy will slow inflationary pressure in general and likely bring rates down.



The Future of Inflation

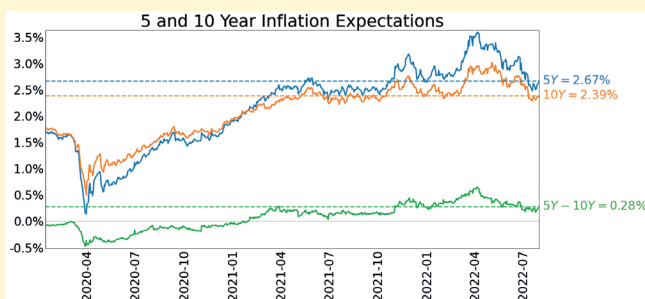
What are the markets saying about expected inflation? One way to distinguish between short-run and long-run inflation expectations is to compare the 5- and 10-year breakeven rates of inflation. The breakeven inflation rate compares the rate of return on inflation-compensated bonds to rates on uncompensated U.S. Treasuries of the same maturity length. They subtract the rate on inflation-adjusted securities from non-adjusted securities. Since these Inflation Protected Securities adjust for inflation as measured by the CPI, the breakeven inflation rates refer to expected changes in CPI.

We can compare the spread on 5-year bonds to 10-year bonds in order to provide a clearer picture of

the inflation expectations over time. A wider spread between the 5- and 10-year breakeven rates means that there exists a discrepancy between short- and long-run inflation expectations.

In the plot, I indicate the spread between these two by subtracting the 10-year breakeven rate from the 5-year breakeven rate. When the 5-year breakeven rate is higher than the 10-year breakeven rate, this means that investors expect that inflation in the near future will be higher on average than in the more distant future. The greater the spread between the rates, the greater the discrepancy between short-run and long-run inflation expectations.

In the first quarter of 2021, short-term inflation expectations rose above longer-term inflation expectations. Investors signaled great concern in April, as the gap between 5- and 10-year breakeven inflation reached 0.65 percent. Since that time, Fed Chair Jerome Powell and other members of the FOMC have voiced their concerns about controlling inflation and inflation expectations. The return of the gap to 0.28 percent indicates that investors are convinced that the Fed is serious about tightening and will be effective. With the change in stance, investors expect that inflation will not only be lower on average over the next 5 to 10 years, but that there will be a smaller discrepancy between inflation in the short- and long-run.



Inflation Expectations and the Pace of Interest Rate Increases

Jerome Powell is slamming on the breaks. But how long and how much should we expect Powell's Fed to tighten? It is difficult to predict the path of policy precisely, but it seems clear that Powell intends to continue raising the federal funds rate target until inflation expectations have cooled. In recent months, inflation expectations have followed a downward trend alongside Core PCEPI inflation. The cooling of inflation expectations is encouraging news since these expectations refer to the more volatile and higher CPI. But PCEPI inflation has continued to rise.

Powell's Fed has made clear that its 2 percent inflation target is not a symmetric target, meaning that it will not compensate for long periods where inflation is above 2 percent. That means it is an average inflation target with upward bias. Still, current inflation expectations are above 2 percent. If Powell and the FOMC want the target to be effective, they must convince investors that the Fed will take action required to keep PCEPI at 2 percent. And they must do so swiftly. The longer inflation is above 2 percent, the less credible will be the Fed's commitment to maintain the 2 percent target. And since the target is not a true average target, the best the Fed can do to maintain stable inflation expectations is to swiftly move PCEPI inflation to 2 percent.

This is one reason to think that the FOMC may "overtighten". Prioritizing a soft landing over maintenance of the 2 percent target would cause a divergence between inflation expectations and the inflation target. The slower the FOMC moves to lower the rate of inflation when it is greatly elevated—it is currently more than 2 percentage points above target—the more markets will perceive the 2 percent target as an ineffective constraint. The result will be relatively higher inflation expectations and interest rates in the long-run, and a persistent discrepancy between the stated inflation

target and inflation expectations. To avoid this, the Federal Reserve might prioritize lower inflation in the short-run.

The quiet shift from a symmetric to asymmetric 2-percent target undermines the Fed's credibility. It says it intends to deliver 2 percent inflation on average, but its asymmetric approach means that inflation will tend to be greater than 2 percent on average. If the FOMC thinks inflation should be higher than 2 percent on average, it should adopt a higher inflation target—say, 3 percent—and compensate for periods of excess inflation by also promoting inflation rates below the average target for extended periods. Doing so would stabilize inflation expectations and increase the likelihood of a soft landing, without necessitating a swift tightening intended to signal that the Fed is serious.

– July 25, 2022

Take the Money and Run: Taxpayers in AZ Will Fund Students, not Schools

LAURA WILLIAMS

Contributor

Last month, the Arizona legislature passed HB2853, heralded as “the most expansive school choice legislation in the nation.” Every school-aged child in the state, all 1.1 million of them, will have access to \$6500 of the taxpayer funds (already set aside for their education) to pay for customized learning solutions their parents choose. Parents, not distant bureaucrats, will direct spending.

The Wall Street Journal proclaimed, “School Choice Blooms in the Desert.” National director of research at the American Federation for Children Corey DeAngelis, whose motto is, “fund students, not systems” called Arizona’s program “the gold standard for school choice nationwide.”

Arizona, in other words, just divorced taxpayer funding for education from government-run schools.

Public Funding for Personalized Learning

ESAs exist in a variety of forms. Arizona calls them “empowerment scholarship accounts,” but they are also called education savings accounts, education scholarship accounts, and tax-credit scholarships. Individuals and organizations fund customized educational expenses, then deduct that spending from taxes.

From 2011, when Arizona launched its ESA program, until last week, just 23 percent of Arizona students were eligible (about a quarter million). Participation was limited to children of veterans, wards of the state, children living on Native reservations, and families zoned to “D” and “F” rated schools. Fewer than 12,000 students received the funds in 2020 – just 5 percent of those eligible took part.

Unlike other programs of its kind, Arizona’s new ESA law doesn’t exclude students already in private schools, nor does it taper off with parent

income. Sure, it’s still funded with forcible taxation, but within the current system, ESAs are a major improvement for families statewide.

At \$6,500 per student, the publicly funded portion covers the median cost of tuition for private elementary school. Even if the ESA doesn’t cover the entire cost, it dramatically lowers the cost, making that opportunity available to more families. Parents can also choose “unbundled services,” like microschool fees, homeschooling curricula, educational or occupational therapies, tutoring – whatever a child might need to reach his individual potential.

Arizona’s ESA program also allows education funds to be spent on educational electronics, like laptops and graphing calculators, and on ride-share services if a student requires transportation to get to a better-suited school.

Parents manage funds through the ClassWallet program. Transactions must meet specific requirements, though the clarity of the requirements, as well as oversight and transparency, have been criticized by all parties. Shoddy administration has resulted in delayed funds, massive breaches of privacy, and frustration for ESA families.

For parents, ESAs’ authorization to customize education for their children has meant a chance to realize the promise of “public education” that schools were failing to deliver. A parent told Arizona’s State Board of Education in 2020: “I am a parent of three children on ESA, but I also have a master’s degree in elementary education, and ESA has saved the educational lives of my three children.”

Benefits for Zoned Schools

Hand-wringing from teachers unions claim ESAs “defund” public schools by allowing a portion of per-student funds to follow the student. When students move with their families to a better district, we don’t generally consider that to be ‘draining funds’ from the school left behind. The funding follows the student already. Arizona just blew open the monopoly.

What’s more, school districts receive \$10,392 per student: 58 percent state, 14 percent federal, and 46 percent local. With ESAs at \$6,500, one-third of local and state spending earmarked for that student, and all the federal funds, will be left behind in the residentially zoned school.

There are less obvious benefits to budgets, which also provide tremendous benefits to families. Students with serious disabilities are especially well-served by alternatives. These students are considered high-need and high-cost by zoned schools, who must force them into a model not built for them. With the freedom of an ESA, such students thrive in environments designed to provide specialized services. Relieved of these costs, zoned schools should experience some budget relief.

Students who’ve been labeled “disruptive” in the traditional classroom are also good candidates for customized ESA solutions, and the staff hours that would be devoted to serving (or suspending) them in a traditional public school can be returned to the general budget. ESAs, in short, should reduce budget pressures on public schools. The only counter argument comes from unions and their backers who think funds don’t rightly belong to students, but to the bureaucracies themselves.

In addition to saving money, ESAs improve school outcomes. ESA-funded alternatives raise student performance, both among those who departed, and those who remained in their zoned schools. As Florida’s tax credit program expanded,

public school students who did not participate still saw higher test scores, lower rates of absenteeism, and lower incidence of suspension. Those benefits were universal, but concentrated among low-income students. Public schools provide better service and better education to students if families have the option to withdraw. Once the rigid grip of zoned schools on public investment is broken, competitive pressures improve outcomes for everyone.

Arizona ranks 48th in funding among the 50 state systems and the district of Columbia, and 44th in teacher salaries, according to the NEA. Chronic teacher shortages plague the state. In September 2021, 26 percent of teacher vacancies in Arizona schools remained unfilled.

When it comes to the amount of money spent on actual student instruction, Arizona ranks dead last with \$4,801, about half of the annual investment per student, according to the Arizona Auditor General. While higher spending doesn’t necessarily equate to better outcomes, the balance between spending on instructional costs (teacher salaries, textbooks) and other priorities (administration, facilities, food service, transportation) may illustrate the tension between how increasing education funding (taxes) is spent and the outcomes that families say don’t work for them.

In Arizona, as in many other states, teachers make up less than half of school staff. Per-student spending and salaries continue to rise. Librarians, counselors, administrators, food preparers, bus drivers may be necessary for a full-scale industrial school to run, but many parents may see more value in employing two or three facilitators in a microschool. A non-“expert” teacher in a 5:1 teacher-student ratio, may provide better instruction than an “expert” for 30:1. And packing their children’s lunch and dropping them off may serve the whole family better than an “all inclusive” solution that isn’t delivering a true education. Families now have

options. And they can turn the tables, look past the traditional, compulsory school, into a rich ecosystem and ask – compared to what?

Responding to Critics: Compared to What?

The Empowerment Accounts won't go into effect without a fight. Save Our Schools Arizona collected signatures to block the expansion, demanding it be put to voter referendum in 2024. They criticized the “privatization” of public schools and claim ESAs will divert \$1 Billion in funding away from zoned schools. Never mind the \$1 Billion in new K-12 spending the state just approved.

Milton Friedman wrote, “One of the great mistakes is to judge policies and programs by their intentions rather than their results.”

Too often, government-run school systems are treated as an ideal, as if they actually provided equal, quality education to all children. If that were true, disrupting that perfection with ESAs might be wrong.

So putting aside the intention, what are the results of government-run, residentially zoned schools? The picture isn't pretty. As a result, most criticisms of ESAs are dismissed with the simple question: “compared to what?”

Arizona's public school classrooms are the second most crowded in the country. High school graduation rates hover about 8 percent below national averages and less than half of the graduating class went on to college in 2020. Workforce participation rates creep downward, and school segregation upward.

Some say parents who choose unbundled education services may spend funds unwisely or unethically.

Compared to what?

Perhaps a parent might use up all \$6.5K before selecting a math or science curriculum. But in a state where 60 percent of public school students failed the state English assessment and 69 percent failed math, it's unclear (at best) that students are worse off with unbundled curricula. This wasn't a

post-pandemic slide, either. At no point in the test's history have even half of students passed.

Learning loss due to school closures certainly should not, in any case, excuse poor student outcomes. Teachers' unions (shadow stewards of zoned school policies) lobbied to keep schools closed long after the risk of COVID to children proved minimal. Closures galvanized support for alternatives among parents, and reopening protocols encouraged teachers to seek (and start!) alternatives, too.

If we leave parents to make their own spending choices, even with certain constraints, some of that spending will be wasted. Critics say a freer market in educational services may expose parents to unqualified teachers or fraudulent services.

Compared to what?

Broadly understood, taxpayer spending on Arizona's education system includes lawsuit payouts to children abused by teachers and sketchy golden parachutes for departing administrators. Several public school superintendents in Arizona were indicted for fraud and for theft in recent years.

Debora Colbert, who launched Black Mothers Forum in Phoenix in 2020, put it this way: “We could be advocating 24/7, and still not make the impact that we wanted to see. So, what do you do, do you go charter? Do you try to keep working in the public school system? Nope, nope, not us. We said, well, we can do it ourselves.” And she did. With a network of 42 students, she launched microschools designed to spur raise expectations for achievement, and disrupt the school-to-prison pipeline for students of color.

ESAs don't divert funding from public schools – they increase the funds available for students remaining in zoned schools. Of all criticisms of ESAs, the strongest might be that they leave too many students, and too much money, trapped beneath a crumbling facade.

Expanding Choice to the Poor

The wealthy have always, and will always have choices in how to educate their children. They might choose to pay the cost of private school from kindergarten to high school, at around \$148,200. They might move to a nearby top-notch public school district, into a house costing on average \$175,000 more, and hefty real estate taxes. Even renters pay a premium. Those with a robust single income or independent wealth also find it easier to homeschool. If you have money, you already have a choice, even if you also have to pay your share of the zoned school your child isn't using.

For the poor, however, ESAs can be the difference between affording homeschool materials or not; between affording a local Montessori or not; between accessing occupational therapy or not. ESAs, pulled from taxpayers and distributed to learners, are an amazing equalizer – arguably, a fulfillment of what “public education” was supposed to mean.

Arizona has turned a corner in its understanding of public education. The one-size-fits-all factory model won't have an iron grip on the state's whole concept of education – nor its budget. More kids will get a customized education, and a fairer shot at a successful future.

The best strategies for Arizona parents? Know your children, and the kind of environment that might best prepare them to thrive. Know your options, whether public, private, charter, home-based, or community pod. Know your “default” zone school, understand its reputation, ethos, performance, and outcomes. And once you know all that? Take the money and run.

– July 26, 2022

The Amtrak Abomination

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The same policymakers who wanted to shut down the American economy for an indefinite period to save just one person from dying with Covid refuse to shutter an increasingly dangerous and expensive government-supported monopoly, the National Railroad Passenger Corporation, better known as Amtrak. Instead of leading with substantive policy improvements, America's leaders prefer to mislead the nation with weak virtue signals. Until the Federal Reserve gets inflation under control, though, the only real virtue will be increasing economic efficiency with bold reforms, including selling Amtrak to the (second) highest bidder.

The weekend before the 2022 Independence Day holiday, one Amtrak train in California struck a vehicle, killing three and injuring two others. In Missouri another derailed, killing multiple passengers and injuring many more. Accidents can never be eliminated entirely, but Amtrak's record is poor relative to other countries, especially given its snailrail speeds. Other economically advanced countries sport trains that travel at hundreds of miles an hour with much better safety records. Trains in Eastern Europe are also safer than Amtrak, even adjusted for passenger miles traveled.

On a tax dollar basis, Amtrak's overall performance is abysmal. Passengers pay a pretty penny for their tickets, but those traveling the northeast corridor routes subsidize those traveling America's vast western expanses. And all Americans subsidize Amtrak through increasing bailouts. Amtrak's leaders learned, for example, that they could spend \$450 million over 11 years to save Acela passengers a little over a minute and a half on the Philly to New York run and not

get fired for it. Annual taxpayer subsidies average over a billion dollars since Amtrak's formation in 1970-71.

Why was the Amtrak abomination created at all, and why then? America, after all, once led the world in both freight and passenger rail service thanks to vigorous competition between numerous privately owned and operated railroad corporations.

Wilma Soss (1900-1986), PR whiz, corporate bigwig nemesis, and subject of a forthcoming biography by myself and Bucknell University's Jan Traflet, was a big fan of passenger rail. As a youth, she regularly traveled by rail between her native San Francisco and her maternal grandparents' home in New York City. During World War II, she commuted between Manhattan and Detroit by rail, and after the war did PR work for Budd, a major Philadelphia-based passenger train car manufacturer. She knew the days of passenger rail were numbered, however, after Robert R. Young failed to turn around the New York Central Railroad in the late 1950s.

By the early 1960s, Soss railed against railroad execs who flew to their annual stockholder meetings in Chicago. Instead of fighting for the long term health of their industry, many executives looked for short-term profits, investors be damned. According to Soss on her nationally syndicated NBC radio show, Young killed himself after receiving a note from an old widow bemoaning the loss of much of her investment in his flailing railroad.

Not that the industry's decline was Young's fault. By the early 1960s, railroads faced

numerous competitors, especially Eisenhower's heavily subsidized interstate highway system. Nevertheless, certain intercity passenger rail routes, too close for planes and too congested for cars, continued to make good economic sense. Regulators, though, kept derailing innovation and squeezing railroad profits between ticket price controls and rising costs. The beginning of the Great Inflation accelerated the wreck of the once mighty industry, fomenting the nationalization of its remnants into the Amtrak abomination.

Fifty some years later, the U.S. government has proven itself as incapable of running a railroad as the Soviet Union did. It should deregulate intercity passenger rail travel and sell off all of Amtrak to the highest bidder at the second highest price in a Vickrey sealed-bid auction. The proceeds, which would be substantial, could be used to plug the hole in the deficit and maybe pay down the national debt a bit. A sale would also free the American people from the expense of subsidizing Amtrak in the future, and the shame of its execrable existence.

The Great Brandon Inflation, aka the Climate Change and Pandemic Overreaction Inflation, promises Americans much pain, especially if more employers do not wake up to the necessity of implementing COLAs. But if liberty lovers awakened to the view that no good crisis should go to waste, some regulatory improvements could be in the offing if for no other reason than it is currently politically expedient to reduce prices without creating shortages.

During the Great Inflation of the 1970s, for example, airplane ticket prices (1978) and brokerage commissions (May Day 1975) were deregulated. Increased competition quickly created efficiency improvements that allowed real price decreases in both industries.

With gasoline prices and airplane tickets currently soaring, and lessons about the perniciousness of

price controls hopefully learned, reform of intercity passenger rail could well be in America's immediate future. While trains are not especially good for the environment, many people assume they are "green," also allowing for some of the fake virtue signaling many American politicians seem to crave.

– July 7, 2022

Leave the Gas Station Owners Out of It

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Over the Independence Day weekend the Biden Administration shifted its blame for rising prices, and specifically rising prices of gasoline, from Vladimir Putin to gasoline retailers. On Saturday, July 2nd at noon, President Biden's Twitter account inveighed:

My message to the companies running gas stations and setting prices at the pump is simple: this is a time of war and global peril. Bring down the price you are charging at the pump to reflect the cost you're paying for the product. And do it now.

On July 1, 2022, the average price of gasoline in the United States was \$5.34 per gallon. That's down from the high of \$5.47 per gallon hit two weeks ago, but still a historically elevated level. On the New York Mercantile Exchange (NYME), gasoline futures prices are up 57% in 2022. Diesel recently topped \$5.75 per gallon and now sits at \$5.73 per gallon, its highest price in decades.

The largest factor input for both gasoline and diesel is the price of oil, which has eased back some over the last month. The major reason for the price declines in both oil and products derived from oil are a mounting accumulation of economic data suggesting that an anticipated recession may already be here. (The first calculation of the second quarter US GDP number will be released on July 28th.) But even despite the recent price declines, West Texas Intermediate (WTI) remains up over 37 percent in 2022, Brent Crude up 38 percent.

Both misinformation and disinformation are essential skills in politics, but under the pressure of rising inflation and slowing economic growth the

current administration has expanded the practice to new frontiers. The tweet, which was undoubtedly not written by the President but to which he has lent his name, begins with a salvo directed at "the companies running gas stations."

In fact, of an estimated 145,000 fueling stations across the United States, less than 5 percent (7250) are owned by refiners who would be, as the President says, "setting prices." But even that small number of gas stations are not ultimately setting the price of gasoline. The prices first derived on world oil markets, a major contributor to which are decisions of the Organization of the Petroleum Exporting Countries (OPEC), are the major factor.

Further, more than 60 percent of retail stations are establishments singularly-owned by a family or an individual. And while the number has undoubtedly changed over the last decade, 2013 Census data reported that 61 percent of those stations are owned by immigrants. Thus the Democratic administration that rails daily against billionaires and "big companies" has taken direct aim at 'mom & pop' stores, in so doing assaulting the newest arrivals to the United States, upon whom it is clear the left and much of the Democratic Party stake their political future.

As for the present time being one of "war and global peril," how tied the interests of the United States are to either of the combatants in southeastern Europe is a matter of opinion. If indeed peril is to be avoided, adopting a far more neutral stance than that which has tens of billions of taxpayer dollars and lethal weapons being sent 5000 miles would be a wiser approach.

But it is by admonishing gas station owners to lower their prices that what is deep-seated ignorance, profound dishonesty, or both are exposed.

In fact, even at the current prices, most gas stations earn a pittance from, or actually lose money, selling gasoline alone. According to IBISWorld, whereas the average US business has a profit margin of just under 8 percent (7.7 percent), the average gas station scrapes by at less than a quarter of that: 1.4 percent. At \$5.34 per gallon, the average national price of gasoline over the Independence Day weekend, a 1.7 percent profit would come to \$0.09 cents a gallon.

The Hustle estimates that after overhead (labor, utilities, insurance, credit card transaction fees, and so on), a gas station owner receives on the order of five to seven cents per gallon. Even selling a few thousand gallons of gasoline per day would only generate a few hundred dollars free and clear to the owner. Franchise City estimates that \$50 spent at the gas pump goes

\$30.75 to the oil company, \$7.00 to refineries, \$4.00 to the delivery company, \$1.25 on processing and transaction fees, and finally right at the end of the chain you get \$1.00. And that number can and does change, sometimes even lower, most owners suggesting an average [profit] of 1 to 3 cents net per gallon.

Meanwhile the Federal gasoline tax of \$0.18 cents per gallon yields a riskless, unearned fee to Washington of 3.4 percent per gallon. That's twice what risk-bearing entrepreneurs, most of whom are small business owners and a sizable portion of whom are immigrants, are receiving. And this doesn't take into account state gasoline taxes, the highest five of which are found in Pennsylvania (\$0.57 per gallon), California (\$0.51 per gallon), Washington (\$0.49 per gallon), New Jersey (\$0.42 per gallon), and Illinois (\$0.39 cents per gallon).

And none of this takes into account other costs and headaches which accompany gas retailing. Miniscule profits come with the costs and recordkeeping

associated with environmental regulations at the local, state, and federal level. Competition tends to be fierce, with numerous locations clustering at high-volume transportation junctions. The price sensitivity of many drivers is active at differences of as little as one cent. Many stations operate 24/7 to maximize revenue. And for those which operate as franchises, in return for name recognition and some volume discounts the associated fees can be enormous. (Not only do franchisees have to pay fees to the parent company, they also have to price their product in accordance with national promotions, which can undercut profitability.)

The awful business economics of gas station ownership are, in fact, why large oil firms and refiners are not interested in it. And it is why they've reduced their exposure to the consumer-facing end of the energy sector over several decades. Unsurprisingly it is lousy financial prospects that have pushed fueling stations into retailing food, drinks, cigarettes, toiletries, and a wide variety of other goods travelers may want or need. All of those goods have appreciably higher profit margins than retail gasoline sales, and for many independent, single owner-operated service stations are the key to their very survival.

So why do so many immigrants choose a business with seemingly dismal financial prospects? Trisha Gopal explored that question in Eater a bit over a year ago; kindly remain mindful of Biden's July 2nd tweet while reading her explanation:

As I speak to each owner, I realize the choice of a gas station is always a utilitarian one. When I ask her why they chose a gas station, Angelina Rizo gives me two answers. The first is one I hear from every restaurant owner I speak to: People need gasoline, so as long as people are driving, the more likely they are to have customers, and the more likely those

customers will need something to eat. It's an explanation rooted in the same immigrant mentality I've seen and heard my entire life: Look for opportunities, stay on your toes, and always find a way to be useful. When we wonder why immigrants are so entrepreneurial, it's because so many of us are taught to first look to see where we are needed, and then, once we are there, go beyond.

There is a darker component to Biden's redirection of blame as well. It is ironic that an administration built upon an ideological commitment to political correctness and the notion that words should be selected with surgical precision would message this clumsily. Gas station owners, a business community overrepresented by new immigrants to the United States, have frequently been targets of racist and xenophobic ire. Saddling them with blame for a particularly damaging aspect of the ongoing inflation increase is, beyond wildly inaccurate, irresponsible and morally unconscionable.

No one expects government officials, especially career politicians, to understand any of this. Neither have they any incentives to take real economic, financial, and business details into their static, oversimplified missives. The image of gas station proprietors as richly-compensated corporate executives at the helm of multinational corporations is one the Biden Administration has a vested interest in promoting. And there is no better measure of a political body out of ideas than an increasingly frenzied leap from scapegoat to scapegoat.

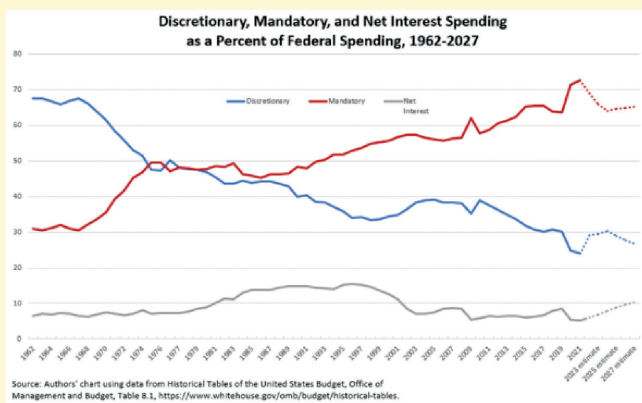
– July 6, 2022

Washington's Budget Deficits: Size and Composition Matter

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If you are wondering why Washington keeps running ever larger deficits, one reason is that fiscal policy-makers are increasingly losing control of their own budget. The figure below breaks down the composition of government spending since 1962 into discretionary, mandatory, and net interest spending.



Discretionary spending from the annual appropriations process has been steadily declining over the last sixty years. In 1962, Congress controlled 67 percent of its budget, but by 1990 that share was down to 40 percent, and it has now reached an all-time low of 24 percent in 2021. Meanwhile, mandatory spending on Social Security, Medicare and other so-called “entitlement” programs went from 21 percent of the budget in 1962 to a high of 72 percent in 2021. Spending on these programs is not literally mandatory. Congress could decide to actively budget these programs each year. But until that happens, spending on these programs automatically increases each year without congressional vote or appropriation.

The Congressional Budget Office routinely publishes budget outlooks that warn about the bad consequences of excessive public debt. Always

high on the CBO’s list is the simple point that a disappearing percentage of discretionary spending makes it evermore difficult for Congress to respond to short-term conditions without running ever larger deficits. Is it really any wonder why we have gotten used to counting deficits in trillions rather than billions of dollars?

As for net interest spending, which is actually mandatory to prevent default, the government’s debt service has been below 10 percent of the budget since 2002. But with interest rates on the rise due to the Fed’s mandate to slow inflation, net interest is projected to again exceed 10 percent of the budget within five years. This will squeeze discretionary spending even more.

One lesson is that past Congresses have been very effective at committing subsequent Congresses to overspend, specifically on the entitlement programs that make up the vast majority of mandatory spending.

Another lesson is the idea of scale versus scope. Concerns about the increasing size of spending and deficits as a whole miss an important point. Equally concerning is that an ever-growing share of Washington’s budget has been on autopilot for the past 60 years, and it has begun to severely crowd out the rest. Consequently, since entitlements are off the table under threats of touching “the third rail of politics,” then proponents of fiscal discipline have been trying to reform and constrain an ever-smaller portion of the overall budget.

– July 4, 2022

Should the Fed Stimulate Growth?

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Although production recovered much faster than many expected following the COVID-19 contraction, real gross domestic product declined in the first two quarters of 2022. Naturally, this has left many wondering what can be done to boost economic growth.

“After the 2008 financial crisis,” Nick Timiraos recently wrote in the *Wall Street Journal*, “the U.S. relied heavily on the Federal Reserve to stimulate growth, leading to a frequent quip that monetary policy had become the ‘only game in town.’” In contrast, he considers several supply-side reforms that would increase immigration, boost labor force participation, and make America less dependent on foreign energy.

If these supply-side reforms improve our ability to produce valuable goods and services with the available physical and human capital, then they should be implemented—not because output growth is sluggish and inflation is high at the moment, but because such reforms are *always* worth doing. They make us more productive.

The case for the Fed to stimulate growth, on the other hand, is not so clear.

In general, I think we should dispense with the notion that the Federal Reserve’s job is to stimulate growth. That framing obscures the fact that growth can be too high, as it probably has been over much of the last year. It also exaggerates the effect of monetary policy on growth. Instead of trying to stimulate growth, the Fed should do its best to ensure the economy is neither over- nor under-producing.

Fundamental Driver of Economic Growth

Production ultimately depends on the available physical and human capital (or, factors of production) and total factor productivity—that is, our ability to use physical and human capital to

produce valuable goods and services. Total factor productivity increases when we discover new and better ways of doing things. These increases in total factor productivity enable us to produce more output with fewer inputs. Total factor productivity growth is the fundamental driver of long run economic growth.

Monetary policy can bolster total factor productivity to some extent, by reducing the risk and cost of inflation. Individuals change prices and recontract more frequently in countries where inflation tends to be high or difficult to predict. These activities use up real resources that could be used to produce other goods and services—and would be used to produce other goods and services if monetary policy were better. By reducing the resource costs associated with inflation, sound money promotes long run economic growth.

Although sound money is pro-growth, the effect of better monetary policy on long run economic growth in rich countries is probably small. How much more frequently do we change prices or recontract as a result of less-than-ideal monetary policy? What’s the potential cost savings?

Real GDP was nearly \$20 trillion last year. If better monetary policy reduced costs by \$20 billion, it would boost GDP by roughly one tenth of one percent. If it reduced costs by \$100 billion, it would add one half of one percent. I doubt the potential gains are that big. To be clear, we should make the necessary monetary reforms and enjoy the gains. But we should also be realistic about the likely size of those gains. Monetary reform is not going to add one to two percentage points to real GDP growth, as some people claim.

Booms and Busts

Although monetary policy probably has a small effect on long run economic growth, it can have very large effects over short periods of time. When monetary policy is loose, people are fooled into overproducing. When monetary policy is tight, they are fooled into underproducing. You can't fool all of the people all of the time, of course. They eventually wise up. You can fool them some of the time, but you shouldn't.

Sound monetary policy accommodates changes in the demand to hold money, so that nominal spending grows at a steady, predictable rate. This bolsters the information content of prices, which will rise and fall to reflect genuine changes in relative scarcity, and thereby supports businesses engaged in long term planning and workers considering long term contracts. Rather than fooling people into over- or under-producing, sound monetary policy helps them produce as much as they want given their preferences and the available technology.

On Stimulating Growth

I understand why some say the Fed should stimulate growth. When the economy is underproducing, the Fed should boost nominal spending so that production rises to a level in line with the economy's sustainable potential. Still, the phrase is misleading. By highlighting the increase in production, it obscures the below-optimal starting point that is necessary for such a policy to be desirable.

The stimulate-growth framing also perpetuates a mistaken tendency to think economic growth is always good and more economic growth is always better. It is possible to produce too much, as people do when they believe the dollars received in exchange will be worth more than they actually will.

Whether the Fed should stimulate growth is contingent on how output compares to the economy's sustainable potential. It is best to be clear about that. Rather than consider whether the

Fed should stimulate growth, we should recognize that its primary task is to prevent over- and under-production.

– July 28, 2022

Tyrannies of Hyperreality

MAX BORDERS

Contributor

Like millions of his generation, my teenage son is a gamer. I've spent hours watching him play *Apex Legends*. This game is not so different from others in that the interface lets players customize their characters. As it happens, his favorite character Bloodhound *identifies as* nonbinary. And in a limited sense, my son *identifies as* Bloodhound for hours at a time.

My son could choose from among other characters, but he likes Bloodhound's enemy scanner. He has earned enough experience with the tracker to modify ~~him~~ *them* with all manner of "skins." Game avatars are an example of how young people spend hours, running around in worlds gamers call "maps," pretending to be someone or something other than themselves.

Baudrillard's Point

As an American trained mostly in anglophone philosophy, it pains me to admit that *Jean Baudrillard has a point*. If you've never heard of Baudrillard, he's a French philosopher known for a theory called "The Precession of Simulacra." He writes:

The territory no longer precedes the map, nor survives it. Henceforth, it is the map that precedes the territory – precession of simulacra – it is the map that engenders the territory....

In other words, one feature of our postmodern condition is that, despite our progress, we have both created and discovered a more complex world. This complexity gives rise to the need to use various models, metaphors, and maps to navigate reality. But these maps, of course, are not the territory. They

are cognitive shortcuts. And they can take on a life of their own.

Though we need maps, models, and metaphors in our investigations, these can take data – 2D representations of 3D reality – out of their contexts. Reality's contexts are rich and not reducible to bits or bytes, stats or data points.

"Warm data," writes complexity theorist Nora Bateson, "is information about the interrelationships that integrate elements of a complex system. It has found the qualitative dynamics and offers another dimension of understanding to what is learned through quantitative data (cold data)."

Bateson's point is that there is more to life than cold data. But such data, sufficiently abstracted, fuels a kind of reductionism—a precession away from the real. So, whether in science or society, how can our minds become so divorced from our world?

Obvious examples include our dependency on smartphones and social media. It's hard to deny that these techno-umbilical cords have transformed us. As Marshall McLuhan is credited with saying: "we shape our tools, and then our tools shape us." I'll pass over the irony that McLuhan probably never said those words, though our hyperreal memplex has other ideas. The point is that technology – including the models, metaphors, and maps they instantiate – changes us enough to prompt questions about our very natures and technology's place in our lives.

Baudrillard describes "precession" as the tendency for simulacra to pull us into a Hall of Mirrors. The simulacra can be layered or nested—so much so that we lose our contact with reality. This strange trap surely relates to our sensemaking crisis. Indeed, we must construct tools and methods

to navigate reality, but the more we use our tools, the more we operate outside reality. The tools, after all, are but simulacra. Our maps can become decoupled from the territory, which means we start to live more of our lives in our heuristic scaffolding than in the world.

Baudrillard calls this condition “hyperreality.” Once you see the problem, it’s hard to unsee it. Baudrillard takes the point too far by suggesting that the “simulacrum is true,” but this is also generally why postmodernism fails. Reality returns with a vengeance. The precession of simulacra eventually collapses, and the world eventually punches us in the face. While postmodernists blame capitalism for such woes, we can set that debate aside for now. The problem of hyperreality rears its head in any number of contemporary debates.

The question looms: Can we acknowledge Baudrillard’s point without collapsing into absurdity?

Hyperreality in Public Health

David Cayley is a Canadian writer and student of social critic Ivan Illich. Cayley gained visibility early in the pandemic for his reflections on how too many experts have come to view public health. Channeling his teacher, Cayley writes,

Illich had a sense, during the last twenty years of his life, of a world immured in ‘an ontology of systems,’ a world immune to grace, alienated from death, and totally convinced of its duty to manage every eventuality – a world, as he once put it, in which “exciting, soul-capturing abstractions have extended themselves over the perception of world and self like plastic pillowcases.

Soul-capturing abstractions are a species of hyperreality.

Cayley noticed that authoritarians of scientism use hyperreality to justify their authority. Public health figures had already begun to conflate science with

narrow academic research methods. The COVID pandemic prompted them to double down on this conflation, and that fact was no more pronounced than when front-line physicians started successfully using treatment alternatives that threatened emergency use authorization (EUA).

Twitter-famous public-health commenters such as Gideon Meyerowitz-Katz (GMK) were not only soul-captured by statistical abstractions but used Illich’s plastic pillowcase to suffocate dissent. In GMK’s view, only randomized control trials (RCTs) ought to qualify as The Science™ when it came to the pandemic.

Writing in the *British Medical Journal*, Meyerowitz-Katz, et al. tip their hands:

The pressure to act quickly and do something instead of nothing in a global health emergency can lead researchers to cause harm or add to already existing injustices.

Such a statement might seem innocuous in isolation. But remember, GMK uses a scholarly medical journal to call out methodological malpractice in studies of off-label Ivermectin used in COVID treatment. To be sure, GMK deserves credit for finding errors in a few Ivermectin studies. Sadly, though, he and his colleagues appeal to hyperreality by suggesting *only* RCTs are justifiable. Other methods – such as relying on past safety research, observational studies, or patterns discovered in successful clinical practice – ought to be off-limits, according to the self-styled Health Nerd.

“But the answer is not to abandon research during crises, which could itself lead to ‘inadequate, ineffective, or even harmful care.’ The answer is to *abandon research exceptionalism*.” (My emphasis.)

Meyerowitz-Katz never really applies his concern about causing “harm” or “adding to injustices” where the vaccines are concerned, even though EUA

is the apotheosis of research exceptionalism. When humanity's greatest medical experiment on humans rolled out, Meyerovitz-Katz was still nattering on about Ivermectin. Indeed, if one compares GMK's history of looking into Ivermectin studies against his history of looking into vaccine trials, one might infer religious zeal in the lopsidedness. Despite mounting proof for vaccine injuries and shoddy clinical trials, Meyerovitz-Katz is content more or less to shrug.

But that seems odd.

"The urgency of a pandemic," writes Meyerovitz-Katz, "is never an excuse for poorly designed studies, ethical misconduct, or the violation of human rights."

Maybe I missed Meyerovitz-Katz's call for abandoning research exceptionalism in the woefully inadequate and potentially fraudulent vaccine trials. If he ever made such a call, it got buried by his obsession with an off-label drug that'd been used safely for decades. Instead, he worked in collusion with so-called "fact-checkers" to deny questions about vaccine safety and efficacy.

Note that GMK's "poorly designed studies" admonition is a subjective assessment intended to exclude anything but RCTs, which mainly only megacorporations and governments can afford (read: "the institutions"). Yet the RCTs that constituted The Science™ on mRNA vaccines were crummy, almost certainly because their purveyors were eager to get EUA and thus billions of dollars. Alas, anyone who suggested such a thing would be hectored as a conspiracy theorist.

In hyperreality, inexpensive therapies determined safe and already in use by billions worldwide would be derided as a "violation of human rights" at best and "horse-dewormer" at worst.



Vaccine boosters (no pun) and skeptics of alternative treatments such as Ivermectin and hydroxychloroquine were too quick to genuflect before the Blue Church. Far from applying a skeptical lens, people like GMK circled the wagons around biopower, or what Michel Foucault refers to as "an explosion of numerous and diverse techniques for achieving the subjugation of bodies and the control of populations."

Those once reflexively skeptical of Big Pharma started carrying water for the vaccine-industrial complex. One can identify them by their willingness to malign mRNA skeptics as anti-vaxxers. Public-health authoritarians are also comfortable with suspending liability for vaccine injury, cheering for mandates, and denying data transparency to the public, which was once a cornerstone of informed consent.

Let me be clear: I am not arguing randomized control trials are somehow wrong or that there are a hundred superior methods for understanding complex features of reality. I am saying that the scientific enterprise cannot be reduced to a single methodology. Other methods should not be discounted because a Twitter-famous graduate student says so in the BMJ, notwithstanding his breathless references to ethics or justice – areas in which he is clearly not an expert.

The Science™ is a series of religious rituals that purportedly improve the quality of scholarly output, but is actually dominated by petty and hopelessly captured gatekeepers of which GMK is an exemplar. Improved standards and methods are great until they run squarely into that iceberg

known as the replication crisis. And peer review has become circular onanism.

Yet a clutch of public-health authoritarians, including GMK, routinely attack others from their Twitter perches using blue-check rhetoric. Their targets included far more accomplished and better-trained statisticians, epidemiologists, and practicing physicians. Such is not to argue these cock-sure health nerds aren't entitled to their opinions. The problem is that their discovery of faulty data in a few Ivermectin studies catapulted them to Warhol fame. People will too often say dumb things to extend their fifteen minutes, but fifteen minutes isn't enough to justify anyone's throwing the rest of medical science into hyperreality.

The epistemic status of a given claim can be justified or critiqued in different ways, including RCTs, meta-analyses, and communication among experienced clinicians and, yes, even amateurs. And that justification can be shored up using multiple methods whose results cohere to make a hypothesis more or less likely to be true.

We must take care, therefore, not to choose a single model or method as *The One True Way*, even if that way is considered the gold standard. Science is a process that, though imperfect, ought to be undertaken by multiple investigators, some of whom will use local knowledge, even tacit knowledge, as many hands upon the proverbial elephant. RCTs, though powerful, can reduce complex multi-dimensional phenomena to plot points and p values. They can also hide errors or evidence of fraud. Meta-analyses, though helpful, can reduce science to data aggregation. Even if not all methodologies are created equal, methodological pluralism is necessary for scientific advance.

When we see someone claiming the *One True Way* in science, we have good reasons to be skeptical—especially if they bludgeon their detractors with appeals to expert laurels, ad hominem attacks, or

The Science™. It's no surprise that GMK referred to one critic as a "transphobic troll." Such accusations are a popular form of discourse among many young people today. Many in his generation have been raised in the cottony confines of hyperreality. It's no wonder they believe hyperreal methodologies are the sine qua non of science—at least when that belief is convenient.

Hyperreality in Trans Ideology

According to *Psychology Today*, "magical thinking—the need to believe that one's hopes and desires can have an effect on how the world turns—is everywhere." You can find synchronicities or spirits or signs. You just have to look for them. This tendency to make imagination into reality is human but it's rarely rational.

One of the most extreme versions of hyperreality manifests in trans ideology, which is an outgrowth of postmodernism. While it offers some justifiable critiques of modernist realism, POMO turns out to be a kind of intellectual ouroboros, a symbolic creature that eats itself in the end. That doesn't mean Baudrillard has no point. It means postmodernism reveals more of its vaunted irony. Specifically, trans ideology thrives in hyperreality.

Before readers throw rotten tomatoes, I am not arguing that there is no such thing as those rare few who experience gender dysphoria. What I am suggesting is that not all transsexuality is created equal. For the purposes of this conversation, I'd like to postulate two basic types: *strong* and *weak* transsexuality. Strong transsexuals experience gender dysphoria as an epiphenomenon, which means the dysphoria is rooted in some *underlying psycho-physiological substrate*—aka reality. Weak transsexuals are those for whom the desire to transition is fundamentally ideological, cultural, or fashionable, and rooted in hyperreality. In other words, weak transsexuals graduate

from “I identify as...” transgenderism, which is a socio-cultural construction they can adopt rather than a condition they must confront. As such, weak trans ideology originates in postmodern Queer Theory more than any supervenient property of their biological natures.

To understand the difference, consider that many trans ideologues are fond of deriding others as “essentialists.” This term comes straight out of the POMO lexicon. Most postmodernists think metaphysics – inquiry into the fundamental nature of reality – is impossible. There are no essences, that is, no properties of the physical world that can be known, much less that can influence other higher-order properties. According to this view, *everything* is a subjective or intersubjective construction. Because science is a subset of metaphysics – which acknowledges reality’s powerful properties – those quick to dismiss ‘essentialism’ end up dismissing *that which is real*, not to mention important modes of understanding that which is real.

Left-handed people who lived in puritanical Massachusetts might have “identified as” right-handed to avoid persecution, but it’s hard to argue their handedness a radically subjective social construction, full stop. Most garden-variety homosexuals agree: *I was born this way*, they’ll say, and quite rightly. Not only does the denial of essences militate against sensemaking, it offends those for whom features of their identity, such as sexual orientation, are more than subjectively determined.

That’s why a lot of homosexuals are feeling the strain of intersectionality.

The label LBGTQ+ has lost its luster for many, especially those who see trans activism gobbling up decades of gains for homosexuals and women. So now we have splinter factions such as TERFs (trans-exclusionary radical feminists). Most TERFs not only understand that synthetic augmentations of biological women and men, far from helping them

“transition” to the opposite sex, actually help them transition to a simulacrum.

Some transsexuals will be fine living in hyperreality. But others will come to regret arresting the fullest expression of their biological natures, especially if they transition during adolescence or earlier. Transition severs the complex nexus among the chromosomal, the hormonal, the developmental, and the psychological that emerges throughout our lifetimes. Now, regret is one thing. Obliging women and girls to make unfair accommodations for trans women is quite another. For many, it’s a bridge too far, not only because it requires women and girls blindly to accept activist hyperreality, but because it requires women and girls to forfeit intimate aspects of their lives to people living under the spell of magical thinking.

Hyperreality in Economics

Hyperreality is not just infecting science and sex.

Behind the esoteric imagery of the U.S. dollar, a monetary cult controls the money supply and the interest rate. These cult members are, in one way or another, the children of John Maynard Keynes. Considered by many to be the most influential economist ever to have lived, Keynes offered models and metaphors to stimulate generations of economists eager to work in the administrative state and play at being God. You might recognize these models by their emphasis on aggregate demand, which only governments and central banks have the power to affect. Perhaps you’ll recall Keynesian metaphors such as “pump-priming,” or, more subtly, “fixing,” “running,” or “building” the economy.

But to understand why Keynesian monetary- or fiscal policy is utterly inapt, imagine trying to prime a rainforest’s pump, or to fix, run, or build the Great Barrier Reef. Most macroeconomists imagine hydraulic models and routinely use machine metaphors, which prompt them to regard a complex economy as something deterministic and, frankly,

much simpler than it is. So the vast majority of economists, and therefore the experts teaching in higher ed, working in government, or practicing reverse-alchemy at the Fed, are living in hyperreality. One might go as far as to say the whole discipline of predictive macroeconomics performs little better than a seer who reads entrails.

What had seemed to many at the time like a great trolley problem was suddenly resolved by authorities pulling the lever towards lockdown, which sent the nation into uncharted fiscal and monetary territory. The tyranny of experts succeeds when people are afraid. As the pandemic raged, experts in ‘the institutions’ told us we needed to compel lockdowns to save lives, but to lock everyone down meant locking down production, collaboration, and exchange. To prevent catastrophe, the experts proposed spending money the government didn’t have. They used debt spending to “rescue” Americans from the very policies they had imposed.

What was supposed to have been a few weeks turned into many months. The people suffered. To repeat, experts at the government’s Department of Helping People dropped legal counterfeit dollars from helicopters onto the self-same poor souls they’d told to stay under house arrest. Businesses closed. Jobs were lost. And one budget-busting COVID recovery bill was not enough. In crisis, the political class saw an opportunity and licked its chops. We needed *five* such bills, insisted the experts, which didn’t include all the Fed’s interventions quietly going on in the background, accelerated by the spate of COVID “relief” spending bills.

Recall that, all along, a new wave of Modern Monetary Theorists (MMT), Keynesian kissing cousins, had been whispering into the ears of power, telling them exactly what they wanted to hear: *If you have the world’s reserve currency, they said, you can use debt spending as much as you like without worry.*

The U.S. government’s debt now stands at \$30 trillion.

Over the course of two years, the Fed created 38 percent of the dollars ever to exist. The experts told us that inflation would be “transitory,” probably because their models told them so. As we have suggested, macroeconomists are not just drowning in hyperreality but drowning us in an ocean of red ink. As rampant inflation (reality) threatens to achieve escape velocity, the Fed has decided – perhaps too little, too late – to confront reality. But that reality presents the horns of a dilemma: Raise interest rates too much, and we could all be thrown into a deep and lasting recession. Raise interest rates too little, and the country could experience inflation like we’ve not seen since the end of the Carter presidency. Some worry we could see both a recession and persistent inflation, which is not unreasonable. Macroeconomic ~~modelers~~ meddlers have been pushing the buttons and pressing the dials on their money printers for decades. The experts sought in 2008-09 to save us from all the problems they’d created before. Intervention begets intervention. Their ‘plan’ is to help the addict with either fentanyl or withdrawal.

When the storm arrives, most everyone will wonder what the authorities will do. But the trouble is coming because we have turned to authorities for far too long. Now the tab has come due. There is little more than can be done from on high. We will have to learn to turn to ourselves and each other again. So it has always been in the real world. So it will always be. We can no longer afford to live in this economic precession of simulacra. Reality will re-exert itself as night follows day. And it will hurt.

But we must confront reality and shed ourselves of national experts or authorities who gain and keep power by clinging to hyperreality.

Hard Lessons

Outsourcing our problems to distant capitals has always gotten us into bigger problems. So the lesson here is not just about hyperreality. We must start to decentralize. Localize. Self-organize.

Of all people, comedian and social critic Russell Brand has been sending out similar messages for a while now. He says we ought to organize our own local polities according to various overlapping conceptions of the good. We must live or die by our chosen niches. You might think I'm crazy for finding common cause with the cockney comic. But boy, he gets it.

It's not altogether different from what Thomas Jefferson refers to as the "consent of the governed," which is neither a hypothetical "social contract" nor a General Will. A consent-based order means real people come together in real communities, signing on to their own rules. Governance pluralism means tighter feedback loops for different experiments in living. Those experiments rooted in reality will be sustainable. Others will pass away.

Whether you lean left, right, or somewhere off the crude political spectrum—it doesn't matter. By joining a civic association, you can choose to live in reality or in hyperreality. But be warned: in a decentralized, consent-based order, we will all bear the costs of our decisions more directly. And that will discipline us.

In the long run, we'll all be better for it.

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Rule, Britannia?

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Reprinted from *Law & Liberty*

There isn't a nation on earth that doesn't experience tensions with its neighbors, even friendly ones. That may be especially true of those peoples who live side-by-side under the roof of the same sovereign state.

Even when Catalans in Spain, Quebecois in Canada, or Flemings in Belgium get along with their Castilian, Anglo, and Walloon neighbors respectively, contested issues—which language is given priority, who receives more tax revenue, etc.—always lurk beneath the surface. In Britain's case, Helen Dale admirably lays out the tensions between its four peoples presently corroding the resiliency of the sovereign state known as the United Kingdom of Great Britain and Northern Ireland (to use its formal title since 1927).

Many factors will continue to bind the English, Scottish, Welsh, and Irish nations together for the foreseeable future. One is a common language. While it assumed many accents, English became a unifying factor with fading use of Scots, Scottish Gaelic, Irish Gaelic, and Welsh. Politically and economically, many effects of England and Wales' integration with Scotland following the 1707 Acts of Union, and then Ireland after the 1801 Acts of Union, persist. Despite the devolution of certain powers to Scottish, Welsh, and Northern Irish legislatures and governments, the four nations continue to function as a common market. Everyone also remains subject to the UK Parliament where ultimate sovereignty still resides. Neither of these things will be easily dislodged.

Many of the cracks in the United Kingdom's edifice identified by Dale have some very immediate

causes. But she also indicates that some deeper underlying currents have, over time, worn away at those more subtle ties that are just as important as the more formal links that have bound the four peoples of Britain together. I would suggest that two such links were especially significant. One was the experience of empire. Another was religion. Their fading has dissolved bonds between the four peoples that are not easily replaced.

Imperial Affairs

Today millions of people are still alive for whom the British Empire was a reality. Apart from the vast Indian realms (modern India, Pakistan, Bangladesh, and Myanmar), it included what were called the Dominions of Australia, Canada, Newfoundland, New Zealand, the Irish Free State, and South Africa as well as numerous colonies, protectorates and mandates in Africa, Asia, the Pacific, the Middle-East, the Caribbean, and Central and South America.

But one defining characteristic of this empire was that it wasn't an exclusively English affair. The other peoples of Britain—particularly the Scottish and the Irish—were deeply invested in the imperial project. In some respects, they were its backbone.

In books like *Scotland's Empire*, the historian T.M. Devine has illustrated the disproportionate role played by Scots as soldiers, administrators, educators, doctors, and merchants throughout Britain's Empire. It has been estimated, for example, that 30 percent of British army officers in the eighteenth and nineteenth centuries were Scottish. Given that Scots constituted roughly 13 percent of Britain's total population in these years, such men plainly punched way above their demographic weight.

One prominent example was the Highland-born Major General Lachlan Macquarie (1762-1824). Like other Scottish soldiers, much of Macquarie's military career during the late eighteenth and early nineteenth centuries was spent in places like North America, the West Indies, Egypt, and India, often leading elite Highland regiments. His grave, however, on the Isle of Mull is graced with the words, "The Father of Australia." This is on account of Macquarie's governorship of New South Wales between 1810 and 1821. During these years, Macquarie built many of the colony's civil, judicial and social foundations. He also established many Australian towns to which he gave Scottish names, and even left an imprint upon their architecture.

What's important is that Macquarie did all this as a Scot and a British official—not an ersatz Englishman. Therein lies the significance of Macquarie's story insofar as his path was a common one for many Scots from the mid-eighteenth century until well into the twentieth century. One estimate suggests that something like 40 percent of the Scottish gentry (and 50 percent of Highland gentry) had strong connections to the army or imperial service in the early nineteenth century. These Scots regarded themselves as Scottish and British. To the extent they even thought about it, they didn't view the two identities as being in tension as they extended and consolidated a global empire that provided enormous opportunities for enterprising Scots.

A similar involvement with the Empire characterized Ireland. Today it's fashionable to regard the Irish as a rebellious people perpetually at odds with England. But Ireland's difficult relationship with England didn't prevent thousands of Irishmen from playing a major role in the British Empire's emergence and consolidation.

Consider, for instance, Britain's greatest nineteenth-century soldier—Arthur Wellesley, the Duke of Wellington. Born in Ireland into the Anglo-Irish

Protestant Ascendancy, he cut his teeth as a soldier fighting in India. He later served there as a colonial governor. Wellington was just one of many Irishmen involved in imperial affairs. Irish regiments were scattered throughout the Empire as extensively as their Scottish brothers-in-arms. The Irish were also overrepresented in the colonial police forces that maintained law and order throughout much of the Empire. From Ireland came hundreds of Protestant and Catholic missionaries who sustained Christianity in British colonies and laid the foundations for the mass conversion of Africans to Christianity in the twentieth century.

Nothing, however, lasts forever—perhaps especially empires. After World War II, a weaker and poorer Britain embarked upon 25 years of decolonization. One side-effect was that the common imperial enterprise which had caused many people from England, Scotland, Ireland, and Wales to view the world as Britons disappeared. Nothing comparable or as unifying emerged to replace it. The European Economic Community and then the European Union to which most British elites turned after the twilight of Empire never filled the gap. Instead, as Dale underscores, Brexit highlighted how the European project had become a sharp point of division between a majority of the English and Welsh on the one hand, and the Scots and Northern Irish on the other.

Protestant Peoples

Even before Britain's acquisition of an empire in the eighteenth century, something else helped bind the four nations: religion. By that, I don't mean Christianity per se. Rather, I have in mind the religious character of the post-Reformation British Isles.

After the sixteenth-century Reformation, small Catholic minorities continued to exist in England, Scotland and Wales. Catholics remained a distinct majority in Ireland. But being Protestant, whether

Anglican, Presbyterian, or various forms of what was called Non-Conformity, became a common feature of English, Scottish, and Welsh identities. It was also central to the Anglo-Irish Ascendancy's self-understanding.

Presbyterians and Episcopalians in Scotland disagreed about many things—often violently. Little love was lost between Anglicans and non-Conformists in England and Ireland. Yet one thing they all shared was hostility to Catholicism. “Popery” was not just regarded as corrupt and idolatrous. By 1600, Catholicism in all four nations had become associated with disloyalty, despotism, and external political threats from Catholic powers like Spain and France. This religious factor is what fundamentally ended the “Auld Alliance” between Scotland and France that lasted from 1295 to 1565. It also helped facilitate growing political bonds between Scotland and England which assumed very concrete form when James VI of Scotland ascended to the thrones of England and Ireland in 1603.

Protestantism and anti-Catholicism's significance as unifying factors for the four nations can be seen in the dynastic disputes that marked early-eighteenth-century British politics. The primary milestone around the exiled Stuart dynasty's neck was the Catholicism of James Edward Stuart and his son Charles Edward Stuart. For most people throughout Britain, this more than outweighed the unpopularity of the first two Hanoverian monarchs. George I and George II may have been German and therefore seen as “foreign.” But at least they were not Catholic. After all, that was the primary reason why they sat on the throne in the first place. During and after the 1715 and 1745 Jacobite Risings, the Hanoverian government didn't hesitate to play the anti-Catholic card to rally support against the Jacobite rebels.

For 300 years, these religious dynamics remained crucial to the identity of the vast majority of the English, Scottish, and Welsh peoples. They were

also an important source of legitimacy for the Anglo-Irish Ascendancy. Even following Catholic emancipation in 1829, the self-understanding of three of Britain's nations as Protestant peoples lasted (especially among the growing middle-class) alongside antagonism towards Catholics.

This bond, however, weakened significantly as religious practice began faltering throughout the four nations in the nineteenth century's last quarter. By the early twentieth century, political ideologies were well on the way to supplanting religion in many Britons' core commitments. This was especially true of the working class where religious indifference—with the exception of the two Irelands—became the norm.

Even in a country with as strong a history of attachment to Protestantism as Northern Ireland, contemporary Ulster Unionism (as Dale reminds us) tends to function more as a generic conservative movement than a bastion for hardline Protestants on an otherwise (now very nominally) Catholic island. Likewise, the republican Sinn Féin party—long associated with the Catholic-dominated Provisional Irish Republican Army—has morphed into a fully-fledged left-wing hyper-secular nationalist party that embraces all such movements' priorities.

What's Left?

The waning of these particular bonds associated with religion and empire among Britain's nations took time. Moreover, their disappearance did not result in the UK's disintegration. Other forms of integration such as the complex legal and deep economic links underscored by Dale remain. Another bond meriting special attention is the Monarchy—one that consistently identifies itself as a British rather than an English institution.

Despite particular Royals' self-indulgent antics, the Monarchy remains something to which most UK citizens remain attached. That is partly because of admiration for Queen Elizabeth II but also because

many in the four nations are happy to have a head of state who remains above the ups and downs of everyday politics. Outside nationalist circles in Northern Ireland, republican sentiment has experienced difficulty attracting support in Britain. Even leading Scottish nationalists whose hard-left tendencies surely incline them to view the Monarchy negatively have carefully avoided public association with republicanism.

That said, loyalty to the British Monarchy may not suffice to keep the British peoples together. It's worth recalling that precedents exist for a formal breakup of the nations. In the eighteenth century, the exiled Stuarts promised to revoke the Acts of Union that merged the sovereignties of Scotland and England in 1707. That promise's popularity gave Jacobitism enormous traction in Scotland for decades. In more recent times, the Irish Free State cast off the British Monarchy's last statutory roles in its affairs in 1948 and became a fully-fledged republic.

Will a sense of British identity prevail over the ambitions of Scottish, Welsh, and Irish nationalists? That is unclear. Perhaps the better question is whether enough people in England will even care in the future whether Scotland, Wales, or Northern Ireland go their separate ways? That, I suspect, will be what ultimately determines if anyone sings "Rule Britannia!" in a century's time.

– July 11, 2022

Inflation, Unemployment, and Fed Credibility

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Our inflationary trajectory looks increasingly grim, and recession fears are mounting. Commentators worry the Federal Reserve will only be able to control surging prices by depressing output and employment. Monetary policymakers seem willing to incur economic costs if it means taming inflation. As the *Wall Street Journal's* Nick Timiraos writes, “Central bankers think when unemployment falls below a certain natural, equilibrium level, a tight labor market puts upward pressure on wages and prices.”

The unemployment-inflation trade off is an old idea in economics. Many policymakers, journalists, and intellectuals believe in it. But they’re wrong. The tradeoff is an illusion. The persistence of this misguided belief is nothing more than zombie economics. If central bankers are doing their job, there is no relationship between unemployment and inflation. It only seems like we face a choice if they’re behaving irresponsibly.

Imagine the Fed clearly and credibly commits to an outcome-based nominal anchor—a variable expressed in current dollars that makes the central bank’s promises concrete. For example, suppose the Fed had a strict 2 percent inflation target. With the Fed creating a secure foundation, markets can allocate resources to their highest-valued uses, ensuring that unemployment is as low as it can sustainably be.

There’s nothing special about 2 percent inflation. It could just as easily be 3 percent or 5 percent. It could even be slightly negative. What matters most is that households’ and businesses’ plans mesh with Fed policies. Given a nominal anchor, households and businesses will build the expected inflation into their asking and offering prices, with employment determined by supply-side factors. These include

the availability of capital and natural resources, the efficacy of technology, and the quality of laws and institutions. There will still be some unemployment, of course, because it is difficult for workers to find suitable positions and businesses to find suitable help. But this minimum sustainable unemployment rate, which is sometimes called the natural rate of unemployment, is consistent with the entire range of inflation rates. There is no tradeoff.

What if the Fed isn’t credible? Perhaps markets have good reasons not to trust the Fed. For example, the Fed might try to fool markets by promising 2 percent inflation and then overshooting. In the short run, unexpectedly easy money gives production a jolt. Laborers work overtime; machines run faster; inventories shrink. But this only lasts until market participants get wise to the game. Once they know the Fed’s policy isn’t compatible with 2 percent inflation, they start replacing those quantity adjustments with price adjustments. Workers demand higher nominal wages. Businesses require higher nominal prices. The end result is a higher rate of inflation than the Fed promised.

In the short run, it might appear lower unemployment goes hand-in-hand with higher inflation. The tradeoff seems real. But this isn’t a meaningful economic relationship. It’s got nothing to do with the structure of market economies. Instead, it’s solely attributable to the Fed saying one thing and doing another. The supposed relationship cannot be reliably exploited—and, when it is exploited, it doesn’t last long. Unemployment eventually returns to whatever level is consistent with the fundamentals of the economy. The only result is permanent dollar depreciation beyond the Fed’s guidance.

This is why inflation expectations are so important. Monetary policymakers have known for decades that household and business anticipations of inflation are crucial determinants of economic health. Ultimately, inflation expectations depend on the Fed's credibility. If a credible Fed promises 2 percent inflation, markets expect 2 percent inflation. If an incredible Fed promises 2 percent inflation, markets can expect anything. Arbitrary monetary policy is the reason inflation expectations have become "unanchored." If the Fed has to put the hurt on markets now to restore its credibility, it's only because central bankers blew that credibility in the first place.

Why did the Fed lose credibility? We know monetary policy was too loose over the last year. That's a big part of it. But the Fed's decision to change its longer-run monetary policy goal in August 2020 also contributed.

From January 2012 to August 2020, the Fed was ostensibly committed to a 2 percent inflation target. Since inflation was generally below 2 percent over the period, markets came to interpret the Fed's 2 percent inflation target as a 2 percent ceiling. That wasn't great for credibility, but at least the range of policy outcomes (0 percent to 2 percent) was small. In practice, the 2 percent ceiling corresponded to a target of roughly 1.7 percent.

In August 2020, the Fed adopted an average inflation target. The goal was to hit 2 percent inflation on average over many years, rather than approximately (or, no more than) 2 percent each year. In hindsight, this seems to have raised the effective target considerably and introduced a host of credibility problems.

For markets to believe the Fed's new policy, the target must be symmetric. If inflation is too low this year, the Fed should allow above-target inflation next year. But this works both ways: If inflation is too high this year, the Fed should allow

below-target inflation next year. Realistically, however, the Fed would never tolerate deflation. Also, it no longer seems willing to tolerate less-than-2 percent inflation, even if necessary to hit 2 percent on average. The inflation *ceiling* became an inflation *floor*. Rather than expecting slightly less than 2 percent, markets have come to expect more than 2 percent—and, potentially, a lot more.

If the target isn't symmetric (and markets clearly believe it isn't), the rule will not anchor inflation expectations very well. Expected inflation is higher, and its variance greater, than under a symmetric average inflation target. The Fed says it will deliver 2 percent inflation, but the actual operation of its asymmetric average inflation target virtually ensures that it won't. Markets seem to have figured this out.

Everything hinges on credibility. Now that the Fed has lost it, perhaps only a painful aggregate demand contraction can get it back. But this doesn't mean lower inflation in exchange for higher unemployment is a permanent policy option. Because of yesteryear's mistakes, unemployment will go higher. Our only "choice" now is whether it comes with a high or low inflation rate.

Any time it looks like there's a tradeoff between unemployment and inflation, something has gone very wrong. We could've avoided both horns of the dilemma if the Fed had done its job.

– July 11, 2022

Biden Borrows the Nixon Playbook on Recessions

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The Biden Administration is turning to historical precedent in its recent attempt to redefine the meaning of the term “recession.” Unfortunately, that precedent is the Nixon Administration.

As news of the second quarterly decline in real GDP growth hit last week, Biden’s economic advisors launched an aggressive media campaign to deflect any attention from signs of an impending economic downturn. The two-quarter decline marked a milestone, as it is usually a sign that a recession has begun according to the conventional economic definition.

When Fox News’s Peter Doocy asked White House Press Secretary Karine Jean-Pierre about the two-quarter decline, she shot back “that’s not the definition [of a recession]. That is not the definition.” Although it is not the only definition of the term, the two-quarter standard is in fact the most common rule of thumb to mark a recession. It appears in almost every mainstream economics textbook. It is also a common standard used by most developed countries, including the UK Treasury, the German Bundesbank, the French National Institute of Statistics and Economics, the Australian Parliament, and Canada’s balanced budget act of 2015.

By contrast, the White House prefers waiting on a recessionary determination by the business cycle timing committee of the National Bureau of Economic Research (NBER), even going so far as to designate them the “official” arbiter of recessions. There is no such official designation in US law, as I documented recently in the *Wall Street Journal*. But more importantly, the NBER approach is fundamentally unsuitable for making real-time policy decisions. It is rigorous and respected as a historical

indicator, but NBER’s determinations are retrospective by design. It often takes a year or more after the start of a recession for the NBER to release its findings, meaning it is functionally useless for the purposes that the Biden administration now claims.

Instead, Biden’s team wishes to exploit the NBER approach so they can buy time to limit the political fallout. This is completely contrary to the intentions of the NBER’s committee, but that has not stopped the White House from invoking their authority as a deflection tactic to avoid political backlash over a recession in an election year.

Biden’s tactic comes straight from the playbook of the man who was president when he first took office as U.S. Senator from Delaware in 1973: Richard M. Nixon. The U.S. economy entered into a downturn around November 1973, and would not emerge from the recession until the spring of 1975. Over the next several months, Washington was abuzz with chatter about crossing the threshold into a multi-quarter decline. Nixon used his State of the Union address on January 30th to declare “there will be no recession in the United States of America,” depicting the previous fall’s turmoil as a temporary residual effect of the 1973 oil embargo following the Yom Kippur War in the Middle East.

When the specter of a two-quarter decline was raised, suggesting that the traditional definition of a recession would soon be met, Nixon’s team went to work by trying to change the definition.

George P. Schultz, Nixon’s Treasury Secretary, dismissed the prospect of a recession in an interview with the New York Times. “I am sure the President will turn out to be right, as we define it,” he announced in a February 1974 budget briefing.

Schultz “maintained that the conventional, “simple-minded” definition of a recession, two successive quarters of decline in real gross national product, would not “fulfill the bill” in 1974, because of the “intrusion of the energy shortage.”” As the *Times* report continued:

[Schultz] said there were “judgmental factors” involved in deciding what a recession is or is not. “In the end,” he said, “it will be up to Geoffrey Moore and the National Bureau of Economic Research to make a scientific judgment” on whether a recession occurs this year, adding that the bureau “would not make that decision for another couple of years.”

When asked why the President had said that something that could not be defined was not going to happen, Mr. Schultz beamed like a man full of confidence in his present job, and even in his next one. He noted that a recession was hard to define because the economy was so complicated.

This act of definitional evasion prompted a biting quip from Arthur Okun, former economic advisor to Lyndon Johnson, who said “when Administration spokesmen begin to split hairs about what a recession is, you can be sure there will be one.” Okun was no stranger to playing definitional games with economic news, but in this case he turned out to be right. The U.S. economy entered into a deep recession in 1974 and would remain there until a rebound in the second quarter of 1975.

Notably, the 1974 recession did not immediately manifest in the unemployment rate. Although the economy went into a downturn in November 1973, unemployment remained relatively stable and hovered at around 5 percent until May 1974. It rapidly increased over the summer and fall, and peaked at 9 percent the next spring.

There’s a lesson for the Biden administration in the Nixon episode, although it is different from the lesson they appear to have taken. The White House’s definitional wordsmithing could not overcome the onset of worsening economic realities in 1974, and its frequent appeals to the NBER determination could not run down the clock against a prolonged recession. Faced with similar risks today, Biden’s advisors may well be stumbling their way into a repeat of the 1970s economic malaise.

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