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RESEARCH REPORTS

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 9 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including *Seeking Alpha*, *Intellectual Takeout*, *Mises Brasil*, and dozens of other outlets. To read all of them, go to

www.aier.org

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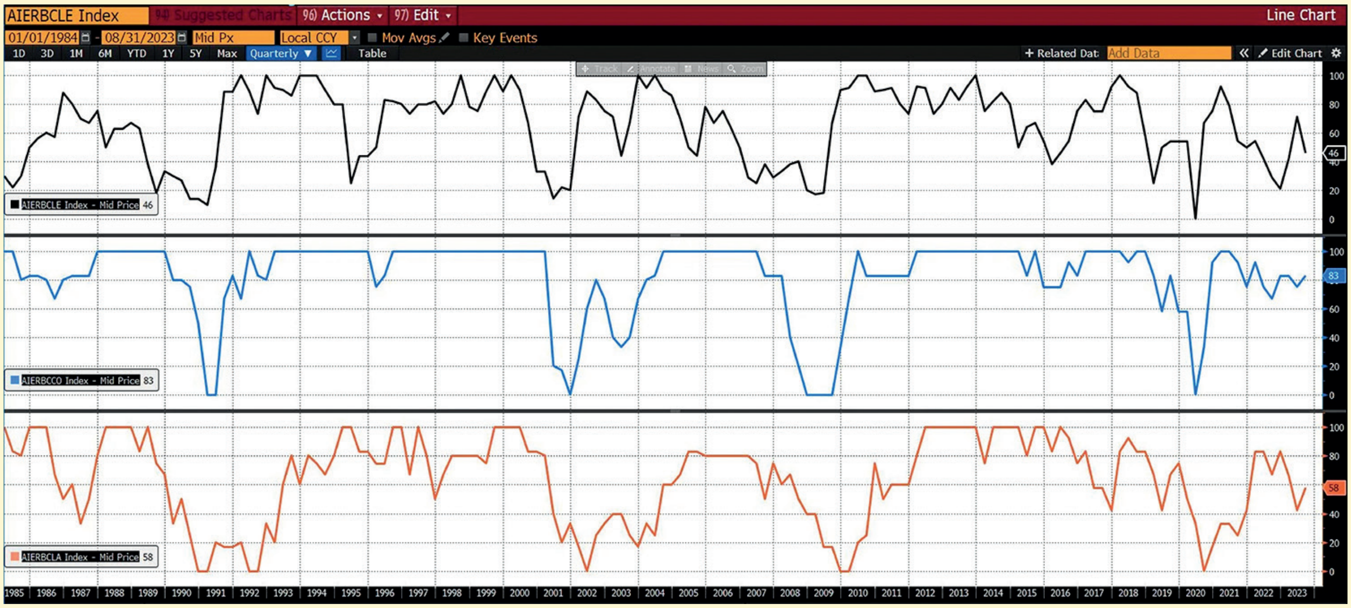
BUSINESS CONDITIONS MONTHLY

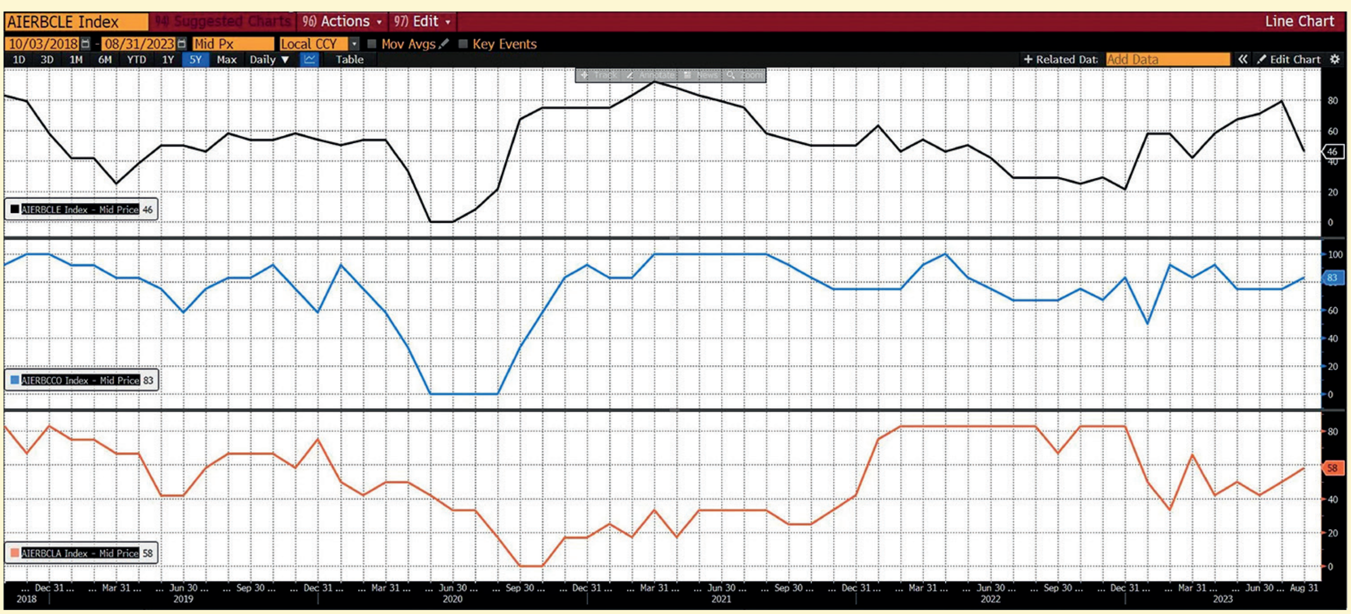
Peter C. Earle
RESEARCH FACULTY

n August 2023, the Leading Indicator in AIER's Business Condition Monthly metrics fell sharply. While the Roughly Coincident and Lagging Indicators edged up slightly (from 75 to 83 in the former, and from 50 to 58 in the latter), the Leading Indicator fell from 79 in July 2023 to 46 in August 2023.

AIER Business Conditions Monthly (5 years)



AIER Business Conditions Monthly (1985 – present)



Leading Indicators (46)

With the decline from 79 to 46, the Leading Indicator is at its lowest level since March 2023. This is the largest month-to-month decline in this indicator since it fell from 33 in April 2020 to 0 in May 2020.

Five of the twelve constituents rose, six declined, and one was unchanged/neutral. Rising from July to August 2023 were the US Initial Jobless Claims (8.73 percent), the Conference Board's US Leading Index of Manufacturers New Orders, Consumers Goods, and Materials (0.07 percent), the Conference Board's US Manufacturers New Orders of Capital Goods Excluding Aircraft (0.47 percent), Adjusted Retail and Food Service Sales (0.56 percent), and the 1-to-10 year US Treasury spread (10.12 percent).

Declining from July to August 2023 were the University of Michigan Consumer Expectations Index (-4.10 percent), the Conference Board's US Leading Index of 500 Stock Prices (-1.13 percent), the US Census Bureau's Inventory/Sales Ratio Total Business (-0.71 percent), US New Privately Owned Housing Units Starts (-11.64 percent), United States Heavy Truck Sales (-1.92 percent), and FINRA Debt Balances in Margin Accounts (-2.91 percent). US Average Weekly Hours (All Employees, Manufacturing) was unchanged.

Roughly Coincident (83) and Lagging Indicators (58)

The Roughly Coincident Indicator edged up from 75 in July to 83 in August, reattaining the broadly expansionary levels seen in February (92), March (83), and April (92) of this year. Five of the constituent indices increased, with one falling. Two of the three Conference Board indices (Coincident Manufacturing and Trade Sales and Coincident Personal Income Less Transfer Payments) rose 0.19 percent and 0.24 percent, respectively. Also ticking up in August were US Industrial Production (0.38 percent), US Employees on Nonfarm Payrolls (0.12 percent), and the US Labor Force Participation Rate (0.32 percent). The Conference Board's Consumer Confidence Present Situation declined 4.12 percent.

The Lagging Indicator also climbed from a neutral 50 to a slightly expansionary 58. Three of its constituents rose, two fell, and one was neutral from July to August. Average 30-day yields rose 0.38 percent, the Conference Board's US Lagging Average Duration of Unemployment increased by 0.97 percent, and the US Census Bureau's US Private Construction Spending (Nonresidential) climbed 0.45 percent. Core CPI fell 8.51 percent, the Conference Board's Lagging Commercial and Industrial Loans declined 0.35 percent, and US Manufacturing and Trade Inventories (Total) remained unchanged.

Discussion

In August and September, consumer confidence data registered a warning regarding economic growth through the remainder of the year.

The Conference Board's consumer confidence index fell sharply from 108.7 to 103.0, below consensus estimates of 105.5. Although consumers' views of the present circumstances improved slightly (146.7 to 147.1), both future expectations fell (83.3 to 73.7) and recession fears rose. In addition, consumer views of the current state of the labor market were generally positive, but expectations pertaining to the next six months continue to sour. Respondents expecting more jobs to be available in six months than are available now fell to 15.5 percent (from 17.5 percent the prior month) with those expecting the number of available jobs to decline rising from 18 percent to 18.9 percent. The broad decline in confidence was seen across all income levels, with the highest income brackets evincing the largest sag.

Polls of entrepreneurs show the same trend. The American Bankruptcy Institute reported just 1500 Subchapter V filings by the start of September 2023, more than the entire number of filings in 2022. Among a Vistage Worldwide poll of 750 small business owners, 52 percent reported thinking that the United States is approaching or already in a recession. And in a Goldman Sachs survey of 1500 small firms in late August, 73 percent of respondents named currently high/rising interest rates as detrimental to their businesses. This data, however, likely underestimates the level of commercial distress as an estimated 90 percent of small business wind-downs occur outside of court.

On top of the ongoing credit contraction, declining consumer and business confidence, and the fragile state of consumption, five potential shocks face the US economy in the coming several months. Three pose a direct threat to consumers.

First, tens of millions of Americans will be required to resume student loan payments in October, a siphoning off of consumption which one estimate holds could cut 0.3 percent from 4th quarter US Gross Domestic Product. A second is rising oil prices, and consequently rising prices at the pump. West Texas Intermediate prices have lifted from the high $60s/low $70s per barrel (bbl) in June 2023 to over $90 bbl in mid-September. A recent high of $93.68 on September 27th was the highest price since November 2022. Commensurately, gasoline has risen. The average price per gallon at US pumps has risen from roughly $3.80 to $4.00 per gallon to over $4.30 per gallon in mid-September. The third are rising interest rates, which of course make borrowing more costly. Since January 2023 the 6-month US Treasury bill yield has risen from 4.75 to 5.56 percent with the one-year US Treasury bill yield rising from 4.71 to 5.46 percent. Out on the long end, the 20-year US Treasury bill yield has risen from 4.14 percent to 4.90 percent.

The epicenter of a fourth potential shock is in Detroit, Michigan. The United Auto Worker strike which began on September 15th marks the first time in history that all of the Big Three automakers (General Motors, Ford Motor Company, and Stellantis) have been hit at once. Because automotive supply chains are global and the production of a single automobile requires upward of 15,000 parts from scores of firms of various sizes, the strike may have a substantial impact on employment and economic growth. The 54-day strike of between 9,000 and 10,000 General Motors workers in 1998 resulted in 150,000 jobs lost. Although the structure of the auto industry and production methods have changed in the last quarter century, the expansion of the strikes to 25,000 additional workers in the last week of September is likely to generate knock-on effects. It may be that, seeing the vulnerable state of the economy, union officials think the current administration's worrisome polling is likely to prompt intervention on their behalf.

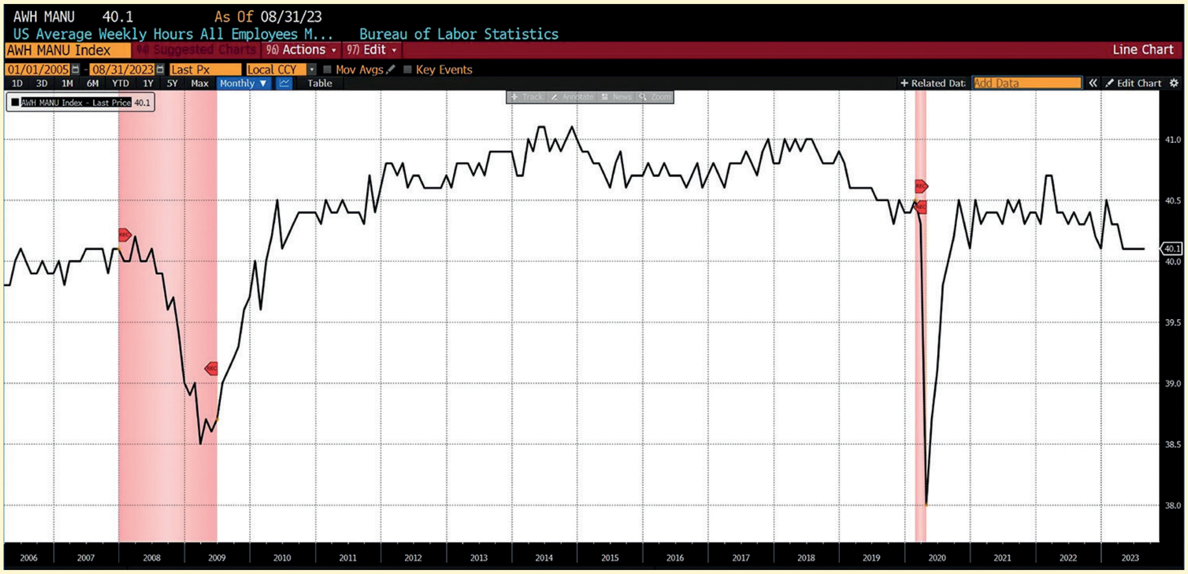
Finally, although a government shutdown was averted in a 45 day deal, it seems unlikely that between now and mid-November the hyperpartisan character of US political discourse will diminish. Risks may resurface at that time. Although estimates of the macroeconomic losses attributable to a shutdown are small (estimated at a reduction of 0.2 percent of GDP for each week of closure), a greater risk resides in the likelihood of severe financial market volatility. Since early August the S&P 500 index has lost just under 7 percent of its value amid a backdrop of political stagecraft. But lest we dismiss the capers in Washington D.C. as so much rank theater and regardless of the sincerity of either side, on June 16, 2023 the US Treasury total public debt outstanding surpassed $32 trillion for the first time. On September 28, 2023, the US public debt surpassed $33 trillion, an astonishing $1 trillion of new debt incurred by the

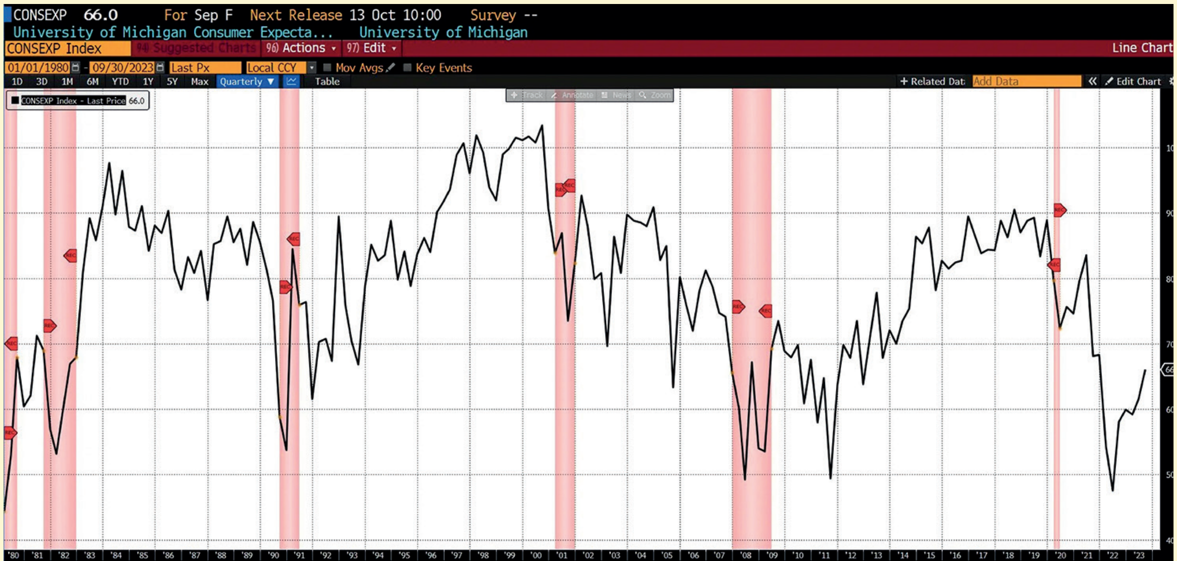
United States in a mere 94 days. In the 13 days between September 28th and October 1st, 2023 an additional $126 billion has been taken on with nary an indication of moderation in sight.

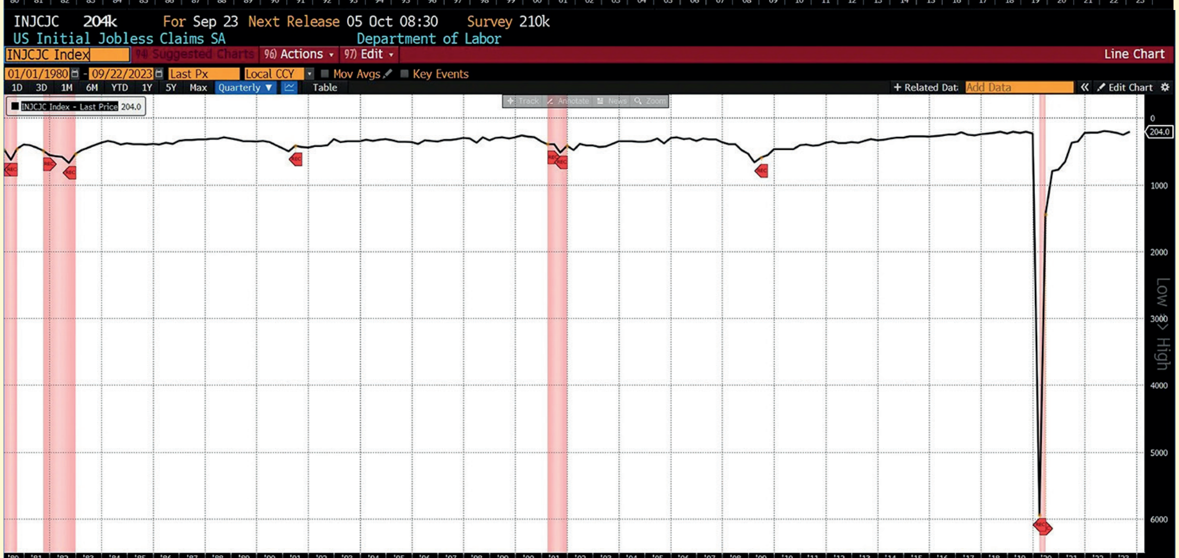
It is in the extremes that forecasts tend to find a quick and silent but rarely painless demise. We must consider the possibility that the extraordinary nature of fiscal, monetary, and other interventions during the COVID pandemic and subsequent upsurge in inflation have warped and perhaps destroyed long-observed relationships between consumption, sentiment, and other economic indicators. This may account for conflicting trends in recent economic data releases and even the seemingly random gyrations within AIER's Business Conditions Monthly indicators.

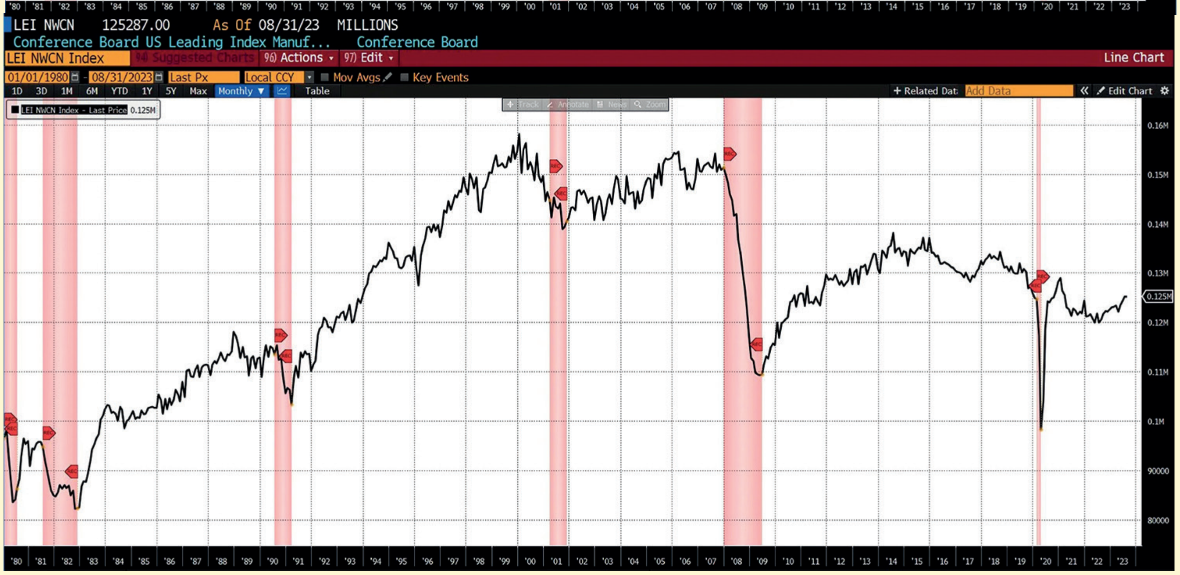
There remains the distinct possibility that Friedman's 'long and variable lags' are much longer and more variable than expected. The polls and surveys upon which so many data series rely may have tipped into ineffectuality. It may well be that accurate means of measuring aspects of the post-COVID US economy require the identification of new variables or the determination of new or improved sources of statistics and information. As social scientists, we remain alert for and open to cogent, economically sound and well-reasoned hypotheses pertaining to the current state of the economy. Presently, though, our expectation of a US recession on or before August 2024 remains undeterred.

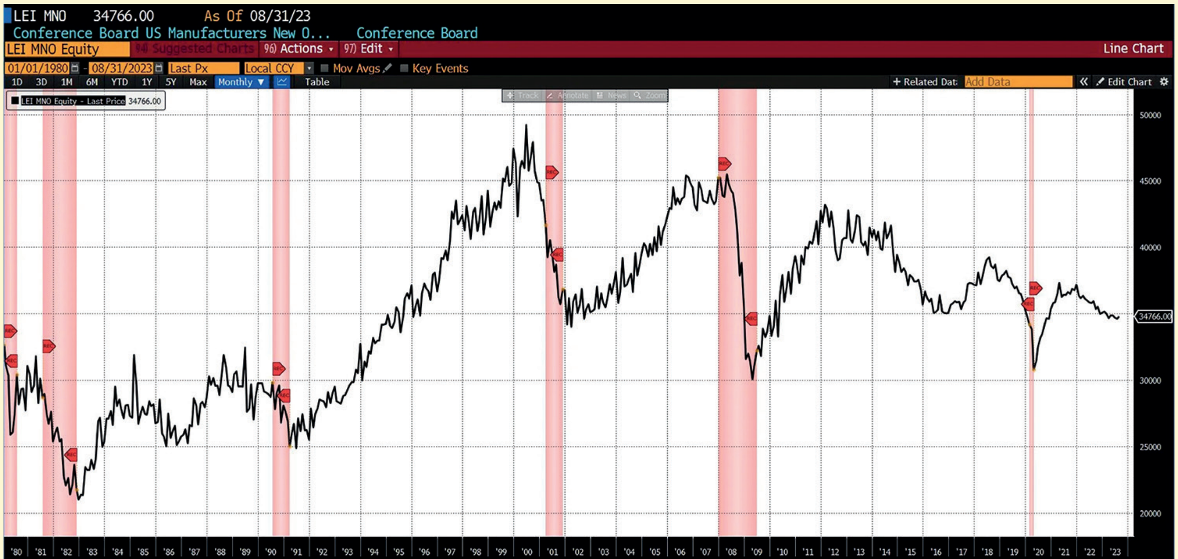
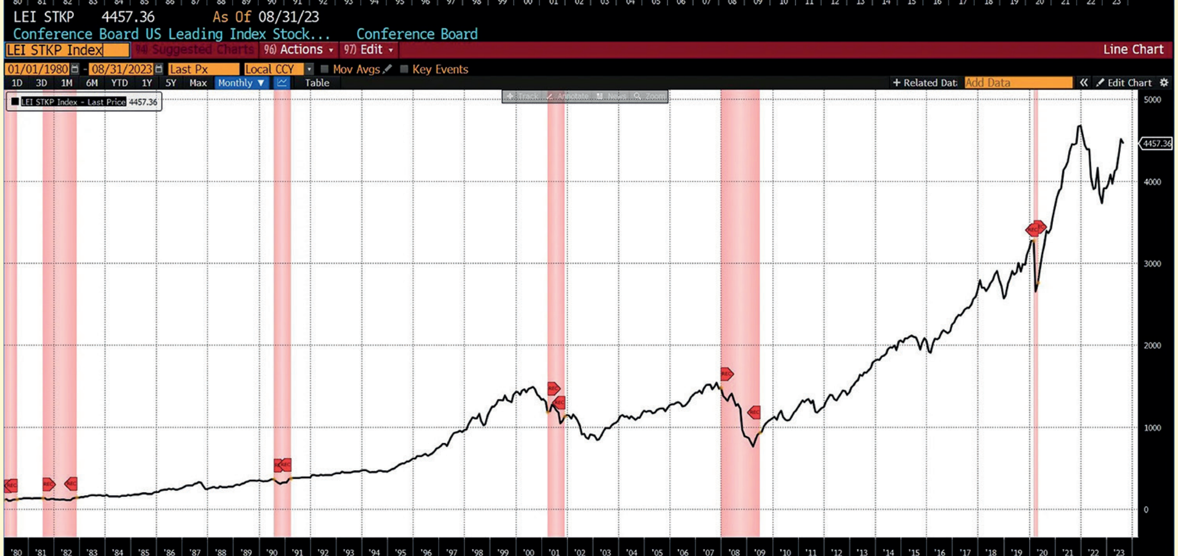
LEADING INDICATORS




CONSEXP 66.0 For Sep F Next Release 13 Oct 10:00 Survey --
University of Michigan Consumer Expecta... University of Michigan
CONSEXP Index
Line Chart
01/01/1980 - 09/30/2023 Last Px Local CCY Mov Avgs Key Events
Quarterly

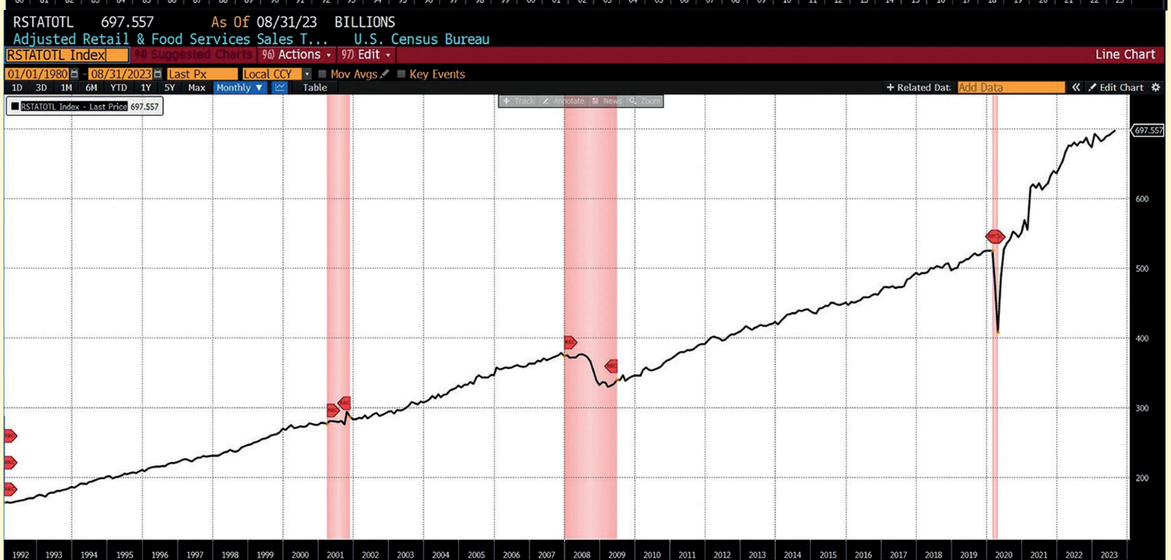

INJCJC 204k For Sep 23 Next Release 05 Oct 08:30 Survey 210k
US Initial Jobless Claims SA Department of Labor
INJCJC Index
Line Chart
01/01/1980 - 09/22/2023 Last Px Local CCY Mov Avgs Key Events
Quarterly


LEI NWCN 125287.00 As Of 08/31/23 MILLIONS
Conference Board US Leading Index Manuf... Conference Board
LEI NWCN Index
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
Monthly


LEI MNO 34766.00 As Of 08/31/23
Conference Board US Manufacturers New O... Conference Board
LEI MNO Equity
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
LEI MNO Equity - Last Price 34766.00
50000
45000
40000
34766.00
30000
25000
20000
'80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20 '21 '22 '23

LEI STKP 4457.36 As Of 08/31/23
Conference Board US Leading Index Stock... Conference Board
LEI STKP Index
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
LEI STKP Index - Last Price 4457.36
5000
4457.36
4000
3000
2000
1000
0
'80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20 '21 '22 '23

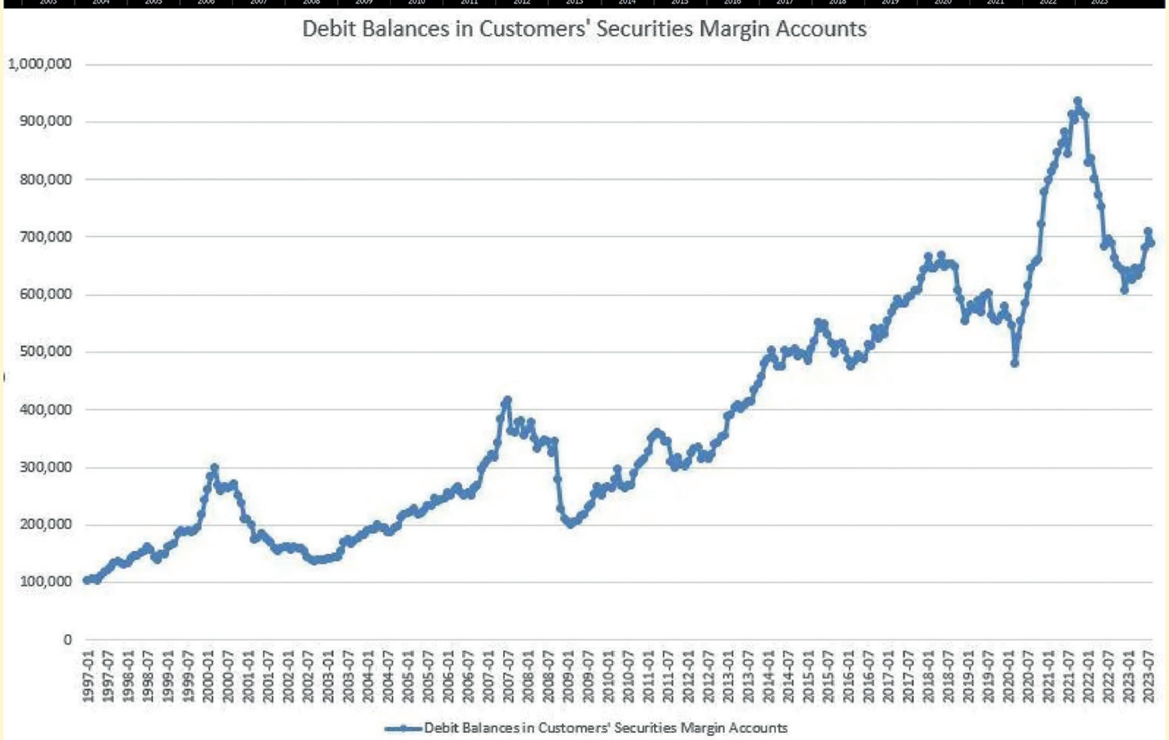
MGT2TB 1.39 As Of 07/31/23 SA
Inventory/Sales Ratio : Total Business U.S. Census Bureau
MGT2TB Index
Line Chart
01/01/1980 - 07/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
MGT2TB Index - Last Price 1.39
1.70
1.60
1.50
1.39
1.30
1.20
'81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20 '21 '22 '23


NHSPSTOT 1283k For Aug Next Release 18 Oct 08:30 Survey --
US New Privately Owned Housing Units St... U.S. Census Bureau
NHSPSTOT Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat Add Data Edit Chart
2000
1500
1000
500
1283
'80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20 '21 '22 '23

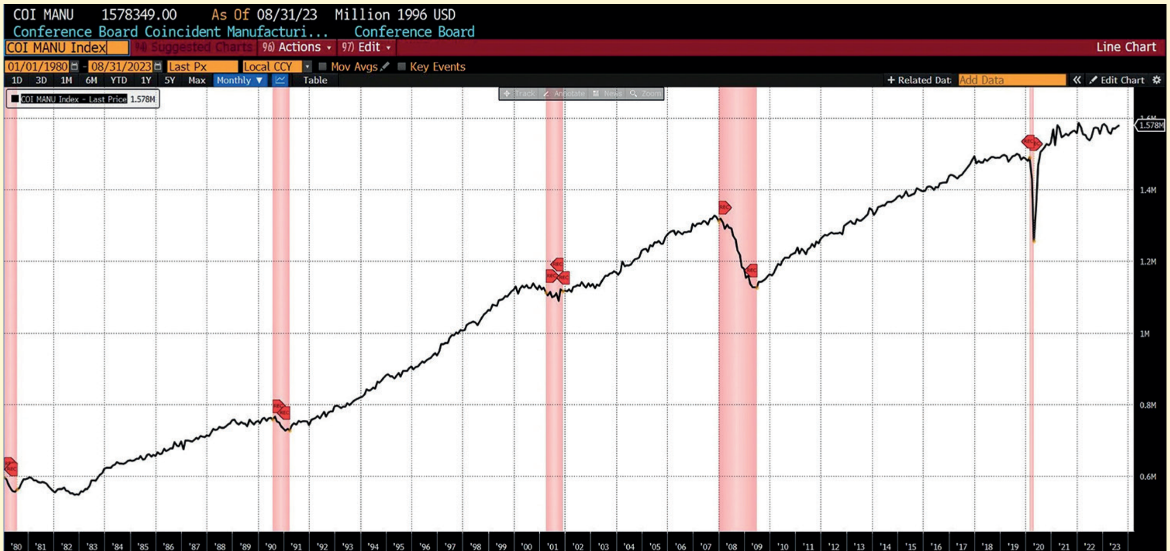

RSTATOTL 697.557 As Of 08/31/23 BILLIONS
Adjusted Retail & Food Services Sales T... U.S. Census Bureau
RSTATOTL Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat Add Data Edit Chart
697.557
600
500
400
300
200
1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

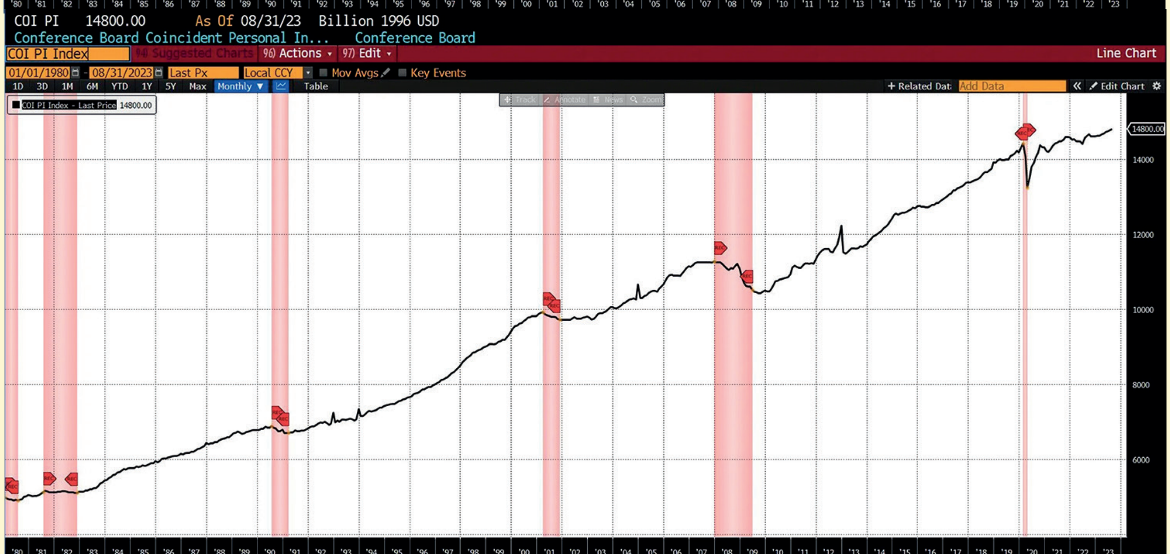

USASHVTK 0.544 As Of 08/31/23 Millions
United States Heavy Trucks Sales SAAR Bureau of Economic Analysis
USASHVTK Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 08/31/2023 Last Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat Add Data Edit Chart
0.600
0.544
0.500
0.400
0.300
0.200
'80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20 '21 '22 '23

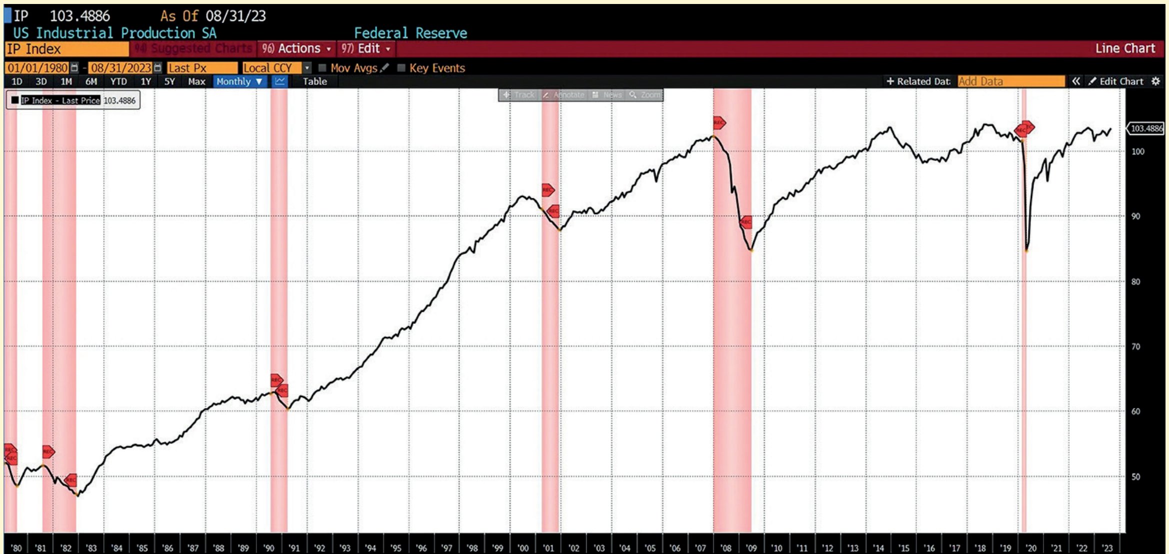

USYC1Y10 -87.592 +2.879 -87.592 / -82.180
At 21:07 Op -90.403 Hi -86.974 Lo -90.745 Prev -90.471
USYC1Y10 Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 08/31/2023
Last Px
Local CCY
Mov Avgs
Key Events
1D 3D 1M 6M YTD 1Y 5Y Max
Monthly
Table
+ Related Data
Add Data
Edit Chart
USYC1Y10 Index - Last Price -129.272
-200
-100
0
100
200
300
-129.272
Low => High
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

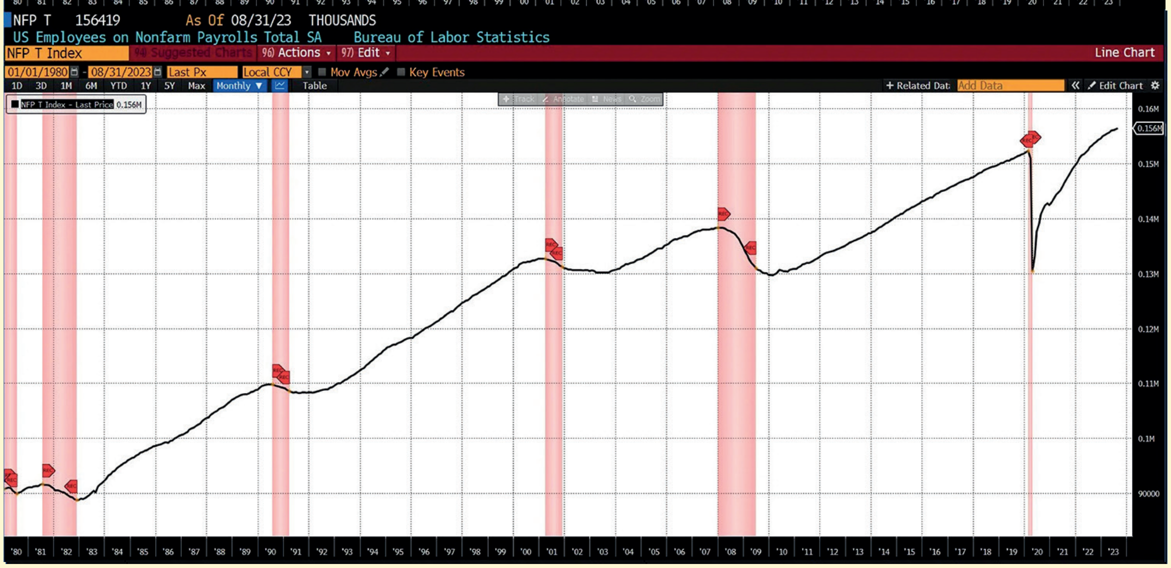

Debit Balances in Customers' Securities Margin Accounts
1,000,000
900,000
800,000
700,000
600,000
500,000
400,000
300,000
200,000
100,000
0
1997-01 1997-07 1998-01 1998-07 1999-01 1999-07 2000-01 2000-07 2001-01 2001-07 2002-01 2002-07 2003-01 2003-07 2004-01 2004-07 2005-01 2005-07 2006-01 2006-07 2007-01 2007-07 2008-01 2008-07 2009-01 2009-07 2010-01 2010-07 2011-01 2011-07 2012-01 2012-07 2013-01 2013-07 2014-01 2014-07 2015-01 2015-07 2016-01 2016-07 2017-01 2017-07 2018-01 2018-07 2019-01 2019-07 2020-01 2020-07 2021-01 2021-07 2022-01 2022-07 2023-01 2023-07
Debit Balances in Customers' Securities Margin Accounts

ROUGHLY COINCIDENT INDICATORS

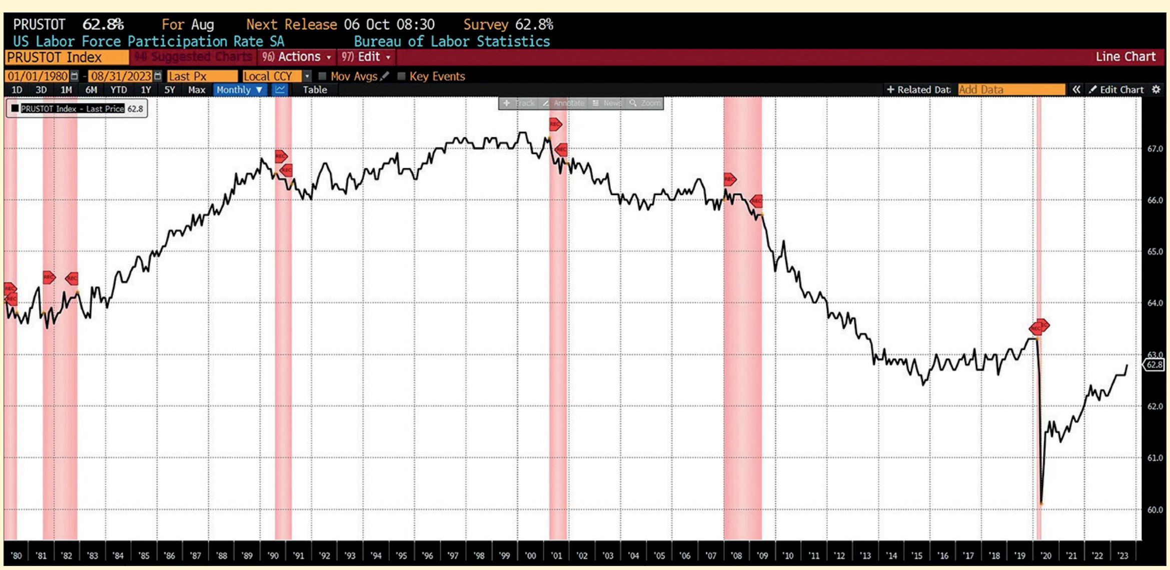


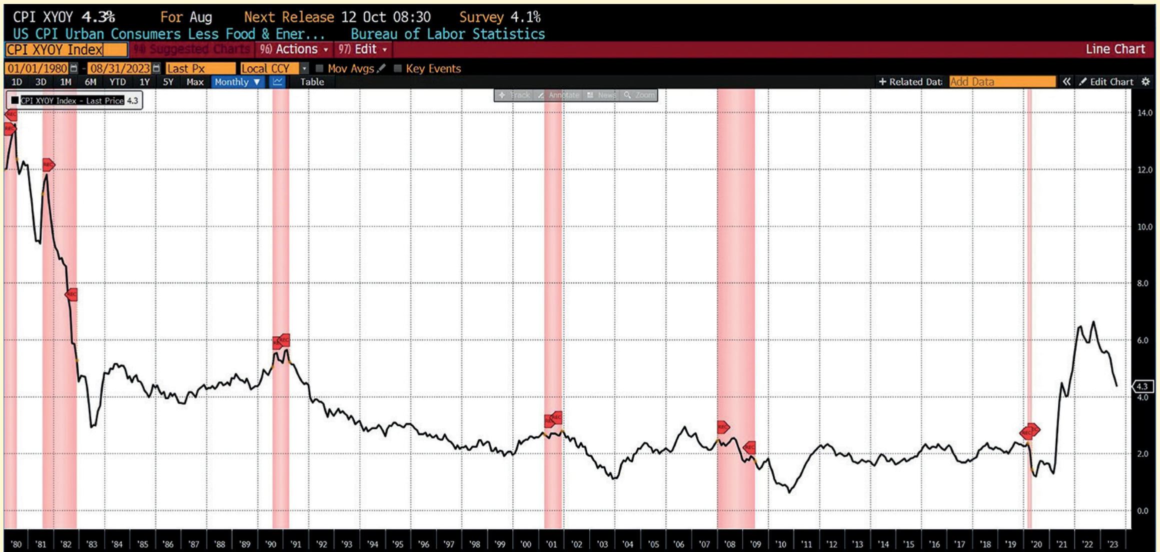




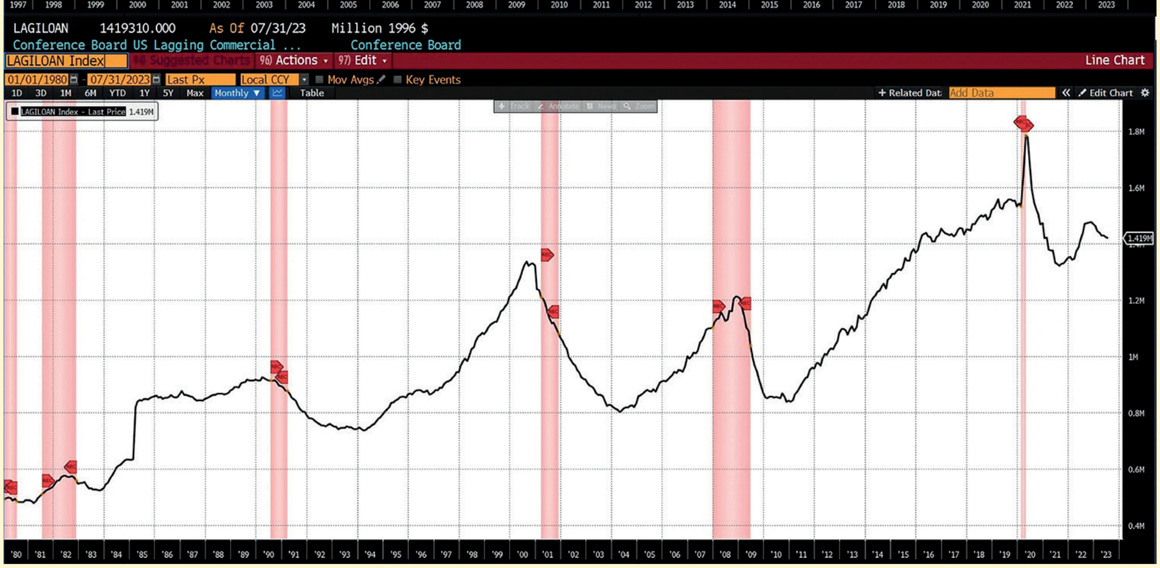


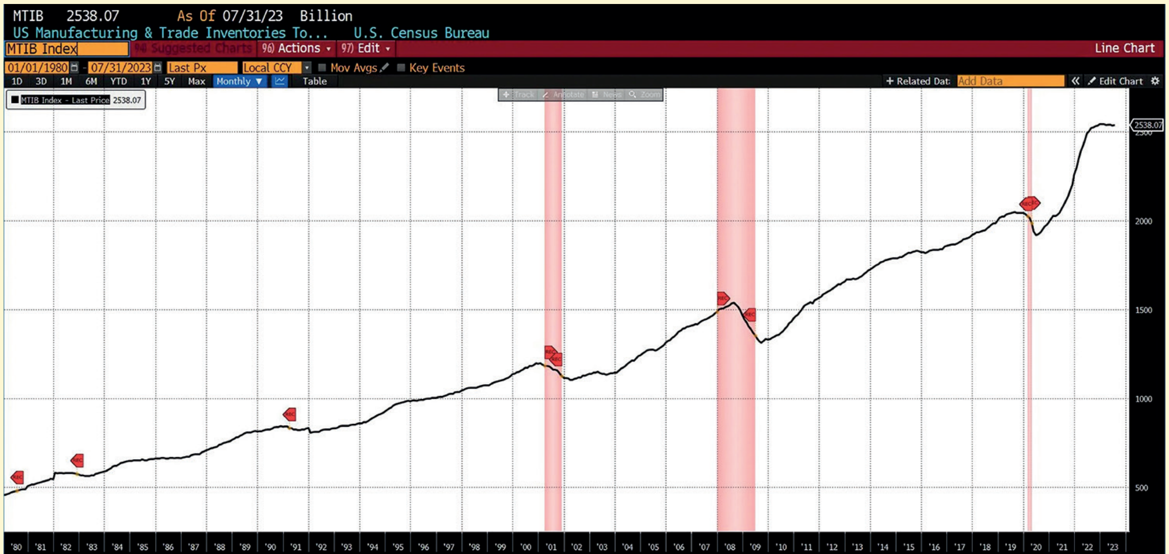
LAGGING INDICATORS

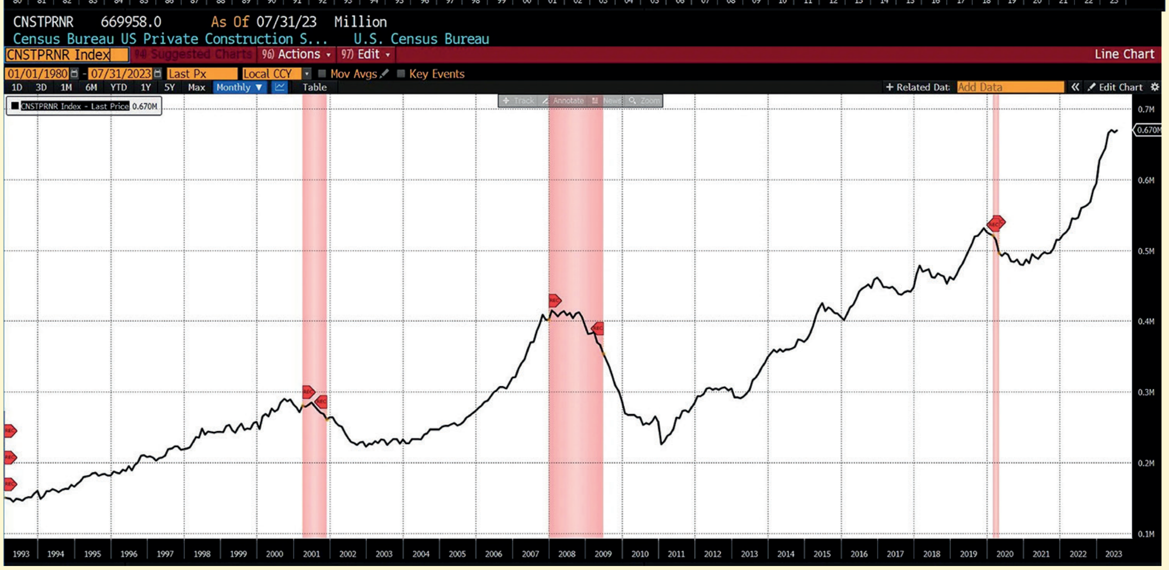



CPI XYOY 4.3% For Aug Next Release 12 Oct 08:30 Survey 4.1%
US CPI Urban Consumers Less Food & Ener... Bureau of Labor Statistics
CPI XYOY Index
Line Chart


DCPB030Y 5.38 +.04 0.00/0.00
At 9/29 Op 5.38 Hi 5.38 Lo 5.38 Prev 5.34 Vol 0
DCPB030Y Index
Line Chart


LAGILOAN 1419310.000 As Of 07/31/23 Million 1996 $
Conference Board US Lagging Commercial ... Conference Board
LAGILOAN Index
Line Chart





CAPITAL MARKET PERFORMANCE

Ticker		Short Name	%1M	%3M	%1YR	3 Year Annualized	5 Year Annualized	10 Year Annualized
SPR		S&P 1500 Composite Index	-5.16%	-3.74%	+18.96%	10.2962	9.4685	11.5252
SPXT	d	S&P 500 Total Return	-4.94%	-3.27%	+21.62%	10.1599	9.9048	11.8331
SPX	d	S&P 500 INDEX	-5.04%	-3.65%	+19.59%	10.1395	9.8879	11.8177
MID	d	S&P 400 MIDCAP INDEX	-6.28%	-4.58%	+13.55%	12.0181	6.0225	8.9080
RTY	d	RUSSELL 2000 INDEX	-7.07%	-5.49%	+7.23%	7.1332	2.3597	6.6136
SXXP	d	STXE 600 (EUR) Pr	-1.73%	-2.54%	+16.08%	11.1668	6.6816	7.2966
TLT US	d	ISHARES 20+ YEAR	-6.49%	-13.84%	-13.43%	-16.6615	-3.3833	.5615
QLTA US	d	ISHARES AAA - A	-2.34%	-4.45%	-.64%	-5.6252	.4267	1.6597
CRY	d	TR/CC CRB ER Index	+.06%	+8.60%	+6.05%	24.2266	7.8233	-.0854
XAU		Gold Spot $/Oz	-4.99%	-3.95%	+8.58%			
XAG		Silver Spot $/Oz	-8.31%	-4.02%	+6.25%			
ILM3NAVG		Bankrate 30Y Mortgage Rates Na	+2.79%	+7.95%	+13.32%			
ILM1NAVG		Bankrate 15Y Mortgage Rates Na	+1.32%	+6.15%	+15.00%			
MB301ARM		5 Year ARM	-.46%	+6.24%	+22.08%			
ILA3NAVG		Bankrate 30Y Fixe Mtg Refis Na	+1.63%	-1.32%	+31.75%			

(All charts and data sourced via Bloomberg Finance, LP)

– October 2, 2023

Freedom of Choice in Education: the Origins of a Slogan

PHILLIP W. MAGNESS

F.A. Hayek Chair in Economics and Economic History

American Federation of Teachers leader Randi Weingarten is currently taking heat for her attempts to revive an old smear against school vouchers. In a recent interview, the teacher's union boss claimed that pro-voucher slogans about "choice" were really coded dog whistles from the segregationist era.

Weingarten has a long history of falsely claiming that vouchers originated as part of the backlash against the 1954 desegregation ruling of *Brown v. Board of Education*. In reality, the concept of school choice traces back centuries prior. It can be found in the works of classical liberal philosophers Adam Smith, Thomas Paine, and John Stuart Mill, all of whom were also outspoken antislavery men. As a matter of education policy, the first voucher programs came to the United States in the late 19th century, when towns in rural New England set up a town-based tuitioning system that offered students a choice in public schooling.

Voucher opponents have nonetheless pushed the line that the idea grew out of the segregationist backlash to *Brown v. Board* in the 1950s south. In addition to its anachronism, this claim is at odds with historical evidence. In Virginia, which adopted a voucher-like tuition grant system in 1959, several segregationist hardliners mounted a campaign against the program. According to their openly racist arguments, vouchers would open the door to the "negro engulfment" of formerly all-white public schools by giving African-American students the ability to transfer schools. This practice undermined some of the main segregationist tactics for slowing the implementation of *Brown*: the use of enrollment caps, geographic zoning, and other barriers to impede the enrollment of black students.

Weingarten's own union forebears had direct culpability in these racist actions. The Virginia Education Association, the state's largest teachers' union, linked arms with segregationist attorney John S. Battle, Jr. to attack the tuition grants. In 1961, the union launched a lobbying campaign to restrict their use after a Richmond newspaper reported that many parents were using the grants to move their children out of segregated schools and into integrated institutions.

In this case, Weingarten's latest argument carries the added twist of a new historical falsehood.

In January of 1959 that year, the Virginia assembly was thrown into chaos after a pair of court rulings struck down the segregationist "Massive Resistance" program of US Senator Harry Flood Byrd and his political machine. Seizing the opportunity to outflank Byrd, an unusual coalition of moderate segregationist "cushioners" and anti-segregationists, the latter mostly from the Northern Virginia suburbs of Washington D.C., crafted a race-neutral tuition grant program as part of a replacement for "Massive Resistance." Supporters dubbed the tuition grant system a "freedom of choice" program, which is the basis of Weingarten's claim about language and the coding thereof.

As we dig deeper into the evidence though, an added complication emerges. The tuition grant provision originated on a subcommittee of the specially-convened Perrow Commission on Education, which was tasked with a legislative response to the court rulings. On that subcommittee sat Sen. John A.K. Donovan, an anti-segregationist from

Northern Virginia. During the Massive Resistance era, Donovan provided one of the only consistent votes against the Byrd machine. He made a name for himself after Brown v. Board by denouncing legislative harassment of the NAACP by the Byrd machine.

Senator Donovan was also a voucher supporter with close ties to the Catholic voucher advocacy group, Citizens for Educational Freedom (CEF). Records from the legislative proceedings indicate that Donovan was one of the main drafters of the tuition grant bill's language

This historical detail matters, because in 1961 Donovan recounted these events in a letter to Father Virgil Blum, a priest at Marquette University who directed CEF's national voucher advocacy efforts. Blum himself was an outspoken anti-segregationist, and encouraged his organization – with Donovan's assistance – to file amicus briefs in the ongoing court battles against Prince Edward County, Virginia, a "Massive Resistance" holdout that shuttered its school system to prevent integration.

In their 1961 correspondence, Blum noted that he had made use of the "freedom of choice" slogan to advocate for vouchers. As Donovan quipped in return, "incidentally, I am to blame for Virginia's school plan being titled 'freedom of choice.'" He recounted that he used this phrase in a press statement as the bill was being unveiled. Thereafter, "the Governor and the press called it the 'freedom of choice plan.'"

Blum responded to Donovan, stating "I am happy that you supplied the title 'freedom of choice' to the Virginia school plan. If this term should receive a general acceptance throughout the United States, it would serve to point up the fundamental issue of the civil rights of parents in the choice of a school for the education of their children." Blum had a reason of his own to appreciate the slogan. Around the same time as the events in Virginia, he published a short book entitled *Freedom of Choice in Education*, laying out the philosophical case for school vouchers.

As these details reveal, the language of "choice" traces back to a voucher-supporting state senator and a voucher-supporting Catholic priest. Incidentally, that state senator provided a lonely voice against the very same segregationist "Massive Resistance" movement that Weingarten invokes to smear voucher advocates today. And the same Catholic priest denounced the segregationist alliances that Virginia's teachers union embraced.

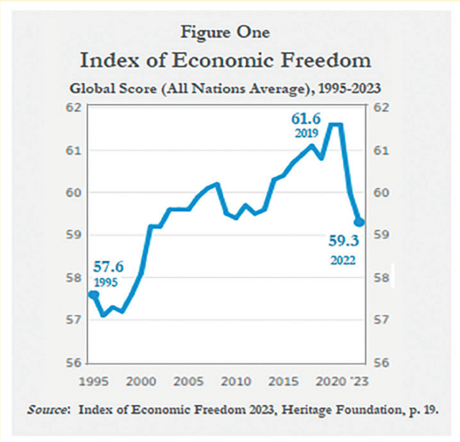
– September 16, 2023

The Multiyear Decline in US Economic Freedom

RICHARD M. SALSMAN

Senior Fellow

Economic freedom in the world has plunged in recent years, due mainly to the interventions and fiscal-monetary profligacy associated with COVID shutdowns, mandates, and subsidies. The global measure is given in Figure One. This is a significant reversal of freedom's increase between 2010 and 2019. But the downtrend is much worse and more prolonged in the US.



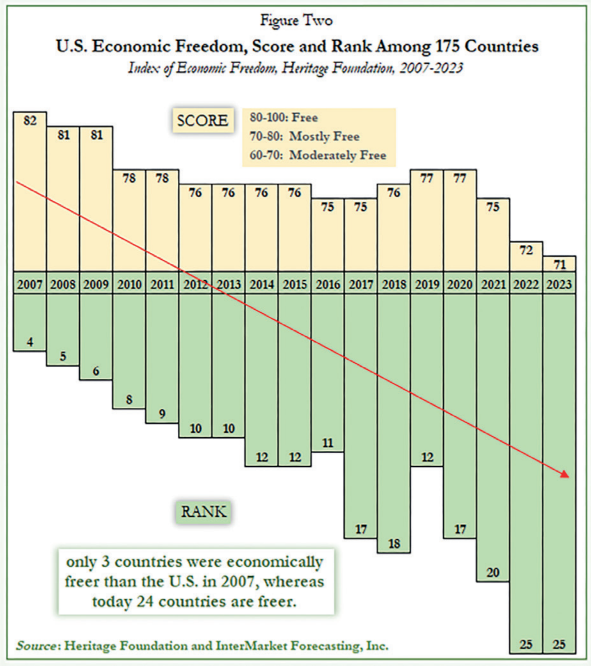
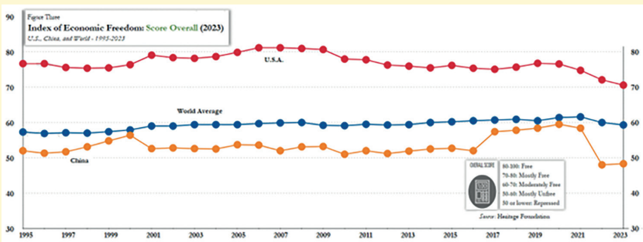


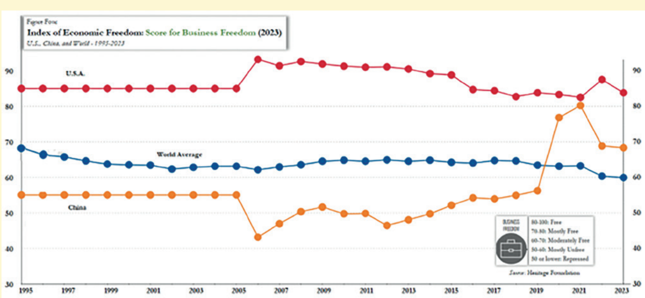
Figure Two makes clear that economic freedom in the US also has declined significantly, but it's done so since the financial crisis and "Great Recession" of 2007-09, not only amid COVID lockdowns. The overall score for the US was 82 in 2007 (out of a maximum of 100) but is only 71 today. In this time the US has moved from the category of "Free" (80-100) to "Mostly Free" (70-80) to the precipice of becoming merely "Moderately Free" (60-70). In 2007 only three countries were economically freer than the US, but by 2015 eleven nations were. Today, 24 are freer (including Canada, Chile, Czech Republic, Denmark, Estonia, Finland, Germany, Ireland, Latvia, Norway, South Korea, and Sweden).

In 2007 the three countries economically freer than the US were Hong Kong, Singapore, and Australia. Hong Kong was ranked #1 every year from 1995 to 2019 (and #2 in 2020), but was then summarily omitted from the rankings by the Heritage Foundation under the mistaken claim that its economic policies were suddenly "controlled from Beijing." Heritage did this in response to Hong Kong's government precluding violent insurrectionists (who posed as "champions of democracy") from taking over the local legislature. For the Heritage perspective, see Edwin J. Feulner's, "Hong Kong Is No Longer What It Was," wherein he admits that the editors of the Index recognize that Hong Kong "offers its citizens more economic freedom than is available to the average citizen of China." For Hong Kong's view, see "Hong Kong Minister Blasts City's Disappearance from 'World's Freest Economies' Rankings."

Figures Three, Four, and Five depict the trend of scores since 1995 for the US, the World average, and China, along three measures: overall economic freedom (Figure Three), business freedom (Figure Four), and trade freedom (Figure Five).



Overall (Figure Three), US economic freedom has declined since 2007 while the world average has held steady (at around 60). On business freedom (Figure Four), China has become much freer and the US less so since 2006. According to Heritage, the "Business Freedom" metric measures "an individual's ability to establish and run an enterprise without undue interference from the state" and without "burdensome and redundant regulations."



On trade (Figure Five), China became substantially freer during the decade of 1995-2005 and has maintained that level since then, while US economic freedom, after being steady through 2005, has eroded since then (especially since 2019, due to Trump's trade wars).

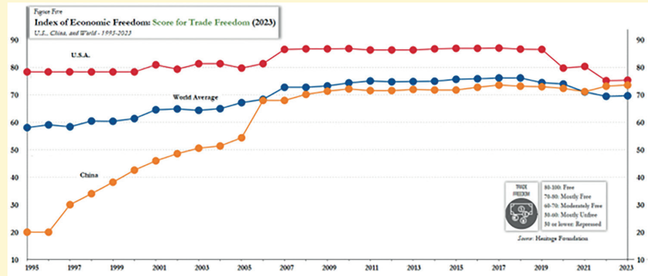
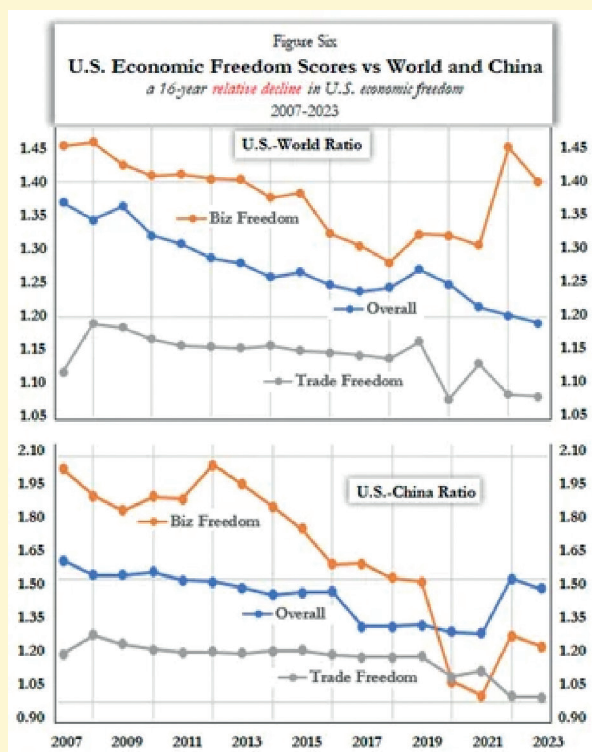


Figure Six depicts relative scores (ratios) for the US versus the world average and China, again using the overall measure, the business freedom metric, and the trade freedom metric. The US-World Ratio for the overall index has declined 13 percent, from 1.37X in 2007 to 1.19X in 2023. The US-China Ratio for trade freedom fell 16 percent in the year before Trump became president (1.21X in 2015) to today (1.02X, as Biden hasn't rescinded or reduced the Trump tariffs). The US-China Ratio for business freedom plummeted 37 percent, from 1.95X in 2007 to 1.23X in 2023 – due to China's absolute measure increasing by 46 percent while the US absolute measure declined by 8 percent.



Why does this matter? Most people, including many professional economists and data analysts (who should know better) seem to cling to the impression that US economic freedom is high and stable, while China has become less free economically. The facts say otherwise, and the facts should shape our perceptions and theories. Human liberty also should matter; much of our lives are spent engaged in market activity, pursuing our livelihoods, not in political activity. Finally, as a rule (which is empirically supported) less economic freedom results in less prosperity.

Neither major US political party today seems much bothered by the loss of economic freedom. They don't talk about it. It's not that a model of the proper policy mix isn't available, for it was adopted in 1980s and 1990s as "Reaganomics" in the forms of supply-side economics and neo-liberalism. Each has been out of fashion for most of this century – and it sure shows, especially in the freedom indexes. So-called "Bidenomics" now pledges the precise opposite set of policies, both supply-crushing and illiberal, and likely to move the economy from slow growth to no growth to "de-growth." Without a reversal in the trend of declining economic freedom in the US, we'll likely be suffering more from less liberty, less supply growth, and less prosperity.

– September 25, 2023

Wishful (Protectionist) Thinking

PAUL MUELLER

Senior Research Fellow

If something sounds too good to be true, it probably is.

That is especially true when it comes to economic policy. Take, for example, a recent column by the Coalition for a Prosperous America (CPA) which claimed that a 10 percent increase in tariff rates, as recently proposed by Donald Trump, will increase real household incomes "by nearly $8000," create "3.3 million new jobs," and generate $300 billion in new tax revenue.

Those results are too good to be true. And you could only get such results by torturing the data (or the model) until it confesses.

The CAP claims that the standard Global Trade Analysis Project model has incorrect elasticities for productivity and factor supply. They also claim that US prices are often meaningfully different and independent of world prices, and that prices adjust imperfectly because of imperfect competition which means output changes in the face of higher tariffs rather than prices.

Correct these errors and "voila," tariffs generate massive economic growth! The problem, however, is that they will not.

If the CPA think they can overturn two centuries of theory and evidence about the economic damage caused by protectionism, they will have to do better than tweak a few variables.

For one thing, the CPA assumes that creating new domestic productive capacity will be easy and quick. It won't. Such things take time. For another, they discount the possibility of export-demand falling significantly—especially if other countries retaliate with higher tariffs on American goods.

Nor does the CPA report account adequately for how consumers will be worse off due to higher prices. Furthermore, they seem to ignore the increased costs of doing business in the rest of the economy due to higher tariffs increasing the cost of labor, materials, and other inputs.

But here is the main problem with the CPA report: Economists disagree about many things, but they overwhelmingly agree that free trade generates greater production and wealth than protectionist policies like tariffs. The textbook logic of comparative advantage, that specializing and trading improves our lives, can be seen at every level of life.

People don't cook every meal at home in order to increase their family output. Nor do they make their own clothes, cars, or electronics. Instead, they specialize in their employment activity and trade for everything else. The same phenomenon occurs between businesses, between towns and cities, and between countries.

The father of economics, Adam Smith, explained how specialization brought about through the division of labor increases productivity. People become far better at specialized tasks they perform routinely and waste less time switching between tasks when they have fewer of them. This specialization increases people's knowledge of their specific tasks, and it rewards them for developing even minor time or labor-saving improvements.

But why do some nations have more extensive division of labor, deeper specialization, and therefore much greater productivity than other nations?

Smith argued that it is not profitable for companies to specialize in making pins (to take

Smith's famous example), if they end up producing far more pins than consumers are willing to buy. But as the pin producer cuts back on his production, and scales back his workforce, he also reduces the specialization, and therefore the productivity, of his employees. As more industries scale back production and reduce specialization, a country becomes less productive.

Larger markets, by contrast, generate greater specialization. Observe how one's consumer and job options multiply when you move from a small town to a large city. Specialized producers—whether of food, music, finance, fashion, or industry—are far more numerous in urban centers because of larger markets. Specialization and productivity also increase when the market's size extends across national borders.

But tariffs like those proposed by the CPA reduce the extent of the market and thereby reduce specialization. They place barriers on the flow of goods and services, and they increase the costs of doing business, thereby undermining productivity. Consider the likely effects of raising tariffs along the lines proposed by the CPA.

Protected industries will face less competition from abroad as foreign competitors pay higher taxes to sell their goods in the US. Prices of protected goods will rise. The subsequent decline of competitive pressures means that prices will rise.

That's good for protected domestic producers (the people that the CPA represents) because they will see windfall profits, at least initially. This will lead to expansion by existing producers, entry by new domestic competitors, and an increase in employment and output of the protected industries.

The gains to protected industry come not from increased productivity, however, but from higher prices. Unfortunately, marginal productivity in protected industries will decline over time as the costs of industry-specific goods rise—such as capital equipment, specialized labor, specific inputs, and the like.

As for non-protected industries, they will also find the cost of doing business rising, because inputs are more expensive, labor is more expensive, and higher prices in protected industries will take a higher share of consumer dollars. American exporters will see foreign demand for their goods decline—both because foreigners have less revenue to spend and because other countries will likely enact retaliatory tariffs. Overall, the economy loses productivity because specialization must lessen as the extent of the market shrinks.

Finally, this proposal ignores the significant costs of rent-seeking. Raising tariffs encourages waste and corruption as protected firms devote more resources to lobbying federal and state legislators and regulators, and fewer resources to innovating or increasing production.

When we take all these facts into account, the CPA's claims about how tariffs will make Americans and the American economy better off look more than shaky.

They become, in a word, unbelievable.

– September 28, 2023

Why Are Mortgage Rates So High?

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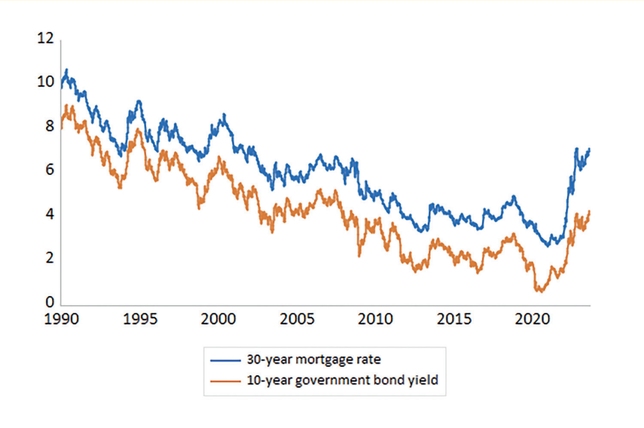
Thirty-year mortgage rates were over 7 percent at the end of August 2023, a level not seen (other than two isolated weeks) since 2002. Why are mortgage rates so high?

Factors commonly mentioned are important. Interest rates are higher due to the Federal Reserve's increases in rates from their near-zero levels. These higher rates indicate some combination of higher expected inflation and higher expected real interest rates.

These higher short-term rates are reflected in higher long-term rates and higher yields to maturity on government bonds. This indicates that the higher short-term rates are expected to persist.

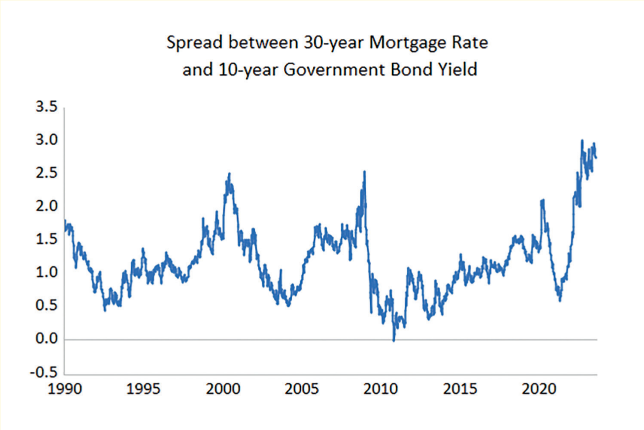
Mortgage rates are most commonly compared to yields on 10-year government bonds. While 30-year mortgages could potentially be paid off after 30 years, most mortgages are paid off much sooner. The maximum possible term to maturity for mortgages is much longer than the actual typical term to maturity. Government bonds are nominally risk free and risky mortgages can be usefully compared to them. The 10-year government bond is used for comparison instead of other bonds because the 10-year bond has a more similar maturity than it might seem and because it is much more liquid than longer-term government bonds.



The figure above shows why the 10-year government rate is used for comparison. Many of the larger and even smaller changes in 10-year government bonds are reflected in 30-year mortgage rates. Hence, part of the recent rise in mortgage rates simply reflects the rise in risk free long-term interest rates, such as the 10-year government bond yield.

The thirty-year mortgage rate hit its lowest level in 30 years the week of January 4, 2021; the rate was 2.66 percent. Since then it has risen to reports of rates as high as 7.5 percent last week. The 30-year mortgage rate averaged 7.09 percent for the week ending Thursday, April 14. This is an increase of 4.44 percentage points from the rate in January 2022. Over the same period, the yield on 10-year government bonds increased quite a bit also, but only 3.23 percentage points. The spread between the mortgage rate and the 10-year government bond yield has widened from 1.66 percent to 2.86 percentage points.

The figure below shows the spread between the 30-year mortgage rate and the 10-year government bond yield. (The spread with the 30-year government bond yield is similar.) Clearly the rise in risk-free government interest rates is not the sole explanation of the increase in mortgage rates.



If the mortgage rate had risen only as much as the 10-year government bond's yield, it would be 5.89 percent. There is little doubt that a mortgage rate of 5.89 percent instead of 7.09 percent would make a big difference to many borrowers.

Why has the spread increased? The increase in the spread is unusual but not unprecedented. As recently as the week ending April 20, 2020, the spread was 2.71 percentage points. The increase in the spread to 2.71 percentage points in 2020 is not surprising. The United States economy was contracting, with a recession from February 2020 to April 2020 and an unemployment rate of 14.7 percent. Recessions make it harder for people to make their mortgage payments and mortgages become riskier investments. The increase in the spread in 2008 is also associated with a recession.

The increase in the spread in 2023 is not associated with a recession.

The recent increase in the spread is due to a decrease in the demand for mortgages for reasons other than a recession. Silicon Valley Bank, which failed earlier this year, held long-term securities which fell in value as yields rose. Perhaps partly because of concern about interest-rate risks going forward, banks have decreased their holdings of mortgages. Since the week ending February 23, banks' holdings of mortgage-backed securities issued by the federal government have fallen 14 percent. No doubt other holders of these securities also now view them as risky, even if they don't have to dispose of them due to concerns about regulators.

Beyond the unfortunate implications for home buyers, especially first-time home buyers, what can be learned from this episode? Interest rates on mortgages were 2.66 percent just two and a half years ago. Why the sudden increase in rates? The Federal Reserve increased the money supply and generated the worst inflation in many years. Additionally, the Federal Reserve was attempting to manipulate interest rates to encourage interest-sensitive activities. That part of the plan worked. The unexpected outcome is that the perceived interest-rate risk of long-term mortgages now is much higher and mortgages are more expensive than they would have been otherwise.

Besides these effects, many people have very low rate mortgages; they will be reluctant to sell their homes and pay off those low-rate mortgages for some time. While good for those who have such mortgages, the low rates on existing mortgages will discourage people from selling their homes and giving up the mortgages. This will reduce purchases and sales of existing homes and make it even more difficult for first-time home buyers to buy a house.

– September 2, 2023

Why is Baby Formula Kept Under Lock and Key?

PETER C. EARLE

Research Faculty

A recent series of memes and social network one-liners purport to expose the moral bankruptcy of capitalism by asking rhetorically, “Why is baby formula kept under lock and key?” The explicit inference is that it is only a profound form of greed that would see such an essential good, critical to the most vulnerable human beings, being so securely held. It is at least shameful and more likely evil, the assertion continues, that infant formula is maintained in cages in supermarkets, revealing the sinister character of the profit system.

First, baby formula regularly appears on lists of the most shoplifted goods at supermarkets. Because it is expensive and occasionally prone to shortages, there exists a liquid, active black market supplied by sophisticated underground networks for baby formula. And owing to prohibition-fattened profit margins, formula constitutes a safe, accessible input for cutting drugs like cocaine, heroin, and methamphetamine.

An adamant collectivist is likely to argue that both shoplifting and drug addiction are afflictions of the desperate, the former a moral imperative and the latter an inevitable consequence of a world in which oppression and avarice run rampant. But such activists must concede that incentives inform choices. How else would the use of violence in the service of revolution be explained? In a market economy, businesses seek to generate revenue, and theft reduces sales. Locking up goods that are prone to robbery prevents stealing and ensures that products are available to paying customers desiring them. Copies of *Das Kapital*, a subscription to the *Weekly Worker*, and even admission to Karl Marx’ grave site are priced as well. And collectivist states are indefatigable adherents of walls, fences, barriers, prisons, and countless other forms of immuring.

Feigned or real, far-left outrage about secured baby formula is suspiciously selective. In fact, increasing numbers of retail items are being locked up. Following the mass looting in US cities throughout 2020 (and occurring even recently), alcohol, consumer non-durables, and even Spam has been moved from open shelving to sealed displays. (Liquor retailers have incentives beyond lost revenue to keep their merchandise safe from larcenists.)

In 2022, the circumstances around the retailing of baby food became all the more complicated as a result of supply chain problems caused by pandemic policies. A recall by Abbott created shortages that exposed little-known features of the market for infant formula. The global market is dominated by a small number of firms, with two firms—Abbott and Reckitt Benckiser—accounting for roughly 80 percent of the US domestic market. (Gerber, owned by the Swiss conglomerate Nestlé, controls another 10 percent.) Those firms are the only three licensed by the United States Department of Agriculture’s (USDA) Food and Nutrition Service to produce formulas for the Special Supplemental Nutrition Program for Women, Infants, and Children (WICs).

> The federal government provides WIC grants to each state, which then contracts with one of the three companies. While WIC is a critical program to feed the most vulnerable, government support of this program… creat[es] a de facto monopoly in each state. The amount of WIC funding to these three

> established companies makes it difficult for any startup to make significant inroads in the baby formula industry. There is little chance they can capture the market share necessary to justify a significant investment.

The competitive landscape, as structured by the US government, makes entrepreneurial prospects a nonstarter. High tariffs heap yet another layer of cost to the retail price of baby food, lobbied for by the National Milk Producers Foundation.

> While the 2022 baby formula crisis grappled the United States, the National Milk Producers Federation called on Congress to resist new action. In November, the group urged Congress to oppose any efforts to extend the tariff suspensions emergently granted to baby formula imports amidst the crisis. Unsurprisingly, Big Dairy succeeded—on January 1st, the tariffs returned on imports of infant formula meaning these imports are again subject to an effective tax of about 25 percent.

In response to the 2022 shortages, eight foreign companies were approved to sell infant formula in the US – but tariffs were reinstituted in early 2023, again raising prices. And there are two additional muddles, one at the production end and one at the consumer end: patents and inflation.

So why, in many stores, is infant food kept in locked cabinets? Collectivists, look no further than your beloved, doughty statesmen. The cogent, provable explanation is an array of government restrictions, each of which drives up retail prices on an already difficult-to-produce good. Patent restrictions, a deliberate oligopoly, protectionist tariffs, and the highest inflation in four decades have resulted in an extremely expensive product at the end of a frangible production process and supply chain. Explosions of civil unrest and the rapid growth of shoplifting (now approaching a $100 billion problem) have led vendors to physically restrict access to products that are frequently stolen. Those include, but are not limited to, baby formula.

There is indeed, as the memesters and social media wags suggest, a severe moral delinquency at work. But it is neither with the shopkeeper nor the choice of lock and key. It lies in the muster of interests which, through political power, conspire to prohibit the unhindered manufacture and distribution of critical goods.

– September 30, 2023

Another Rate Hike? Let's Not

ALEXANDER WILLIAM SALTER

Senior Fellow, Sound Money Project

The Federal Open Market Committee opted not to raise its interest rate target at its September 20 meeting. The range for the federal funds rate remains 5.25-5.50 percent. However, several Fed officials hinted another hike could come later in the year. Do we need tighter monetary policy?

The FOMC also released its latest Summary of Economic Projections (SEP) on Wednesday. This contains estimates about the future path of GDP growth, unemployment, and inflation. The last of these is particularly important for ascertaining the stance of monetary policy.

Median estimates for the annual growth rate in the Personal Consumption Expenditures (PCE) index for 2023 were 3.3 percent headline and 3.7 percent core (excluding food and energy prices). The June estimates were 3.2 percent and 3.9 percent, respectively. The slight uptick in headline inflation forecasts is likely due to unexpectedly high energy prices.

Recall that the real (i.e., inflation-adjusted) federal funds rate is equal to the nominal federal funds rate minus expected inflation. Hence, we can use the Fed's inflation projections to estimate the real federal funds rate. The headline inflation projection implies a real federal funds rate range of 1.95 to 2.20 percent. The core inflation projection implies it is between 1.55 and 1.80 percent.

To gauge the stance of monetary policy, we can compare the real federal funds rate estimates to the natural rate of interest. This is the rate that brings the quantity of capital supplied into alignment with the quantity demanded, promoting optimal resource use throughout the economy. Real output will equal potential output when the market rate of interest equals the natural rate of interest. This is the most that monetary policy can accomplish.

The New York Fed has two estimates for the natural rate of interest. It's currently between 0.57 and 1.14 percent. Even the lowest real federal funds rate estimated above is significantly higher than the New York Fed's estimates of the natural rate. That suggests monetary policy is already tight enough.

Liquidity conditions offer supporting evidence. The M2 money supply is falling at an annual rate of 3.69 percent. Broader measures of the money supply, which weight their components by liquidity serviceability, are shrinking between 1.92 and 2.69 percent per year. This is likely a consequence of financial disintermediation. Banks are scaling back their loan-making activities, which contribute to broader money growth, due to the effects of higher interest rates on their balance sheets. Higher rates lower the value of bank assets (e.g., bonds) and increase the costs of maintaining their liabilities (e.g., checking and saving accounts). By simple accounting, this results in lower bank capital (shareholder equity), which then can support only a smaller volume of loans.

Interest rate and liquidity data point to the same conclusion: monetary policy is sufficiently tight. Further tightening could cause a painful economic contraction. This is especially worrying in an election cycle. The Fed is already thoroughly politicized. We must avoid even the appearance of political meddling by central bankers. Instead of cryptic messaging, Fed officials should clearly announce an expected future path for PCEPI growth and stick to it. Central banking should be as obvious and unexciting as possible.

– September 26, 2023

Academic Lies about Free-Market Economists

PHILLIP W. MAGNESS

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The academic history profession has a problem with intellectual integrity. Over the past decade, a cottage industry has emerged in elite university departments that explicitly aims to tear down free-market economists (often misnamed as "neoliberals") by accusing them of racism, fascism, and similarly discredited beliefs.

Although these are serious charges, the historians who make them seldom have evidence to back their accusations. Instead, they misrepresent historical records, make up falsehoods out of thin air, and even rearrange quotations by their targets to make them appear racist. One of the worst offenders in this regard is Duke University historian Nancy MacLean, whose 2017 book *Democracy in Chains* tried to portray pioneering Public Choice economist James M. Buchanan as a complicit partner of Senator Harry Flood Byrd's "Massive Resistance" efforts against *Brown v. Board of Education.*

MacLean's thesis collapsed under scholarly scrutiny. To build her case, she mixed up the contents of historical records, misread and conflated footnotes in the secondary literature, and simply fabricated salacious stories wherein Buchanan became a secret admirer of John C. Calhoun and Agrarian Poetry, despite providing no evidence of either. When she wasn't making them up out of thin air, MacLean also altered quotations to change their meaning, usually in ways that depicted their authors as monsters. In a more honest academic climate, it's the type of behavior that would earn a professor a stern reprimand from the dean and perhaps a few article retractions.

Six years have passed since this episode, but MacLean is still up to her old tricks. Her newest target is the South African economist William Harold Hutt, who wrote a blistering critique of racial apartheid in 1964. MacLean's interest in Hutt stems from the fallout over Democracy in Chains, because Buchanan recruited Hutt to the University of Virginia as a visiting faculty member in 1965. Having a prominent opponent of apartheid in Buchanan's department did not mesh well with MacLean's attempts to depict Buchanan as an agent of the arch-segregationist Byrd machine.

To get around this obstacle, MacLean has now seeks to besmirch Hutt. She has a new article out in the *History of Economics Review,* co-authored with Duke professor William S. Darity and graduate student M'Balou Camara. Its "thesis," if it could even be called that, is to accuse Hutt himself of being a "white supremacist."

Most of the new article is a recycled and slightly updated version of an error-riddled working paper that advanced similar claims. Art Carden and I dissected that paper last year, finding multiple instances where MacLean and her co-authors misrepresented their source materials to make their flimsy charges stick. But MacLean's latest piece adds a new line of attack on Hutt, containing one of the most egregious examples of quote-editing that I have ever encountered in an academic work.

To support their contention that Hutt was a "white supremacist," MacLean et al. excerpt a passage from his 1963 anti-apartheid book, *The Economics of the Colour Bar*. I reproduce their treatment of that passage here in full:

> [Hutt] went further, admonishing that 'races which grumble about the 'injustices' or

> ‘oppressions’ to which they are subjected can often be observed to be inflicting not dissimilar injustices upon other races (Hutt 1964, 39). The choice of verb (grumble) along with the scare quotes around injustices and oppressions illustrate how Hutt aimed to undercut the legitimacy of apartheid’s black South African critics, who were gaining international support as he wrote. His aim can be readily inferred: to deny the victims of apartheid the moral high ground claimed by the anti-apartheid movement.

In fact, this quoted excerpt is one of the main pieces of “evidence” that MacLean and her co-authors deploy to support their claims. As they describe it, “These passages attest that Hutt clearly saw the world through the lens of white racial superiority.” By allegedly denigrating the victims of apartheid in their cause, Hutt “demonstrated his belief that the fundamental source of racial disparity in South Africa and elsewhere was dysfunctional black behaviour.”

This is a serious charge to make against another scholar. It is also a falsehood.

Compare MacLean et al.’s portrayals to the full passage from page 39 of the *Economics of the Colour Bar*. The excerpted part of the quotation is in bold:

> “**Races which grumble about the ‘injustices’ or ‘oppressions’ to which they are subjected can often be observed to be inflicting not dissimilar injustices upon other races.** We find a very clear case of this in any study of the grievances of the Afrikaners against ‘British imperialism’ and their fight against the threat of ‘Anglicisation’. In their policies towards the non-Whites, they are inflicting injustices which are remarkably similar to those of which they themselves have complained.”

If you’re wondering how these transgressions on the text passed basic peer review with the journal’s editors, you are not alone. Contrary to the claims of MacLean and her co-authors, Hutt was not attempting “to undercut the legitimacy of apartheid’s black South African critics.” He was writing about the racist hypocrisy of South Africa’s white Afrikaner community. The Dutch-descended Afrikaners often complained of historical injustices against their community at the hands of British colonial authorities, yet as Hutt pointed out, they turned around and perpetrated injustices against black Africans in the form of apartheid.

MacLean et al. took Hutt’s attack on white racists and, through selective excerpting of the original quotation, altered it into an attack on the victims of apartheid.

If this quote-editing exercise was a single incident, it might be possible to chalk it up to sloppiness or incompetence. But Hutt’s explicit reference to Afrikaner hypocrisy appears in the very next sentence, making a careless oversight unlikely. More importantly, MacLean and her colleagues have a long track record of similar behavior, misrepresenting sources and abusing historical evidence.

To academics like MacLean and Darity, both of whom write from positions of power, holding endowed chairs at an elite institution, historical inquiry is no longer an exercise in pursuing truth and understanding about the past. It is a tool for their own far-left political activism. To borrow a phrase from ethicist Nigel Biggar, they treat history as “an armoury from which to ransack politically expedient weapons.” In the process of that ransacking, they cross the line into willful misrepresentations of their source material, all in the service of a modern-day political cause. It’s a pattern of scholarly dishonesty that the academy has tolerated (and even elevated) for far too long.

– September 23, 2023

Inflation was Worse than We Thought

WILLIAM J. LUTHER

Director, Sound Money Project

The Bureau of Economic Analysis has revised its estimates of inflation. The bad news: prices have risen faster than was previously thought. The Personal Consumption Expenditures Price Index (PCEPI), which is the Federal Reserve's preferred measure of inflation, grew at a continuously compounded annual rate of 4.1 percent from January 2020 to July 2023. The BEA's previous efforts put inflation at 4.0 percent. In July 2023, prices were 8.2 percentage points higher than they would have been had the Fed hit its 2-percent inflation target over the period, compared with the previous estimate of 7.7 percentage points.

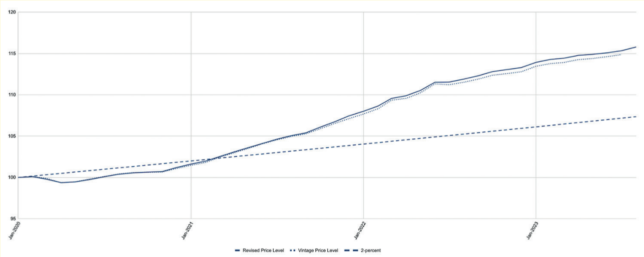

Figure 1. Revised and Vintage Personal Consumption Expenditures Price Index, January 2020 – August 2023

More bad news: inflation picked back up in August 2023. The PCEPI grew at a continuously compounded annual rate of 4.7 percent in August, compared with 2.6 percent in the prior month. The PCEPI grew 3.4 percent over the 12-month period ending August 2023. Prices today are 15.8 percent higher than they were in January 2020, and 8.4 percentage points higher than they would have been had inflation averaged just 2 percent over the period.

The recent uptick in inflation was largely due to a surge in energy prices. The price of energy goods and services grew at a continuously compounded annual rate of 70.7 percent in August.

Fortunately, the most recent release was not all bad news. Core PCEPI inflation, which excludes volatile food and energy prices, has continued to decline. Core PCEPI grew at a continuously compounded annual rate of just 1.7 percent in August 2023, compared with 2.6 percent in the prior month. Core PCEPI has grown at a continuously compounded annual rate of 3.8 percent over the last twelve months, and 3.8 percent per year since January 2020.

More good news: the BEA's recent revision shows that core PCEPI inflation has declined more than previously thought over the last six months. Prior to the revision, the BEA said core PCEPI inflation had grew at a continuously compounded annual rate of 3.7 percent over the three-month period ending in May, 3.3 percent over the three-month period ending in June, and 2.9 percent over the three month period ending in July. Now, it says core PCEPI inflation averaged 3.7 percent, 3.1 percent, and 2.7 percent over those periods—and just 2.1 percent over the three-month period ending in August 2023.

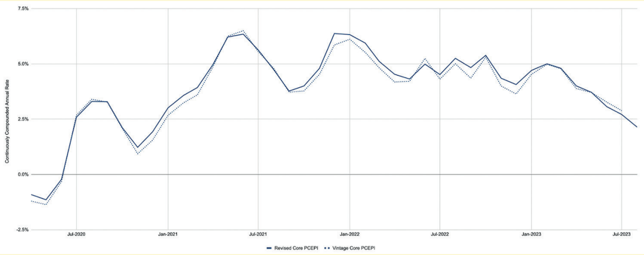

Figure 2. Revised and Vintage Core Personal Consumption Expenditures Price Index Inflation, Continuously Compounded Annual Rate Over Last 3 Months, April 2020 – August 2023

Although Fed officials were late to tighten monetary policy, their efforts over the last year appear to have worked. The risk today is that monetary policy is too tight—and will remain so for too long.

The nominal federal funds rate target range stands at 5.25 to 5.50 percent. Assuming energy prices will not continue to rise as rapidly as they did in August, the prior month's core inflation rate serves as a reasonable estimate of expected inflation over the current month. That suggests the real federal funds rate target range is roughly 3.55 to 3.80 percent. For comparison, the highest estimate of the natural rate offered by the New York Fed is just 1.14 percent. Even if one were to use the average core PCEPI inflation rate over the last three months, the resulting estimate of the real federal funds rate target range at 3.15 to 3.35 percent would still suggest monetary policy is very tight.

Inflation has been too high over the last few years. And the BEA's recent revision reveals it was even higher than we thought. Fortunately, high inflation now appears to be behind us. Unfortunately, Fed officials do not seem to have realized that yet—and may over-tighten monetary policy as a consequence.

– September 30, 2023

An Insider Untangles the Causes of the Financial Crisis in American Cities

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The municipal financial crisis, with the failure and decline of cities that follow, is here. But it's a crisis of mission, not just solvency.

That's the thesis of Mark Moses, a longtime senior management professional and finance director in California local government. Informed by his decades of experience and a solid grasp of economic principles, Moses contends most cities overextend themselves because they lack a clear, realistic mission, or even worse, see their mission as something like "maximizing services." Trendy budgeting methodologies like zero-based budgeting and performance budgeting can't fix the problem, because they can't overcome inarticulate goals and the administrative inertia they foster. Only a clear-eyed analysis of the proper role of local government, followed by root-and-branch reform, can put cities on the proper path.

Moses says local governments get in trouble because even severe problems have little urgency. Dealing with problems is painful, and postponing hard choices means that someone else will have to make them. Why bother now, if you can't go out of business? Perversely, governments' permanence promotes a short-termist mentality.

Moses notes that when he started a new role, a few open-ended questions revealed that municipal employees mostly acknowledge the importance of operational improvements, recognize what's at stake, and are willing to change. They weren't the indifferent and unambitious bureaucrats he imagined. Still, nothing gets done. "[W]hy are these organizations a decade or more behind in the use of technology and modern work processes?" Because the burden of proof lies on anyone who wishes to disturb the status quo. Also, those seeking to change things, everyone assumes, must have a political motive. So problems persist.

Even bankruptcy is no solution. Cities emerge from the process with "the same city charter, the same organizational chart, the same array of boards and commissions, the same mission, vision, and goals–i.e., the same fundamentals that paved the road to bankruptcy."

There are many ways public officials can conceal a problem. You can balance a budget with one-time revenues. You can underfund future liabilities, like defined-benefit pension plans. You can defer maintenance or distract attention with splashy new projects. You can forbid certain land uses rather than buying the rights to them. Regulation looks "cost-free," other than the small cost of enforcement, but its true costs are merely hidden.

Citizen surveillance of local government is difficult. Local officials themselves often don't know how other parts of government work. Local governments have become bigger and more complex over time. Frequently, no one knows *why* things are done a certain way; they just seemingly always have been. Without true voter control of local government, it's easy for problems to persist and grow in the dark.

While bankruptcy or fiscal distress is the most visible sign of crisis, growing tax and regulatory burdens and gradually deteriorating public infrastructure are the real consequences people suffer. The incentives are simply not aligned in most states for long-run local government performance for the benefit of the citizen.

What's the solution? Moses advocates clearer, more focused missions for local governments and reorienting service delivery around those missions. Too many local governments define their missions vaguely: "providing the right public services for [our] way of life" (Bend, Oregon) or "provid[ing] municipal services and programs essential to a desirable community" (Walla Walla, Washington). A mission statement that subsumes anything you want is a recipe for disaster for any organization, but especially a permanent one equipped with the right of force.

Moses proposes that local governments limit themselves to tasks that the private sector cannot do. Recreation centers, golf courses, and even libraries might be "nice-to-haves," but there's no reason they should be a part of government.

Even fire services can be rethought. Fire hazard has declined precipitously in cities over the last century, but instead of downsizing fire departments, cities gave them EMT and ambulance responsibilities. Could the latter be private functions? Could firefighting be partly or wholly an insurance company function, as in the 19th century?

Moses even advocates a role for competition in water and sewer networks, pointing to telecom innovation after the breakup of AT&T as a precedent. Still, he realizes there will need to be a transition period: "Although the changes from commercializing utilities and other enterprises will be dramatic and exciting, they will not be immediate or routine." It certainly seems that water and wastewater networks could be privatized and then rate-regulated as a transitional measure. Moreover, technological changes such as the arrival of "community septic systems" make the possibility of decentralized waste disposal networks not so far distant.

In the end, Moses says, we need to decide on the proper scope and purpose of local government and then budget for scope. Balancing budgets without reassessing what municipal governments should or should not do, and the long-term benefits and costs of their activities is insufficient. To put the point slightly differently, once local government does less, it will do what it is supposed to much better. People need their government, as Moses says, to use its unique authority "to apply the legislative and enforcement powers of government to define and enforce personal and property rights that ensure residents' and business owners' freedom to engage in personal and commercial activities." Every effort and resource municipal staffs put into providing commercial services themselves are not spent on achieving the proper role of local government – creating and maintaining an institutional environment for its constituents to operate and flourish freely.

The Municipal Financial Crisis ends up being a refreshing read despite its pessimistic hook. Fixing local government in the US isn't out of our reach. We don't have to accept the usual pathologies of bureaucratic paralysis, infrastructural decay, and outmoded business practices. Moses' longtime experience on the inside of local government gives him the credibility to diagnose what's wrong with it and to recommend a path forward. Anyone curious about how local government really works, and how we can do better, should read this book. And while following Moses through his stories and recollections of the intricacies, difficulties, and details of budgeting can be exhausting, it only enforces his point: Operating a municipal government efficiently is so complex it urgently requires earth-shaking reform.

– October 1, 2023

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