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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

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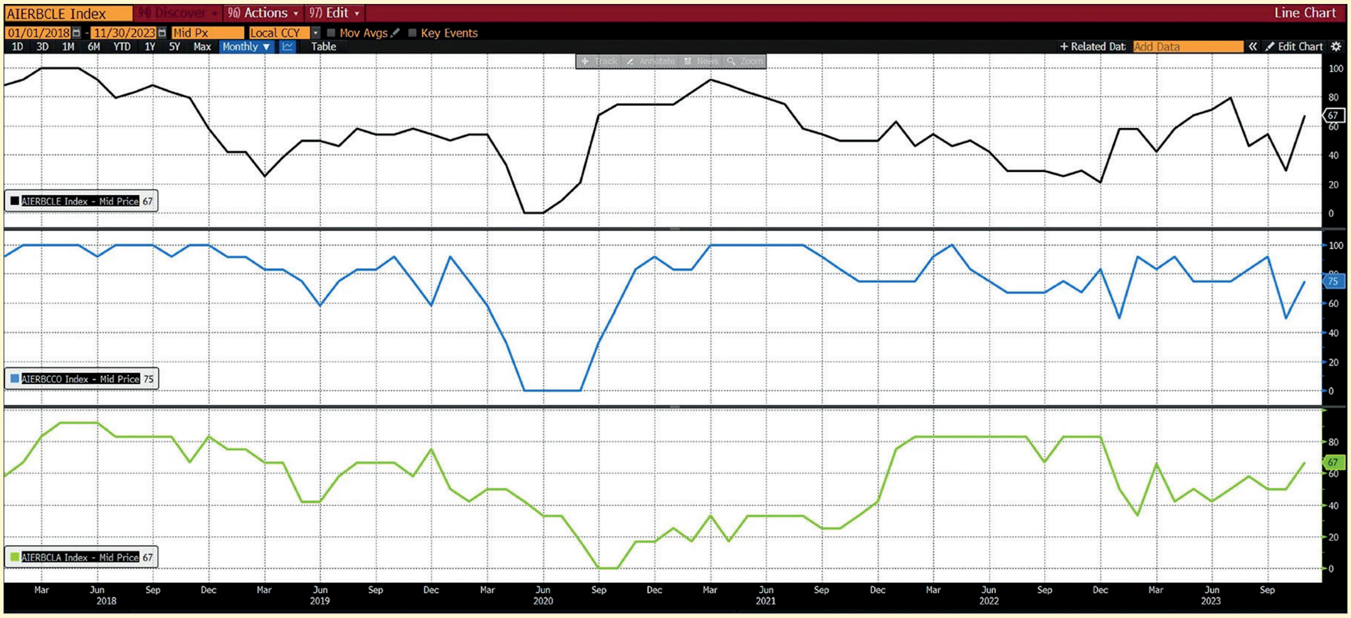
Contents

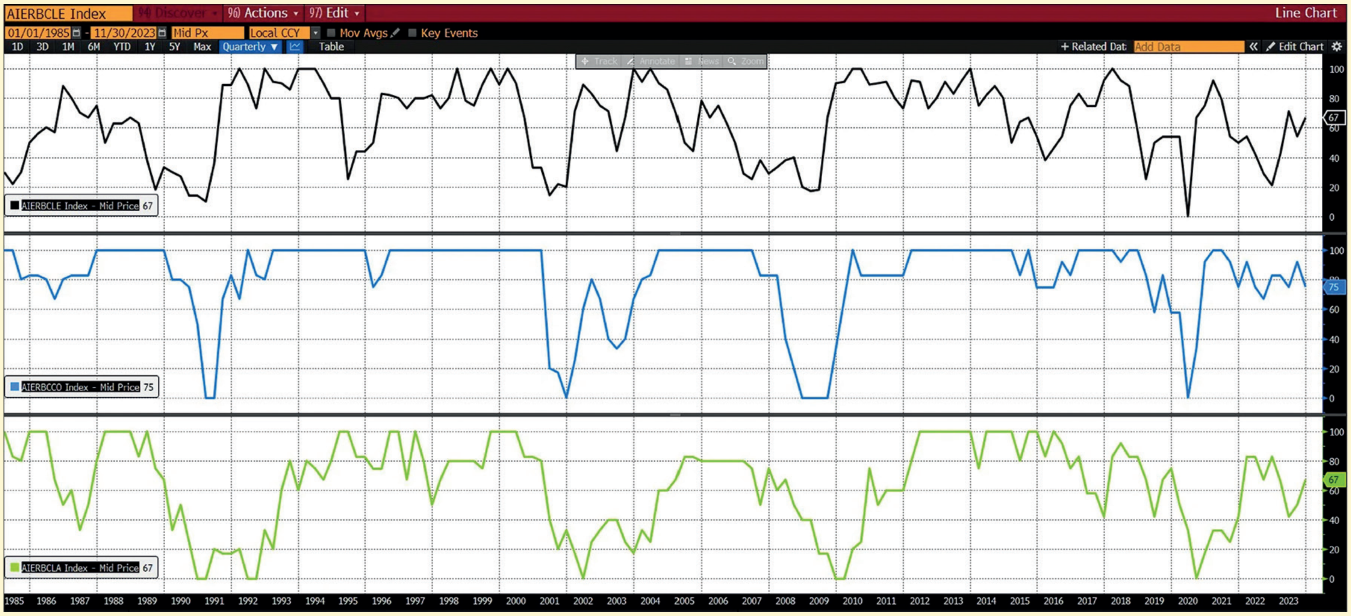
BUSINESS CONDITIONS MONTHLY

Peter C. Earle
SENIOR RESEARCH FACULTY

In November 2023, the AIER Business Conditions Monthly indices spiked up in all categories after the dip in October, highlighting the irregular character of economic data in the post-pandemic period. At 67, the Leading Indicator returned to levels not seen since the spring and early summer of 2023. Both the Roughly Coincident and Lagging Indicators did the same, rising to 75 and 67 respectively from the 50 level in October.



(Source: Bloomberg Finance, LP)



(Source: Bloomberg Finance, LP)

Leading Indicators (67)

From October to November 2023, eight of the twelve leading indicators rose while four declined.

Rising were the US New Privately Owned Housing Units Started by Structure (14.8 percent), United States Heavy Trucks Sales (6.0 percent), Conference Board US Leading Index of Stock Prices (4.7 percent), FINRA's Debt Balances in Customers' Securities Margin Accounts (4.0 percent), Inventory/Sales Ratio: Total Business (0.7 percent), Conference Board US Manufacturers New Orders Nondefense Capital Good Ex Aircraft index (0.5 percent), Adjusted Retail and Food Services Sales (0.3 percent), Conference Board US Leading Index Manufacturing, New Orders, Consumer Goods, and Materials (0.2 percent).

The US Average Weekly Hours All Employees Manufacturing declined (-0.3 percent), as did the University of Michigan Consumer Expectations Index (-4.2 percent), US Initial Jobless Claims (-4.5 percent), and the 1-to-10 year US Treasury spread (-50.4 percent).

The jump in the Leading Indicator from 29 in October 2023 to 67 in November 2023 is the second largest since September 2020. Since January 2020, three of the five largest monthly positive changes in the Leading Indicator took place in 2023 (November, January, and April), underscoring the erratic and unpredictable nature of economic statistics in the post-pandemic period.

Roughly Coincident (75) and Lagging Indicators (67)

Within the Roughly Coincident Indicator, there were four rising metrics, one unchanged, and one declining. Coincident Personal Income Less Transfer Payments and US Industrial Production rose by 0.3 percent each, with the Conference Board's Coincident Manufacturing and Trade Sales rising by 0.2 percent and total US Employees on Nonfarm Payrolls rising by 0.1 percent. The US Labor Force Participation rate in November 2023 was unchanged, and the Conference Board Consumer Confidence Present Situation fell 1.5 percent.

Three components rose, two were unchanged, and one declined in the lagging category. The Conference Board US Lagging Average Duration of Unemployment increased by 10.2 percent from October to November 2023, as did average 30-day yields (0.6 percent), and Conference Board US Lagging Commercial and Industrial Loans (0.3 percent). Both the year-over-year US CPI Urban Consumers Less Food & Energy and Census Bureau's Private Construction Spending (Nonresidential) were unchanged, with US Manufacturing and Trade Inventories Totals falling -0.1 percent.

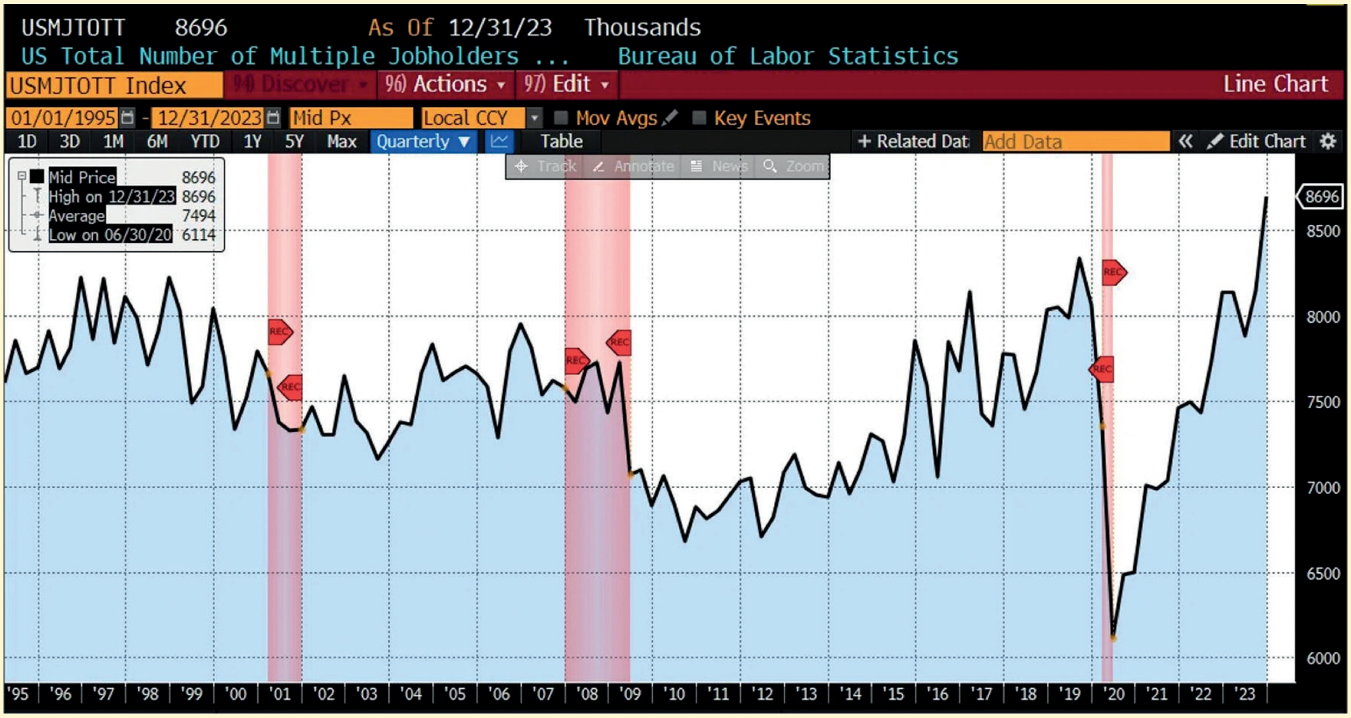
Substantial reversals in both the Roughly Coincident and Lagging Indicators from October to November were, as in the case of the Leading Indicator, among the largest since January 2020. The surge in the Roughly Coincident Indicator from 50 in October to 75 in November is the sixth largest, while the move from 50 to 67 over the same period in the Lagging Indicator is the fifth largest such jump.

Discussion

On January 5th, 2024, the Bureau of Labor Statistics (BLS) released its employment report for December 2023, providing a nuanced view of the current state of employment in the United States. The headline number, showing an increase of 216,000 in nonfarm payrolls, surpassed the expected 175,000, leading many to believe that the long-discussed soft landing in the economy was taking shape. Beneath this headline, however, less-discussed aspects of the report revealed signs of a rapidly deteriorating labor market.

The household employment data showed its most significant drop since April 2020, with a loss of 683,000 jobs (compared to a gain of 586,000 in November). Although the U-3 unemployment rate remained unchanged at 3.7 percent from November 2023, this stability was largely due to a decline of 676,000 individuals from the workforce. Other concerning indicators included an increase in the average duration of unemployment and a drop in the labor force participation rate, which fell from 62.8 to 62.5 percent and nevertheless remains several percentage points below pre-pandemic levels.

Further analysis of the report revealed a rise in the number of workers taking on part-time employment for economic reasons, and a record-high of 8.69 million Americans holding multiple jobs. It's worth noting that the actual number of individuals with multiple jobs may be even higher, as secondary employment often occurs off the books.



(Source: Bloomberg Finance, LP)

Another concerning aspect of the December report involves the nature of current and recent job growth, most of which has taken place in activities closely tied to government spending, sectors which, with an aging US population are important and valuable, but not necessarily economically productive. Healthcare, social assistance, government jobs, and construction saw substantial growth. Leisure, hospitality, and the retail sector additionally experienced job gains, likely relating to the holiday season. In contrast, industries primarily composed of private, for-profit firms have seen the most significant declines in employment, including manufacturing, transportation, and warehousing, which reported job losses. Professional services, wholesale, and financial activities are reporting notably slower employment growth. Elsewhere within the report the U-6 underemployment number ticked up from 7.0 to 7.1 percent in December 2023. If nothing else, the markedly different picture of the US labor market revealed by the less-reviewed portions of the report emphasizes the need to investigate beyond the headline numbers.

The Institute for Supply Management (ISM) Services report for December reinforces the perspective which looking below the surface of the December 2023 BLS report does. While business conditions remained relatively stable, there was a notable deceleration in services activity, which was more pronounced than anticipated. This slowdown was driven by a decline in both new orders and employment levels. Notably, the employment component of the index fell significantly into contractionary territory, with some respondents citing increased layoffs amid economic uncertainty leading to decreasing customer demand. Furthermore, the decline in new orders and inventory levels suggests that private firms are proactively reducing excess inventory in anticipation of falling demand. Although order backlogs showed slight improvement, it remained in contractionary territory, reflecting firms' efforts to consume backlogs more rapidly.

In March 2023 we called for a recession within 18 months (by September 2024). Over the last two months, owing to initially strong (but consistently revised downward) nonfarm payroll numbers, progress in disinflation, and an uncharacteristically strong US stock market performance during the final two months of 2023, broad sentiment has shifted away from expectations of a recession and toward that of a soft landing.

While disinflationary progress is indeed positive, stock market returns tend to reflect forward-looking expectations. They are additionally susceptible to the dynamics of institutional liquidity and the cyclical rotation into and out of asset classes at the end of the year. While equities play a crucial role in financial markets, discounted earnings from the stock market do not always serve as dependable macroeconomic indicators.

On the other hand, robust economic conditions are strongly characterized by broad-based job growth, in particular employment in sectors that tend to hire more early in and during economic expansions but cut back during downturns. Recent data suggest that the US labor market is presently not robust in this regard. In November 2023, the three-month average of nonfarm payroll gains stood at 204,000 jobs, with — as previously stated — a significant portion of hires concentrated in just two sectors: healthcare, and leisure and hospitality. Healthcare consistently requires a workforce, regardless of the overall economic conditions, while the leisure and hospitality sector historically manages its headcount through attrition rather than layoffs due to comparatively high worker turnover. If workers are staying in their jobs for longer periods, as indicated by the declining quit rate in November's JOLTS report, it's possible that we may observe stagnant or even negative employment changes in the leisure and hospitality sector in the upcoming months. If jobless claims continue to rise in upcoming weeks, and notably if they surpass the usual seasonal layoffs, concerns will heighten regarding a notable decline in labor demand.

Current continuing claims data indicates a 15 percent year-over-year increase in the four-week moving average (1.88 million). In summary, unemployed individuals are taking longer to find jobs amid a small number of sectors (most of which are characterized by their proximity to government spending) accounting for increased employment in a shrinking labor pool. Placed in a historical context, excluding the COVID-19 downturn, the past five recessions began with initial claims averaging 388,000 and continuing claims averaging 2.63 million. Current initial claims are far from those levels, but as mentioned in the previous (October 2023) Business Conditions Monthly report,

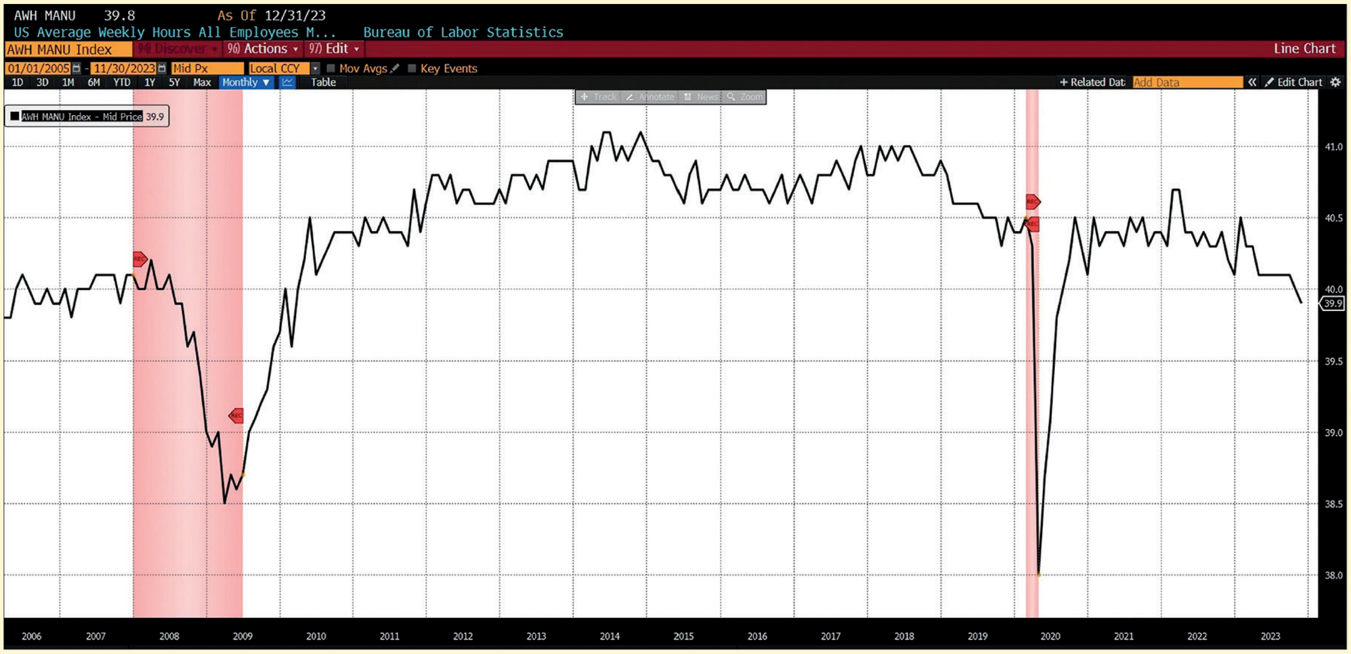
> [O]n the eve of … recessions, predictions of soft landings dominate discourse … The distribution of unemployment rates is highly bimodal, meaning not normally distributed, and with a long right tail. In short, we see a large cluster of unemployment in the 4 to 5 percent range, with a small but appreciable cluster of employment at the 7 percent and higher range. Forecasting models which rely on normal distributions, as many likely do, will thus consistently and predictably understate those worse outcomes represented by the long, fat right tail of the distribution.

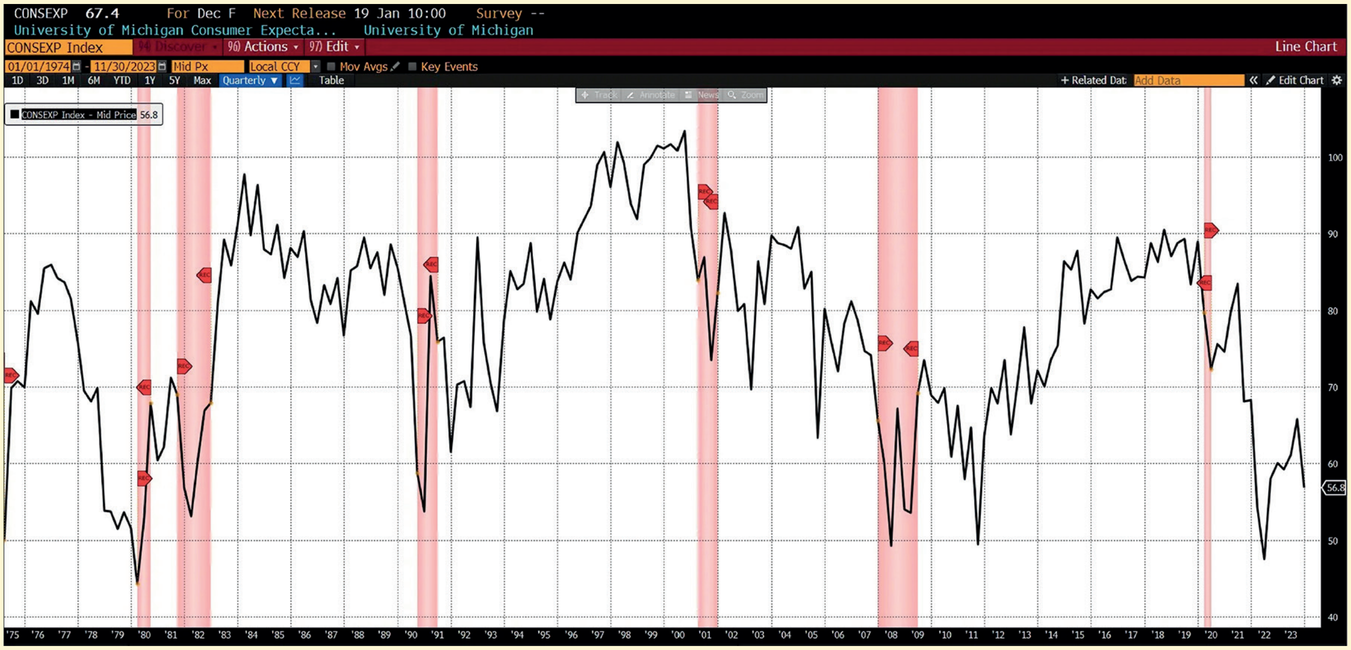
In other words, the unemployment rate typically experiences a significant uptick during economic recessions, accelerating nonlinearly. While a substantial portion of unemployment outcomes over time center around the historical norm of 5 percent during prosperous periods, another noteworthy cluster emerges around an unemployment rate of 7 percent. This distribution reveals that any forecasting model relying solely on a mean estimate would underestimate the risk of more severe outcomes due to the presence of a long and heavily skewed right tail.

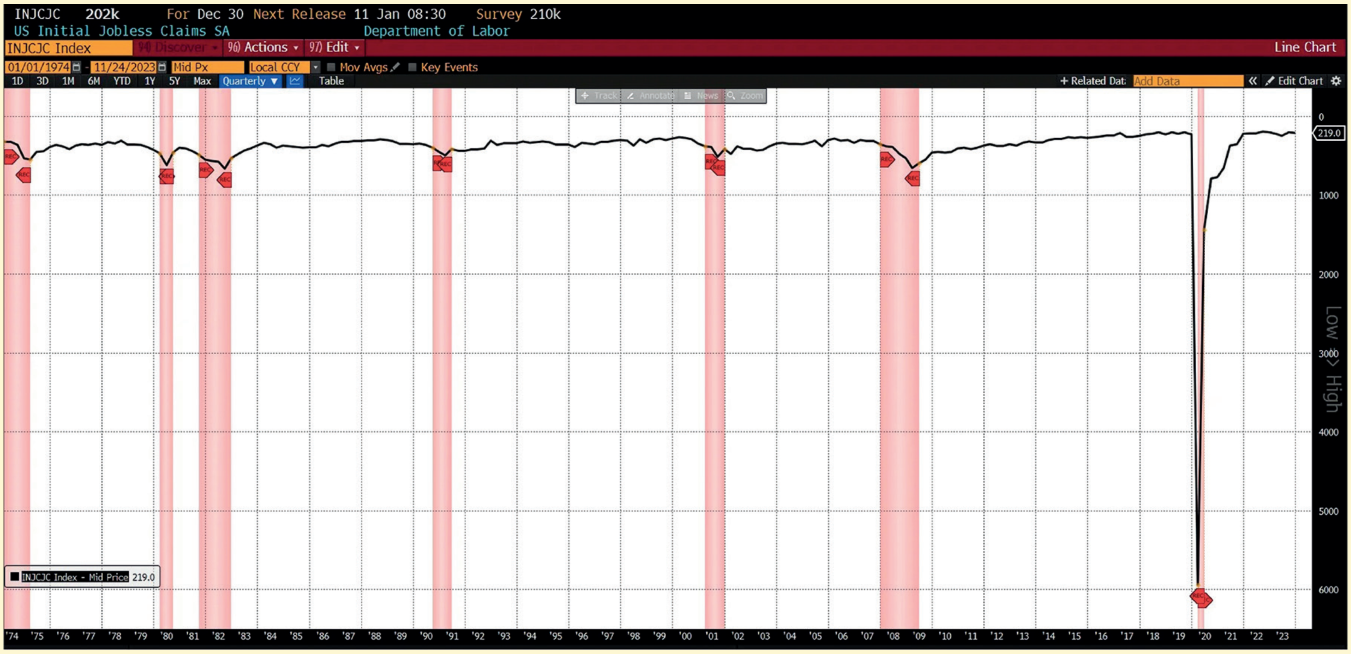
The prevailing rationale behind forecasts of a soft landing in historical economic downturns and, likely, in the current context (given the recent deterioration in labor market indicators) are thus reflected in the December report. Economic recessions are characterized by nonlinear dynamics, which pose a challenge to traditional forecasting approaches. It is additionally essential to acknowledge the influence of high degrees of political polarization serving both predictions of a soft landing and unwarrantedly upbeat descriptions of the current economic landscape.

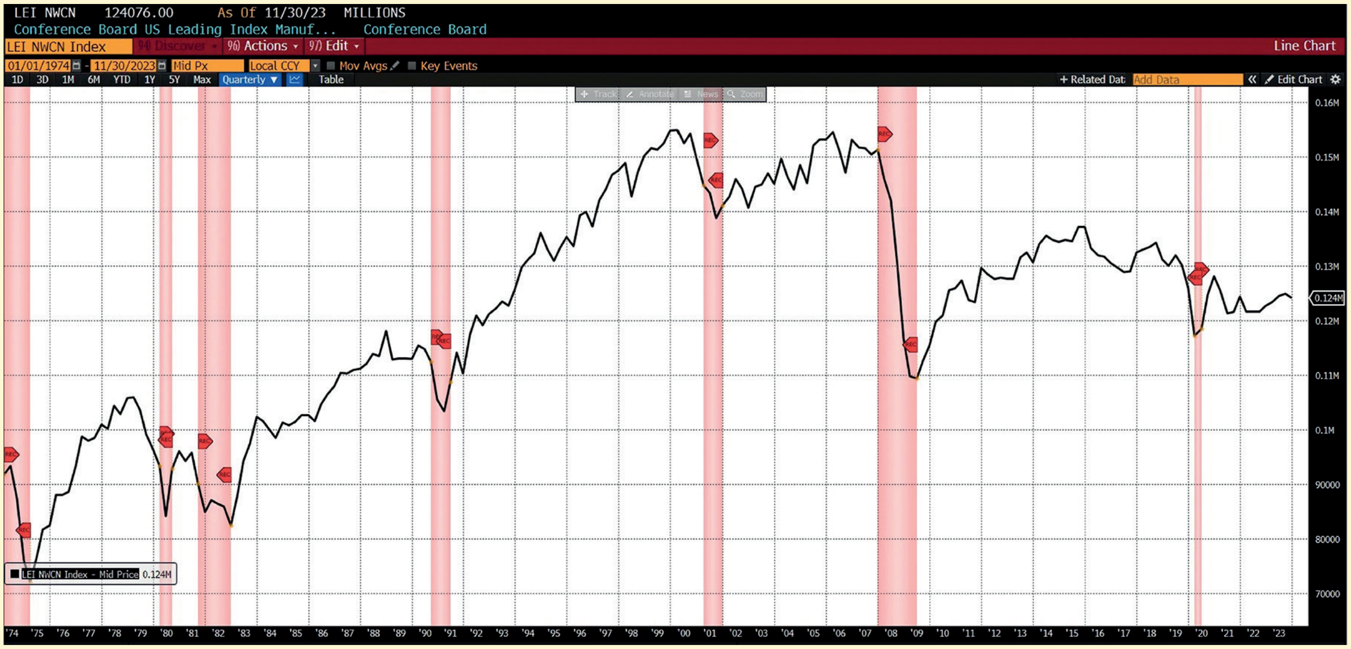
From the ISM report, businesses are beginning to take action consistent with expectation of falling demand. In light of this and the increased vulnerability of the US economy to geopolitical shocks — with conflict spreading in the Middle East in addition to southwestern Europe — our prediction of a US recession by September 2024 stands.

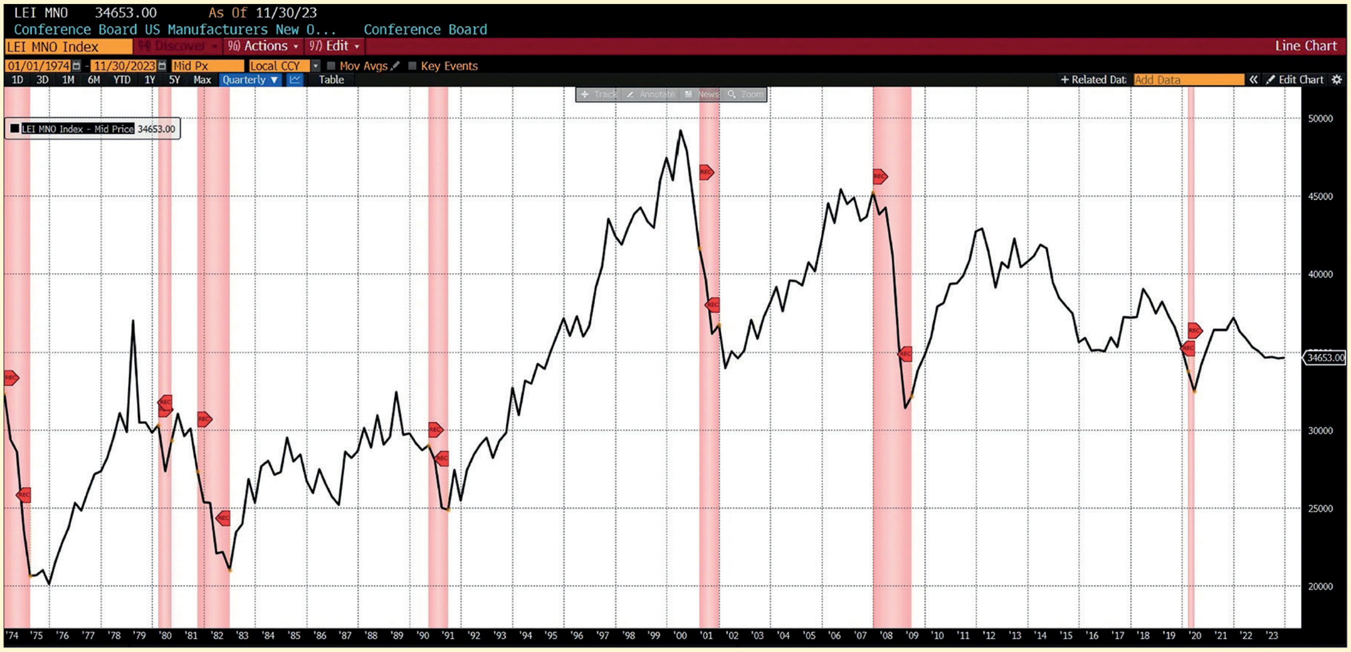
LEADING INDICATORS

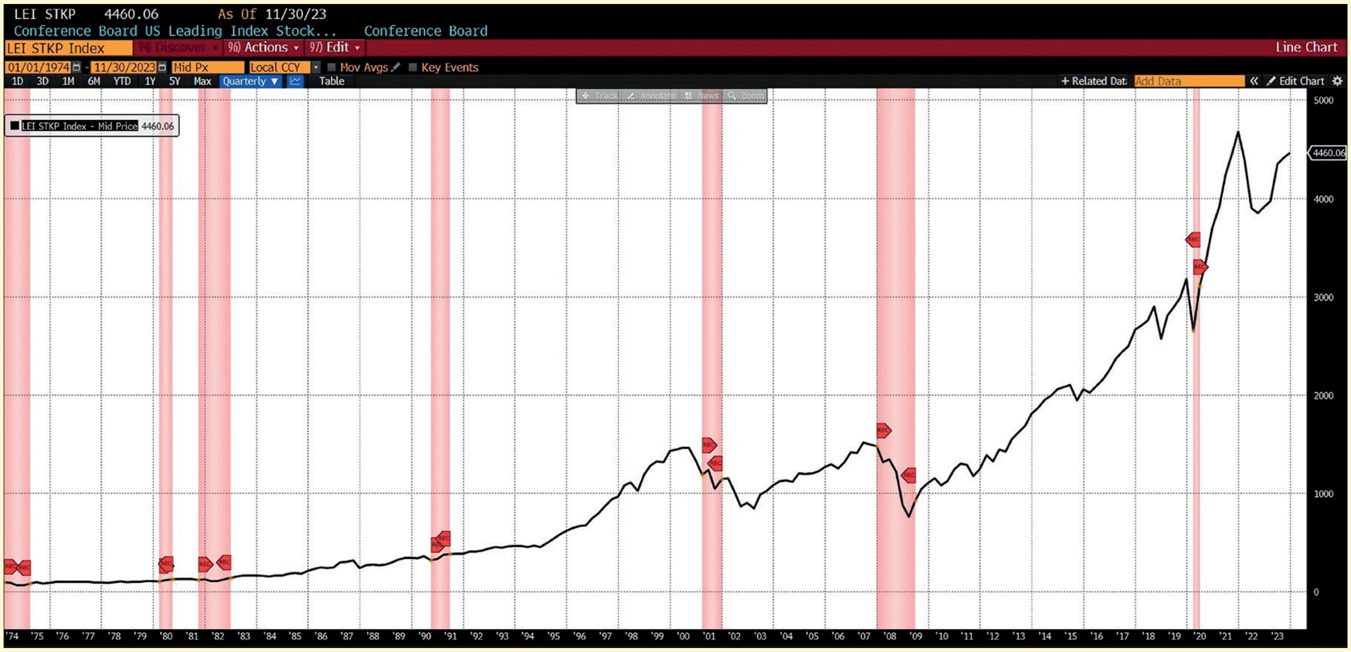





INJCJC 202k For Dec 30 Next Release 11 Jan 08:30 Survey 210k
US Initial Jobless Claims SA Department of Labor
INJCJC Index
Line Chart
01/01/1974 - 11/24/2023 Mid Px Local CCY
INJCJC Index - Mid Price 219.0
Low > High
'74 '75 '76 '77 '78 '79 '80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '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
0
1000
2000
3000
4000
5000
6000

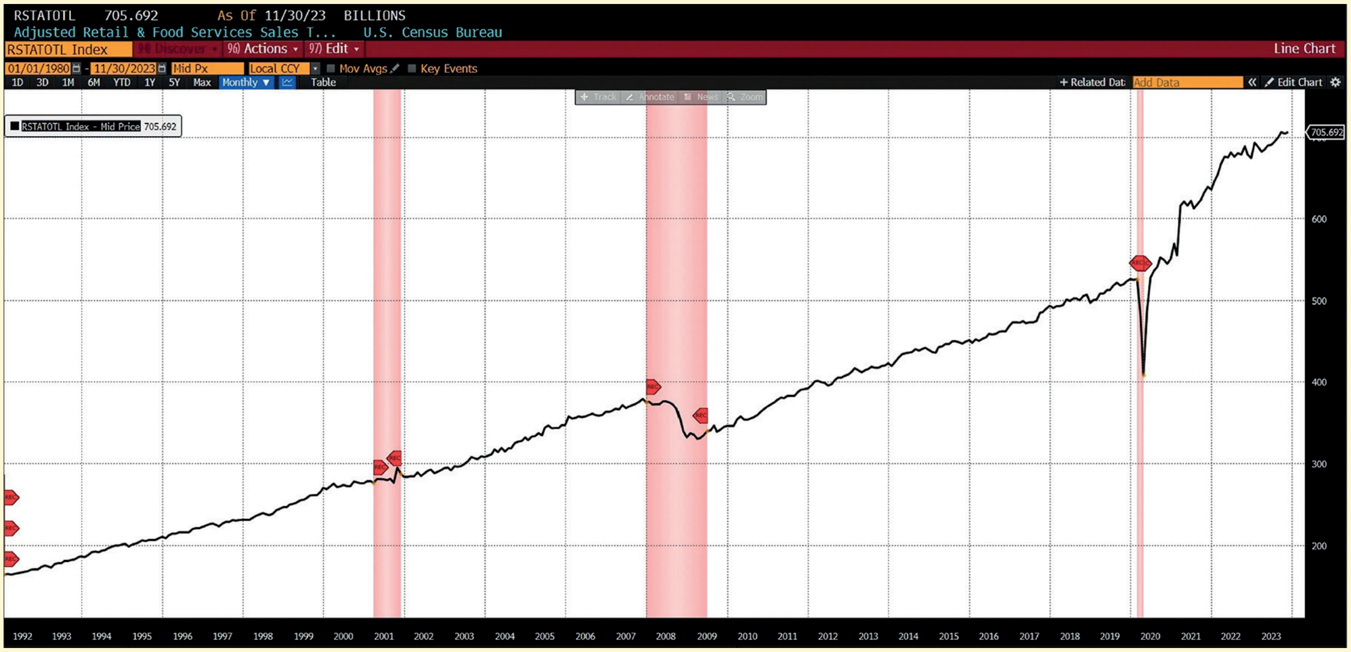

LEI NWCN 124076.00 As Of 11/30/23 MILLIONS
Conference Board US Leading Index Manuf... Conference Board
LEI NWCN Index
Line Chart
01/01/1974 - 11/30/2023 Mid Px Local CCY
LEI NWCN Index - Mid Price 0.124M
'74 '75 '76 '77 '78 '79 '80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '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
0.16M
0.15M
0.14M
0.13M
0.12M
0.11M
0.1M
90000
80000
70000


LEI MNO 34653.00 As Of 11/30/23
Conference Board US Manufacturers New O... Conference Board
LEI MNO Index
96) Actions
97) Edit
Line Chart
01/01/1974 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Quarterly Table
Related Dat Add Data
Edit Chart
LEI MNO Index - Mid Price 34653.00
50000
45000
40000
34653.00
30000
25000
20000
'74 '75 '76 '77 '78 '79 '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

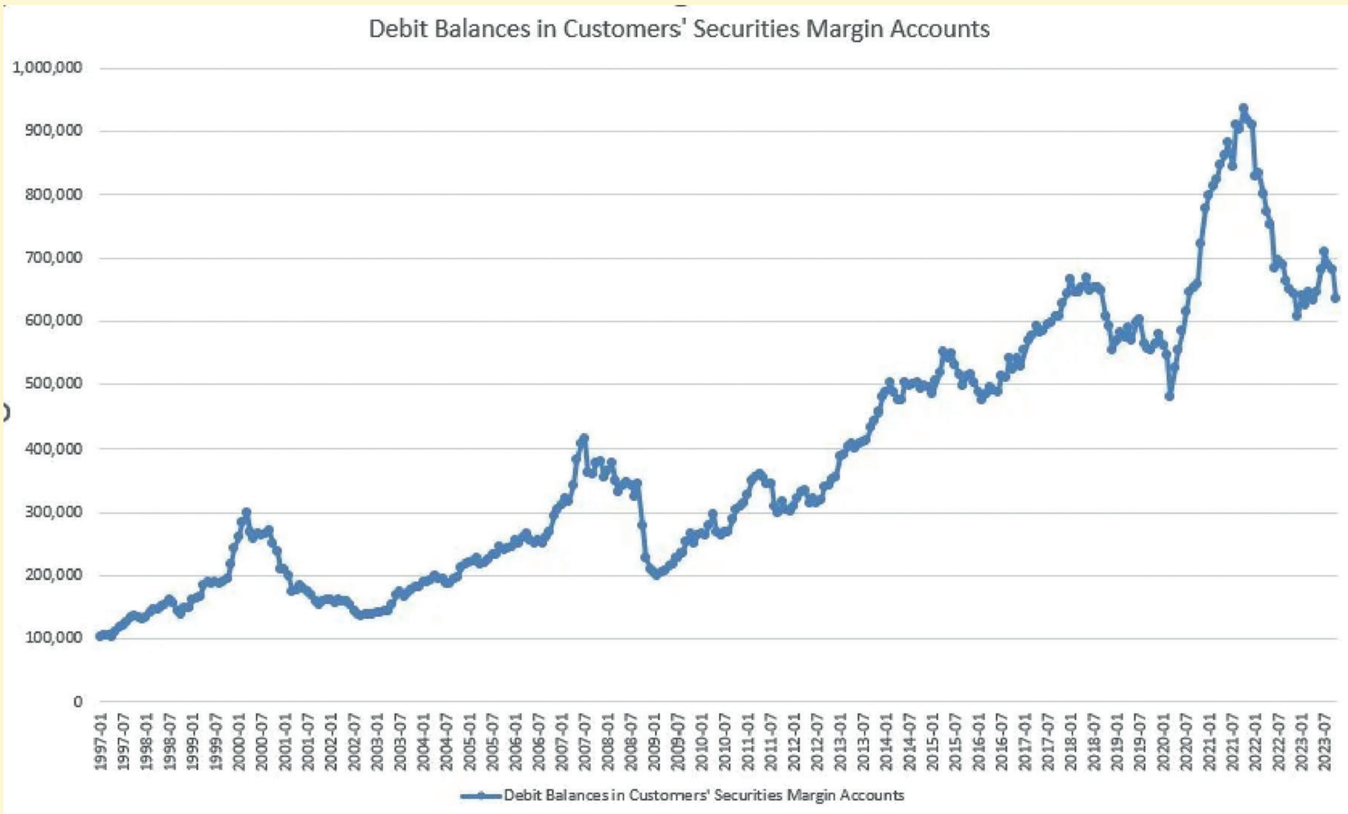

LEI STKP 4460.06 As Of 11/30/23
Conference Board US Leading Index Stock... Conference Board
LEI STKP Index
96) Actions
97) Edit
Line Chart
01/01/1974 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Quarterly Table
Related Dat Add Data
Edit Chart
LEI STKP Index - Mid Price 4460.06
5000
4460.06
4000
3000
2000
1000
0
'74 '75 '76 '77 '78 '79 '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 1.37 As Of 10/31/23 SA
Inventory/Sales Ratio : Total Business U.S. Census Bureau
MGT2TB Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 10/31/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
+ Related Data Add Data Edit Chart
MGT2TB Index - Mid Price 1.37
1.70
1.60
1.50
1.40
1.37
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 1560k For Nov Next Release 18 Jan 08:30 Survey 1417k
US New Privately Owned Housing Units St... U.S. Census Bureau
NHSPSTOT Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
+ Related Data Add Data Edit Chart
NHSPSTOT Index - Mid Price 1560
2000
1560
1500
1000
500
'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

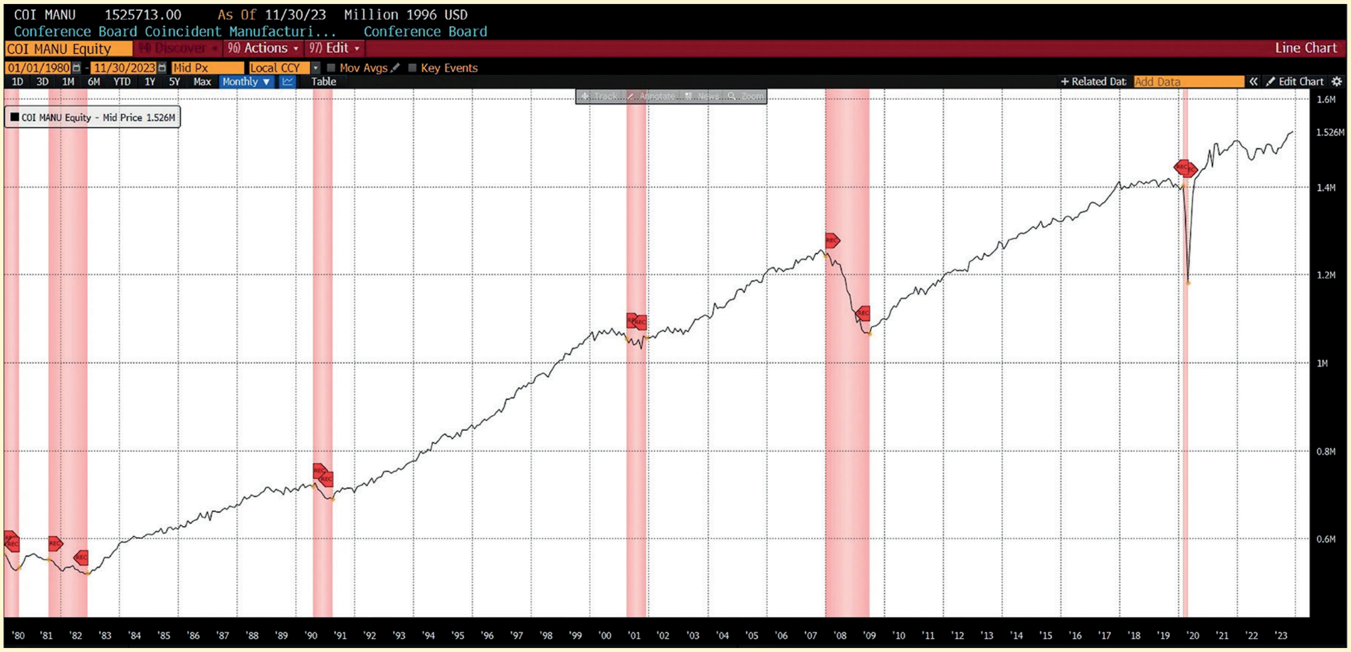

RSTATOTL 705.692 As Of 11/30/23 BILLIONS
Adjusted Retail & Food Services Sales T... U.S. Census Bureau
RSTATOTL Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat: Add Data
Edit Chart
RSTATOTL Index - Mid Price 705.692
705.692
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

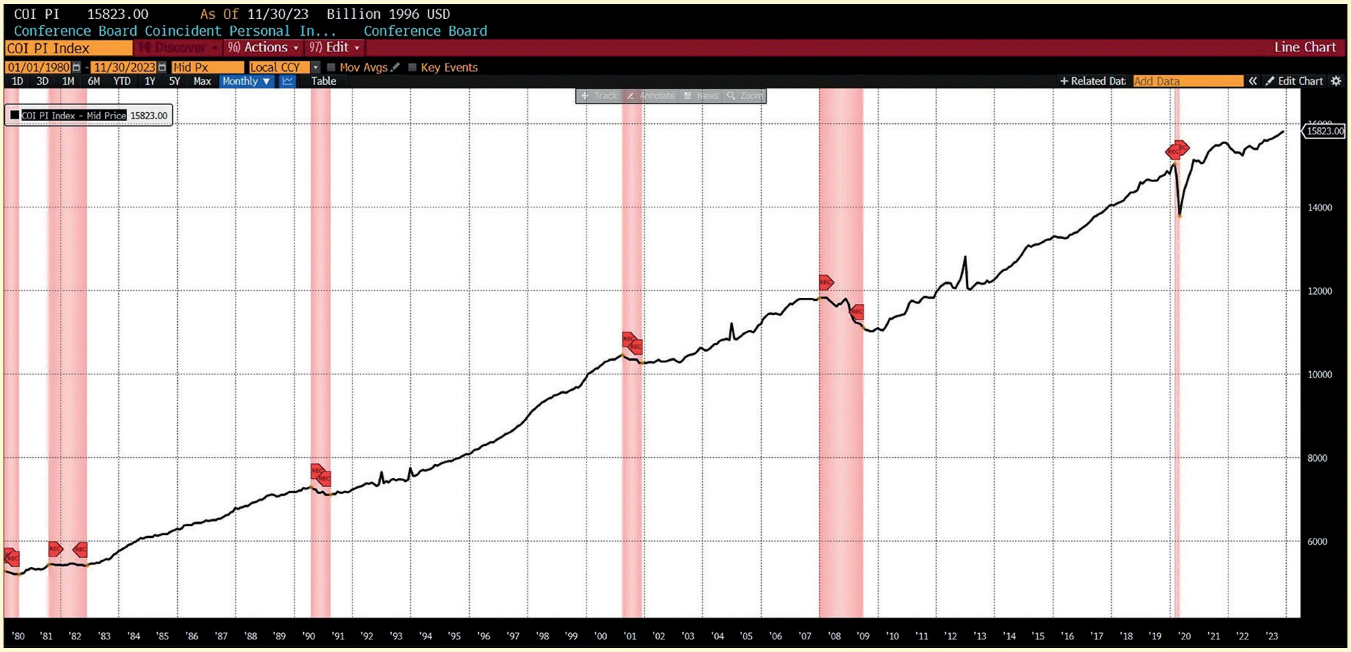

USASHVTK 0.450 As Of 12/31/23 Millions
United States Heavy Trucks Sales SAAR Bureau of Economic Analysis
USASHVTK Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat: Add Data
Edit Chart
USASHVTK Index - Mid Price 0.478
0.600
0.500
0.478
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

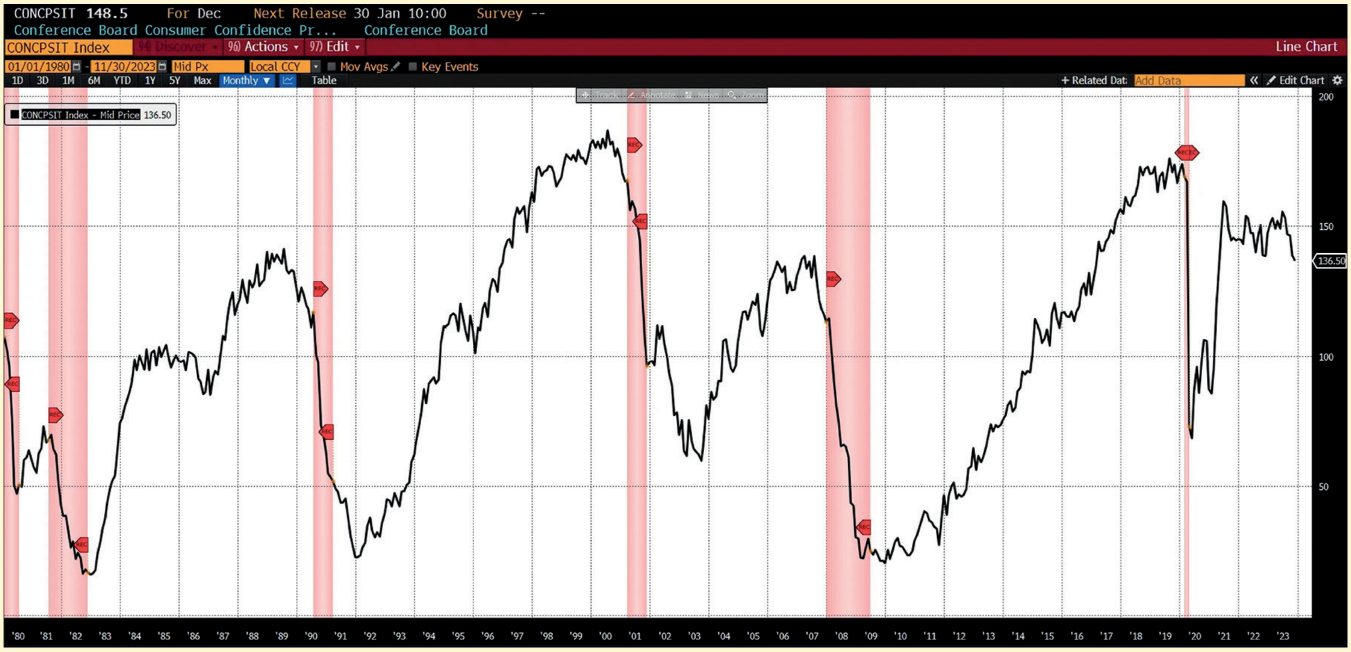


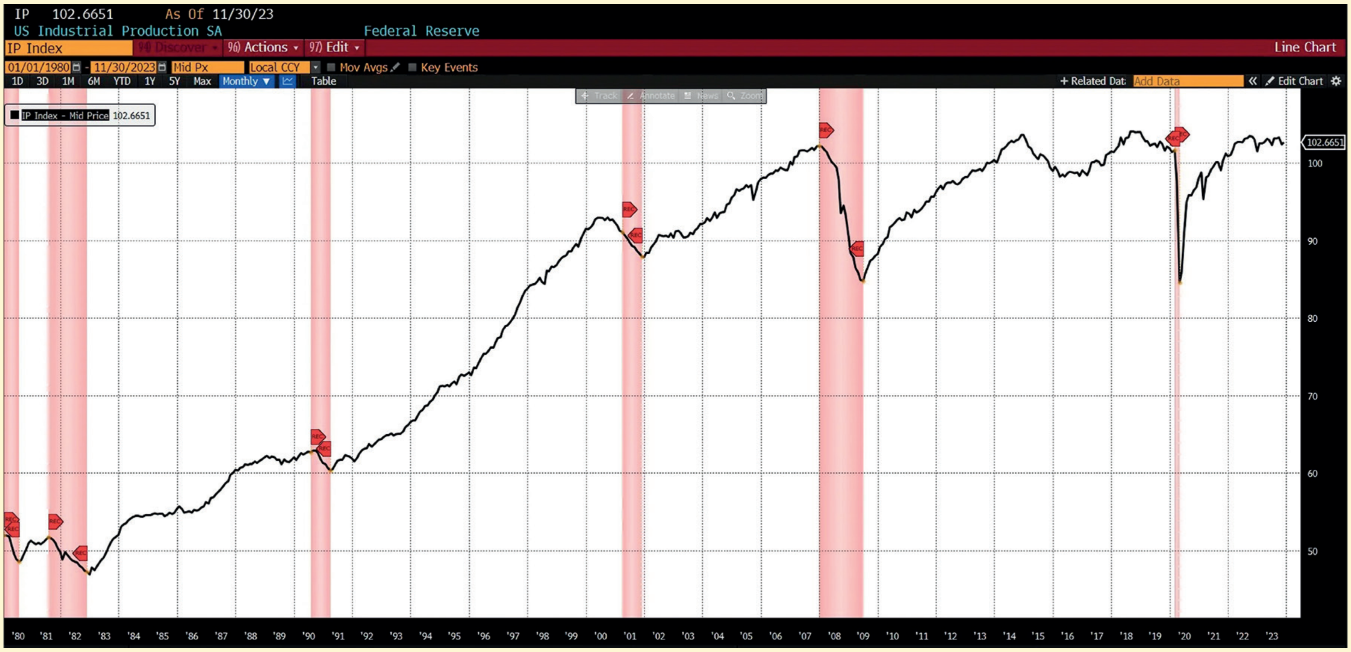
(All sourced from Bloomberg Finance, LP)

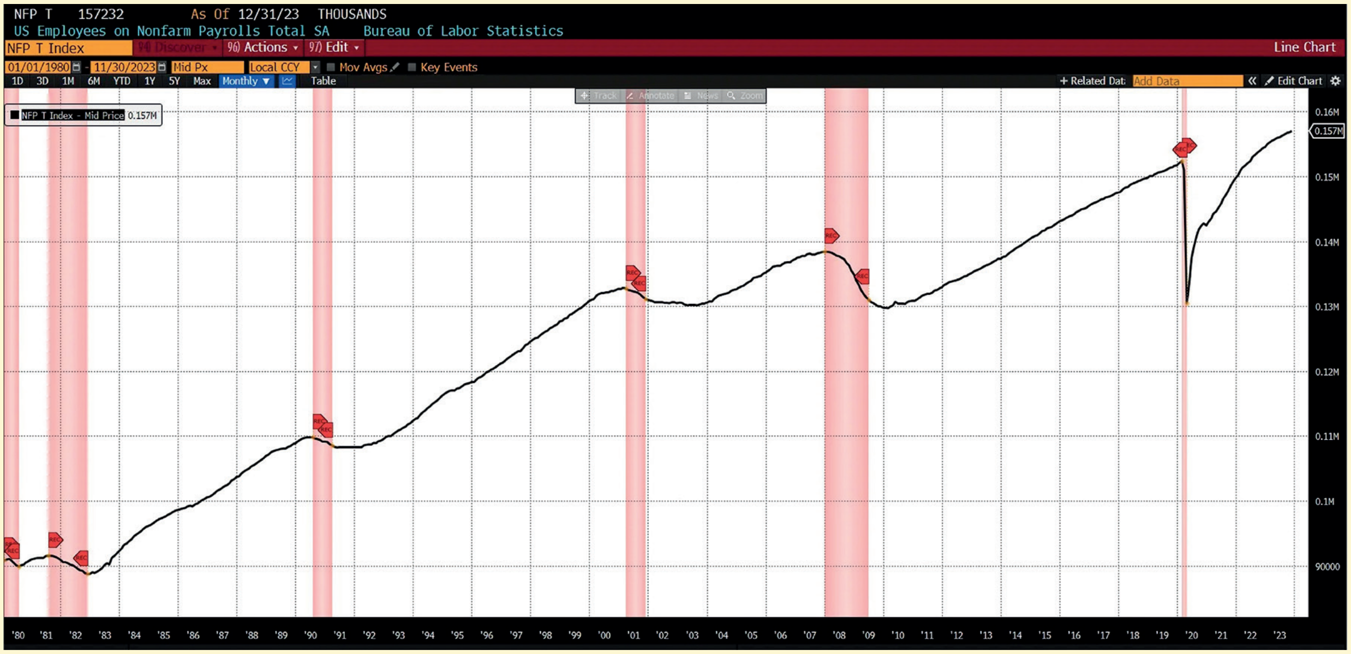
ROUGHLY COINCIDENT INDICATORS





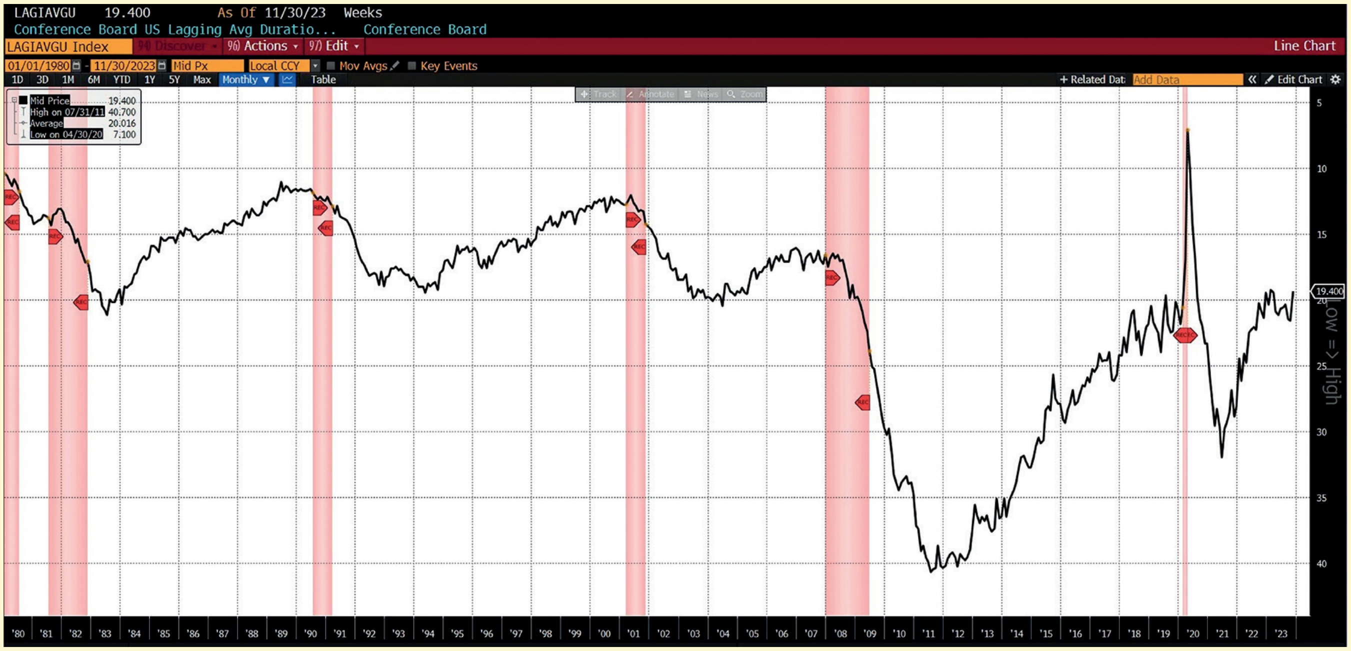

CONCPSIT 148.5 For Dec Next Release 30 Jan 10:00 Survey --
Conference Board Consumer Confidence Pr... Conference Board
CONCPSIT Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat Add Data
Edit Chart
CONCPSIT Index - Mid Price 136.50
200
150
136.50
100
50
'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

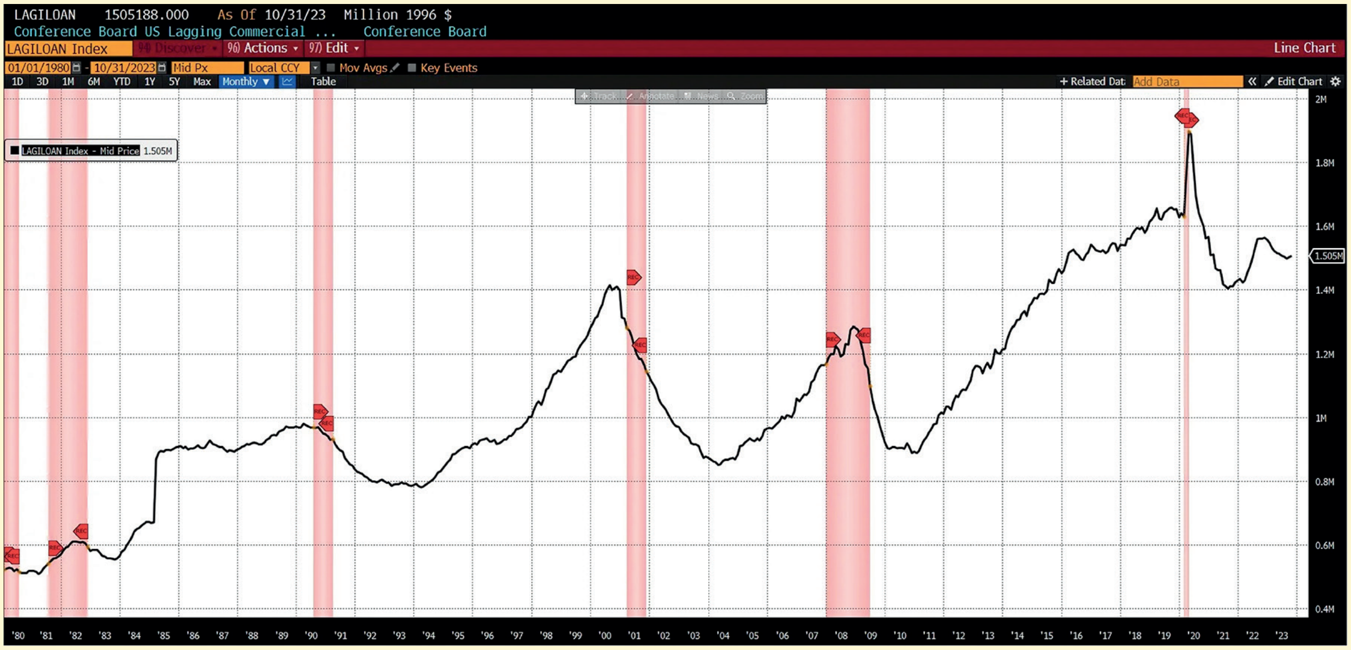

IP 102.6651 As Of 11/30/23
US Industrial Production SA Federal Reserve
IP Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
Related Dat Add Data
Edit Chart
IP Index - Mid Price 102.6651
102.6651
100
90
80
70
60
50
'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

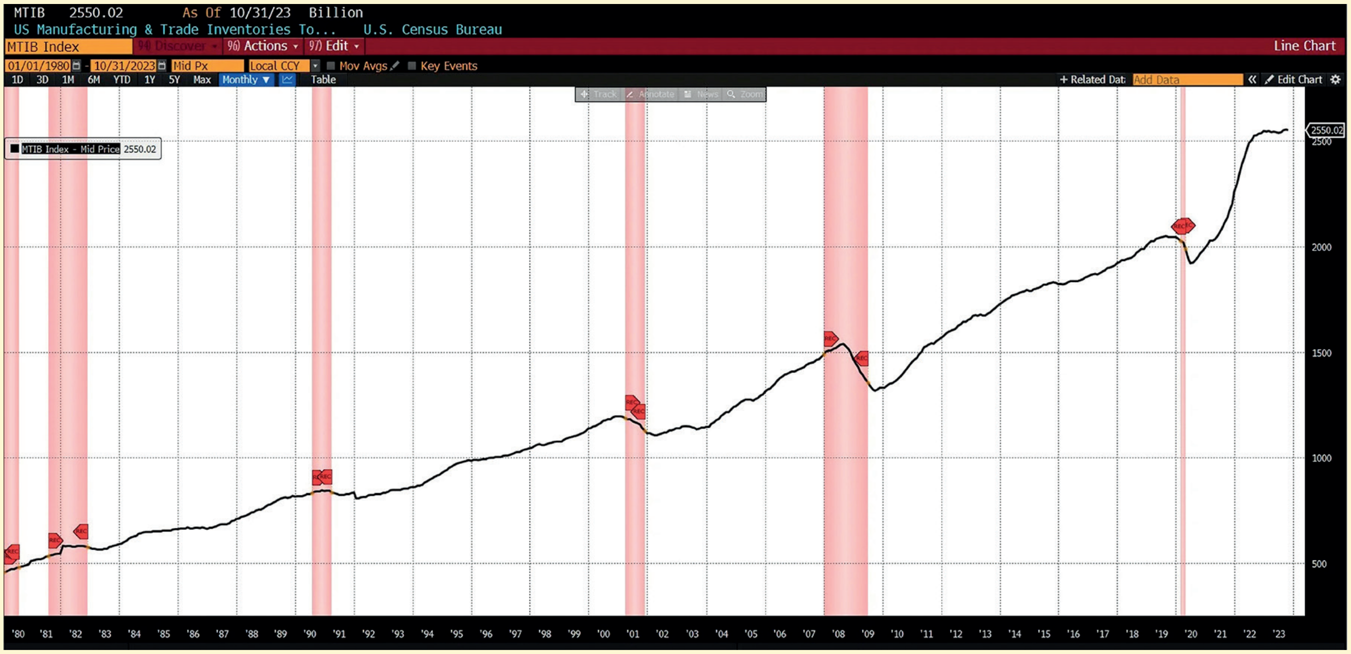

NFP T 157232 As Of 12/31/23 THOUSANDS
US Employees on Nonfarm Payrolls Total SA Bureau of Labor Statistics
NFP T Index
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
NFP T Index - Mid Price 0.157M
0.16M
0.157M
0.15M
0.14M
0.13M
0.12M
0.11M
0.1M
90000
'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

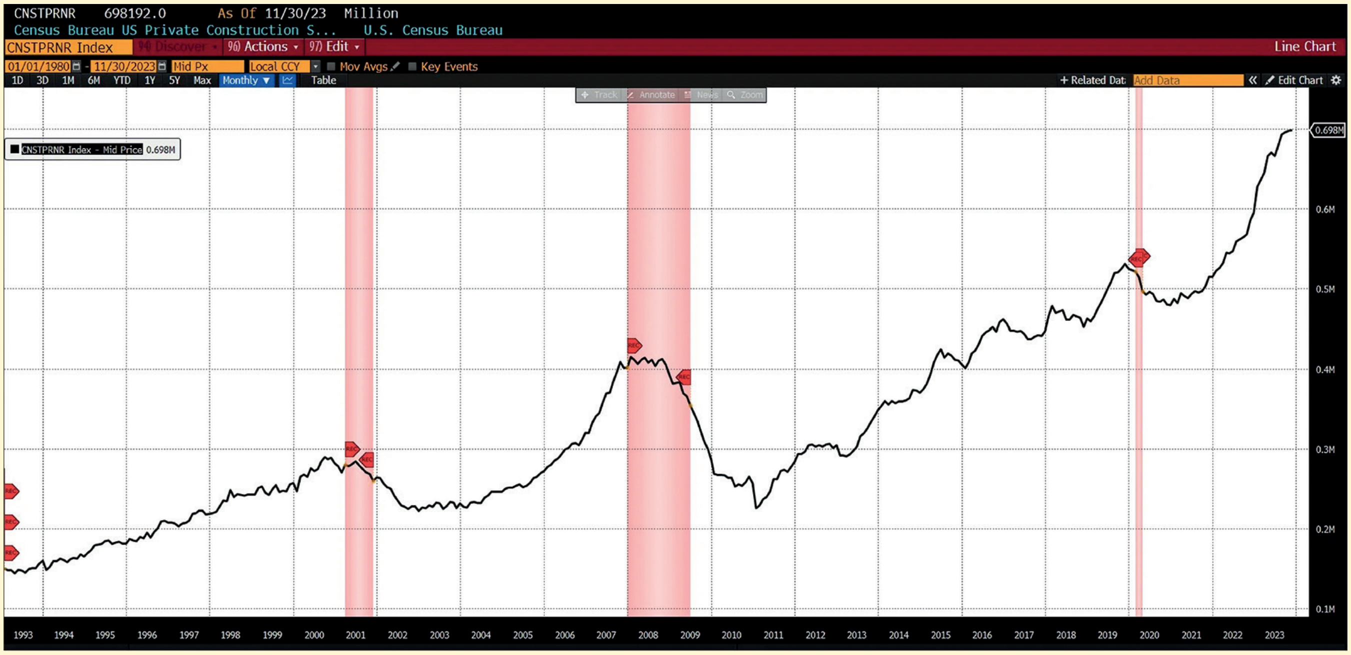

PRUSTOT 62.5% For Dec Next Release 02 Feb 08:30 Survey --
US Labor Force Participation Rate SA Bureau of Labor Statistics
PRUSTOT Index
Line Chart
01/01/1980 - 11/30/2023 Mid Px Local CCY Mov Avgs Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table
PRUSTOT Index - Mid Price 62.8
67.0
66.0
65.0
64.0
63.0
62.8
62.0
61.0
60.0
'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

LAGGING INDICATORS


LAGIAVGU 19.400 As Of 11/30/23 Weeks
Conference Board US Lagging Avg Duratio... Conference Board
LAGIAVGU Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 11/30/2023
Mid Px
Local CCY
Mov Avgs
Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly
Table
Related Dat
Add Data
Edit Chart
Mid Price 19.400
High on 07/31/11 40.700
Average 20.016
Low on 04/30/20 7.100
Low => High
19.400
'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


LAGILOAN 1505188.000 As Of 10/31/23 Million 1996 $
Conference Board US Lagging Commercial ... Conference Board
LAGILOAN Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 10/31/2023
Mid Px
Local CCY
Mov Avgs
Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Monthly
Table
Related Dat
Add Data
Edit Chart
LAGILOAN Index - Mid Price 1.505M
1.505M
'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





(All sourced from Bloomberg Finance, LP)

CAPITAL MARKET PERFORMANCE

		Ticker		Short Name	%1M	%3M	%1YR	3 Year Annualized	5 Year Annualized	10 Year Annualized
		▸ SPR		S&P 1500 Composite Index	+2.57%	+9.68%	+20.08%	9.4623	14.7272	11.7743
		▸ SPXT	d	S&P 500 Total Return	+2.12%	+9.45%	+22.58%	9.7260	15.0835	12.0625
		▸ SPX	d	S&P 500 INDEX	+2.41%	+9.44%	+21.06%	9.7031	15.0648	12.0470
		▸ MID	d	S&P 400 MIDCAP INDEX	+3.36%	+10.79%	+9.26%	7.2185	11.7286	9.2941
		▸ RTY	d	RUSSELL 2000 INDEX	+4.20%	+12.27%	+9.31%	.8276	8.5780	7.1496
		▸ SXXP	d	STXE 600 (EUR) Pr	+1.08%	+7.29%	+7.41%	9.3924	10.2686	7.4366
		▸ TLT US	d	ISHARES 20+ YEAR	+2.35%	+14.12%	-8.00%	-12.8413	-2.5056	2.1364
		▸ QLTA US	d	ISHARES AAA - A	+1.34%	+7.25%	+.27%	-4.0056	1.5978	2.4248
		▸ CRY	d	TR/CC CRB ER Index	+1.18%	-3.97%	+.41%	15.6960	8.9230	-.7390
		XAU		Gold Spot $/Oz	+1.34%	+9.14%	+8.53%			
		XAG		Silver Spot $/Oz	+.56%	+5.71%	-2.21%			
		ILM3NAVG		Bankrate 30Y Mortgage Rates Na	-4.85%	-10.05%	+6.64%			
		ILM1NAVG		Bankrate 15Y Mortgage Rates Na	-4.01%	-8.24%	+6.08%			
		MB301ARM		5 Year ARM	-13.35%	-12.02%	+1.78%			
		ILA3NAVG		Bankrate 30Y Fixe Mtg Refis Na	+.13%	+2.81%	+17.58%			

(Source: Bloomberg Finance, LP)

– January 9, 2024

New Hampshire's Lesson for America

WILLIAM RUGER (President)

JASON SORENS (Senior Research Faculty)

New Hampshire may be a small state in New England, but it offers a big lesson for America.

That lesson is this: The best way to keep your freedom is never to lose it in the first place, and once you've ensured that, to whittle down the remaining barriers to liberty and opportunity.

Look at what happened in Connecticut. Formerly a haven for tax refugees from New York, the Constitution State adopted an income tax in 1991, and now it is one of the highest-taxed states in the country.

By the same token, when formerly pro-big government states elect conservative governments, they often try to make changes – then find out how difficult it is to do. For example, Kansas saw government growth for decades, particularly in the mid-1990s and mid-2000s. In the last decade, when the Kansas legislature tried to turn things around by putting income taxes on a path to zero, it ran into a political buzzsaw of opposition, comprising all the interest groups who've benefited from government largesse. (Leaders could also have done more to better structure tax cuts and cut spending up front to avoid deficits.)

It remains to be seen what will happen in North Carolina, where the legislature has enacted a gradual phaseout of the business income tax. For many years, North Carolina was a relatively high-tax state, and it's been difficult even for committed lawmakers to make more than a small dent in that burden.

Meanwhile, New Hampshire scores at the top of freedom indices not just because of its recent reforms, but because its leadership has resisted efforts to adopt big sources of new revenue. A broad-based income or sales tax is politically taboo in New Hampshire, and the absence of these taxes has kept the temptation of easy revenue out of the hands of legislators.

That's not to say New Hampshire has faced no danger. The state very nearly adopted an income or sales tax in 2001, in the wake of state supreme court decisions that forced the state to provide more funding to local public schools. The tax increases that happened then, coupled with new government regulations in the late 2000s, knocked New Hampshire out of its first-place spot in the Cato Institute's freedom ranking.

But since 2014, the Granite State has come roaring back. This year, for the first time, New Hampshire has not only scored first, but also put clear water between itself and every other state.

So what has New Hampshire been doing right?

First, the state has gradually and responsibly cut growth-impeding taxes, such as business taxes and the interest and dividends tax, which is being phased out. Since these tax cuts began in 2015, New Hampshire's economic growth rate has powered ahead of its closely connected neighbor, Massachusetts.

Second, the state has mostly kept school funding local, which tends to make educational decisions more fiscally responsible. Property owners have more direct leverage and choice over their local property taxes than they do state taxes.

Third, the state is trying to solve its housing shortage, which it shares with most other Northeastern states. Local zoning has strangled housing construction, and the state has stepped in with a law requiring towns to allow "accessory dwelling units" (in-law apartments), expedited local permitting, and a housing appeals board to provide quick resolution of zoning disputes.

Fourth, the legislature has expanded personal freedom for its citizens, most notably with Education Freedom Accounts. The state's per-student adequacy grant to local districts is now available for parents to cover educational expenses outside the public school system.

Finally, the state has been getting rid of cronyist regulations in order to increase competition and opportunities in the marketplace. Some small barriers to starting businesses have been repealed, and the governor signed universal licensing reciprocity this year.

The consequences of all this reform have been economic growth and a growing number of people who want to make New Hampshire their home. New Hampshire is outpacing every other state in the region.

It has the highest real personal income growth rate in New England since the Great Recession of 2008. All three southern New England states have been losing workers and taxpayers to the rest of the country, while New Hampshire has been gaining. New Hampshire's population also recently passed Maine's for the first time in 200 years.

The Cato Institute study shows that increases in growth follow increases in economic freedom, and Americans are moving from states with less economic and personal freedom to states with more. Free-market reforms can pay off, but states must make them sustainable for the long term. One of the most important lessons is that an ounce of prevention is worth a pound of cure: Never give government tools it will be tempted to abuse in the first place.

– December 11, 2023

A Profound Misdiagnosis of American Transit

PAUL MUELLER

Senior Research Fellow

New York Times editor David Leonhardt recently claimed that Americans spend more time commuting than they did twenty, thirty, and forty years ago. Traffic congestion in major urban areas has worsened. Air travel takes longer. The train from NYC to DC runs slower. It takes over thirty minutes to get from Times Square to La Guardia, while the Chinese make a longer trip from downtown Shanghai to the airport in just ten minutes.

These are all interesting observations. But what has caused these delays?

Remarkably, Leonhardt says the culprit is decades of declining investment by the US government in research and development. If that surprises you, you're not alone. How can declining government investment spending on research and development contribute to rising commuting times?

Leonhardt claims that we need massive public investment to update airports and train stations, build new transit infrastructure, improve technology, and expand road networks. The private sector, he says, has little reason to invest in these things.

But Leonhardt is mistaken.

He has profoundly misunderstood how transportation can and ought to work. While he claims that we lack bullet trains and state-of-the-art airports because of insufficient government investment, governments have, in fact, spent massive amounts of money on transit. Over a trillion dollars is spent annually in the US on infrastructure. The real problem is how much more expensive governments have made it to build mass transit systems and how much money they waste in doing so.

Government regulations and policies have made our commutes worse.

Why does air travel take longer than in the past? Well, required TSA scanning adds 30-60 minutes to most trips. We don't need a massive federal bureaucracy that provides the illusion of safe air travel. Let airlines and airports take care of their own security.

Why is Acela slow? Because it is run by Amtrak, a government agency. They have little incentive to invest in better equipment or other improvements. Or consider another government agency, NJ Transit, that will likely run a deficit of over a billion dollars this year. Private entrepreneurs would never run Amtrak or NJ Transit the way they are being run. They would have too much to lose.

Unfortunately, Leonhardt and many of his readers don't seem to understand the importance of incentives and market capitalism. It's not just that a privately-owned Amtrak or private airport security would be run better. They would be run *differently*, and they would become increasingly different over time with the introduction of new methods and technology.

If we really want better travel options, we should rely on the private sector.

The private sector built the New York City subway system over a century ago, after all. The private companies who did that building, though, were then run out of town by politicians so that the city could take over. And it has been one long story of decline ever since, with one expensive exception.

Contrast NYC's initial private subway construction with California's attempt to build high-speed rail. With over $5 billion dollars spent and next to no track laid, the project is all but dead. Projected costs are at least five times higher than initial estimates, even as the powers-that-be have begun lopping off routes. As commentators have observed, it has become a high-speed "train to nowhere."

CA's high-speed rail project did not fail due to a lack of government spending on research and development. It failed because labor unions, environmentalists, lobbyists, and a lack of accountability drove up costs. But beyond all that, the project never really made economic sense. It was simply a much more expensive way of transporting people than air travel – which is part of why the proposed high-speed rail project in Texas is floundering too.

The high-speed transit systems of other countries are not perfect either or the result of wise public investment in R&D. They are either heavily subsidized, such as SNCF in France or KORAIL in S. Korea, or semi-private as in Japan, with extremely dense populations. The solution to "public transit" deficiencies in U. S. cities is to remove "public" from the transit.

But won't private transit ignore poor people and be corrupted by greed? Not if local grocery, hardware, or tech stores are any guide. Or the far more difficult launching of payloads into space.

Privately run mass transit systems will reduce costs and improve quality. Air travel and private toll roads are great examples of how private companies will invest in productive improvements. They innovate in ways that make their customers' lives better. And they run their enterprises far more efficiently, including maintenance, because they want to have profits rather than losses. They will benefit those who cannot afford to live near their place of employment the most.

Publicly owned and operated transit systems in the US are dinosaurs of the 20th century. It's time to recognize that transportation, just like food, fuel, clothing, and every other economic good, can be provided by private market actors with higher quality and at lower cost than government agencies.

We don't need a resurgence of government spending on research and development to get more innovation in our transit systems.

We just need governments to get out of the way!

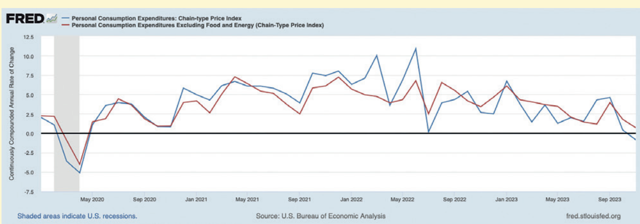
– December 19, 2023

Inflation Undershoots Fed Projections

WILLIAM J. LUTHER
Director, Sound Money Project

After years of underestimating inflation, Federal Reserve officials now appear to be overestimating it. The personal consumption expenditures price index (PCEPI), which is the Fed's preferred measure of the price level, declined slightly in November. It was the first month of deflation recorded since April 2020.

Prices have grown at a continuously compounding annual rate of 2.6 percent over the last year, but much of the increase occurred in the first half of the period. Inflation has averaged 2.0 percent over the last six months and just 1.4 percent over the last three months.



Core inflation, which excludes volatile food and energy prices and is thought to be a more reliable indicator of future inflation, is also low. Core PCEPI has grown at a continuously compounding annual rate of 3.1 percent over the last year. It has grown 1.9 percent on average over the last six months and 2.1 percent on average over the last three months.

Last week, Federal Open Market Committee (FOMC) members projected 2.7 to 3.2 percent PCEPI inflation for 2023, with a median projection of 2.8 percent. Actual inflation will almost certainly come in below that range. Prices have grown just 2.4 percent year-to-date. Prices would need to grow at an annualized rate of 3.1 percent or more in December 2023 to hit the low end of the projected range.

Those same officials projected inflation would remain above target over the next two years. Projections ranged from 2.1 to 2.7 percent for 2024, with the median FOMC member projecting 2.4 percent. They ranged from 2.0 to 2.5 percent in 2025, with a median projection of 2.1 percent.

Bond markets, in contrast, suggest inflation will be on target. After adjusting the TIPS spread to account for the average difference between the consumer price index (CPI) and PCEPI, I estimate the breakeven PCEPI inflation rate—that is, the rate bond traders are pricing in — at 2.0 percent over the five- and ten-year horizons. In other words, those putting their money where their mouth is expect inflation will be around 2 percent.

It is important that FOMC members accurately project inflation conditional on their monetary policies. When FOMC members underestimate inflation, as they did in 2021 and 2022, they will tend to do too little to keep inflation down. When FOMC members overestimate inflation, as they appear to be doing now, they will tend to do too much — increasing the risk of a painful recession.

The FOMC changed course last week, foregoing a previously projected rate hike and projecting deeper rate cuts in 2024 than previously anticipated. But those rate cuts may come too late. The federal funds futures market is currently pricing in a 14.5 percent chance that rates will be lower following the Fed's meeting in January. The FOMC looks unlikely to cut its target rate until March.

Given the most recent inflation data, the FOMC should probably begin cutting its target rate in January. Lower-than-anticipated inflation means that the real (i.e., inflation-adjusted) federal funds rate target is higher than FOMC members intended it to be.

Using last month's core inflation rate (0.7 percent) as a proxy for expected inflation, I estimate the real federal funds rate target range at 4.55 to 4.80 percent. For comparison, the New York Fed estimated the natural rate of interest — the rate that would keep policy neutral — at 0.88 to 1.19 percent for Q3-2023. Even if the natural rate has risen somewhat in Q4, monetary policy looks very, very tight. A 25-basis-point cut would not change the stance of monetary policy from tight to neutral or loose, but it would reduce the extent to which policy is tight — and might prevent the Fed from overtightening.

The Fed was very late to address rising inflation in 2021. Inflation remained too high for too long as a consequence. Fed officials should avoid erring in the opposite direction now that inflation has come down.

– December 23, 2023

Is China America's Biggest Threat?

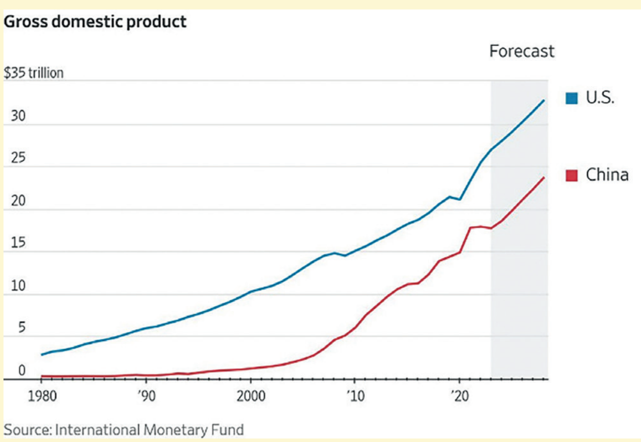
VANCE GINN

Associate Research Fellow

Rating agency Moody's just downgraded China's credit outlook from stable to negative after doing the same to the US about a month ago. Does this mean that China is on equal footing with us? Worse? Better off?

An economic analysis suggests that China is not our biggest threat, nor are we theirs. In fact, the biggest problem we face is completely self-inflicted and found on our home soil.

Apprehensions about China's military actions and trade strategies maintain resonance, especially among middle-aged and older Americans. While caution is warranted, especially concerning their censorship and the treatment of Hong Kong and Taiwan, an economic comparison settles many doubts.

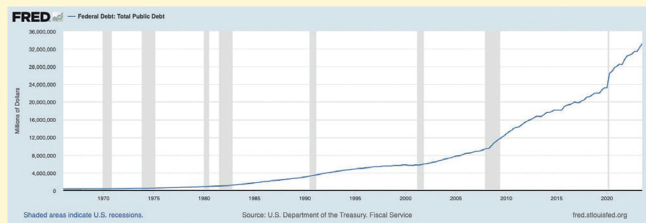


Regarding economic might, the US outshines China with a GDP of $27 trillion compared to China's $18 trillion.

The contrast is stark on a per-capita basis. Americans enjoy an average income of $79,000, six times more than their Chinese counterparts.

One alarming similarity stands out though: Both nations have weathered credit downgrades mainly due to escalating budget deficits and national debts.

The United States' national debt is shaping up to be this decade's hallmark. Now nearly $34 trillion, the deficit spiked in 2020, with trillions of dollars more added since. Net interest payments on the debt climbed by 39 percent and recently surpassed $1 trillion annually.



The repercussions of the national debt crisis are not merely theoretical – they are tangible, affecting the everyday lives of citizens.

In 2023, the dollar has significantly depreciated. Fitch (and now Moody's) downgraded our creditworthiness. Home sales hit their slowest pace since 2010. Average 30-year fixed mortgage rates reached their highest point since 2000. And real median household income dipped to its lowest level since 2018, to name just a few of our recent economic woes.

These findings shed new light on our competition with China. They should prompt America's leaders to reevaluate our priorities and consider whether the enemy across the Pacific is as pressing as the ones we face at home.

While some argue the government spending that drove the deficits was necessary, especially during the pandemic's peak, it underscores the broader problem – a lack of fiscal discipline and a predisposition to rely on debt as a quick fix. It is high time the US adopted a spending-limit rule. Without one, we've only made things worse and failed to reach budget agreements.

A reasonable spending limit of no more than the rate of population growth plus inflation has worked at the state level, and it would work at the federal level.

While the US points the finger at China, we have three other fingers pointing back at us.

Excessive government spending and a burgeoning national debt are eroding the foundation of our economic stability. Now is not the time to allocate excessive resources to confront external foes, but to address the fundamental issue plaguing us: a government that refuses to rein in spending of taxpayer money.

America should also correct the errors in recent years of trade protectionism.

There is reason to counter those countries who don't play by the same rules, like China, but that should be done by joining free trade agreements with allies. This would be a more effective and affordable approach for Americans instead of raising taxes on them through tariffs, appreciating the dollar thereby increasing the trade deficit and contributing to trade wars that often lead to military wars.

Let's refocus our efforts, fortify our economic foundation, and confront the genuine threat within our borders. If not, governments will not be able to do their job of preserving liberty. This is of utmost importance.

– December 10, 2023

Fake Meat: More Entrée or Agenda?

PHILLIP W. MAGNESS (Contributor)
PETER C. EARLE (Senior Research Fellow)

The Fed's aggressive interest rate hikes, the surge in retail trader activity, and pandemic-driven valuations have led many previously high-flying public firms to face a sudden reversal of fortunes. Transitioning from pandemic-era policies to a more typical economic environment, firms again need strong business fundamentals to survive in a competitive landscape. A reality check has arrived for the "meme stocks" like GameStop and AMC Theatres, the SPACs (Special Purpose Acquisition Companies) like WeWork and Virgin Orbit Holdings, and even firms with tangible post-pandemic prospects, like Zoom and Netflix.

Among the casualties are a growing number of plant-based meat substitute companies that initially garnered substantial investor interest but have since grappled with low and diminishing consumer demand. In June of this year, UK-based Meatless Farm shut its doors not long after Heck, a maker of meatless sausages, announced that it would substantially reduce its consumer offerings. Nestlé-owned Garden Gourmet also pulled its vegan offerings from UK shops in March 2023. Canada's Very Good Food Company, a vegan food producer which soared 800 percent on the day of its public offering in 2020, recently collapsed after revealing it had never been profitable.

By far the biggest turnabout has occurred in the most prominent plant-meat substitute enterprise, Beyond Meats. The corporate flagship of the sector conducted its IPO in May 2019 priced at $25 per share, opening at $46 and rising to as high as $72 on its first day of trading. By July 2019 the stock price briefly surpassed $230 per share, spiking above $150 per share several times during the pandemic. But since mid-2021, the stock price fell from over $100 to recently close below $6. For six consecutive quarters, the company has reported negative sales growth amid not only a loss of market share but a contraction in the size of the fake meat market. Nearly one-fifth of the firm's non-production workforce was laid off early in November 2023. Financial analysts have characterized the firm as in survival mode, with its financial deterioration bringing about a "going concern" risk.

So why are so many plant-based "alternative" meat companies faltering at the same time? Part of the answer, we propose, may derive from a pattern of noisy market signals that we dub Conspicuous Production.

Conspicuous Production refers to the creation of goods that are not necessarily sought by a large consumer base, but that are thought to convey certain social signals when they are marketed to the public. It's a supplier's counterpart to the more famous concept of Conspicuous Consumption, wherein consumers purchase products to show off the status, wealth, tastes, or social desirability that ownership of a good is perceived to convey. In the case of conspicuously produced goods, the supplier offers a product that caters to certain social trends and causes, whether or not people are willing to purchase it.

It is not difficult to see how artificial "meat" companies fall into a pattern of Conspicuous Production. These plant-based alternatives are presented as more environmentally friendly alternatives to meat. They ostensibly facilitate the reduction of meat-based diets, which is an increasingly vocal political demand of climate activists.

Many of these products are also marketed as vegan under an ideological presumption that eating plants is more ethical than eating animals. A retailer might accordingly choose to carry large selections of plant-based "meat" products out of the belief that it will gain them reputational accolades from their shoppers by signaling social responsibility, sustainability, and similar sentiments. Similarly, a restaurant may add a meat-colored congealed vegetable patty to their burger lineup, hoping to garner goodwill from diners who perceive this offering as environmentally ethical.

But what happens if very few people buy these same conspicuously produced food items?

We suspect that many vegan food companies have mistakenly interpreted the social signaling of "alternative meat" store displays and menu items as indicative of a much larger consumer base than they actually possess. It's only when they unexpectedly encounter financial difficulties due to sluggish sales that the true state of affairs becomes evident. Furthermore, the prolonged shelf life of plant-based alternatives to meat, attributed to the numerous chemicals and binding agents used in their production, could be convenient for those seeking to showcase their company's social consciousness by stocking their freezers. As we've witnessed during events such as hurricanes, COVID-induced grocery store rushes, and similar natural or political crises, what Pete Earle has termed "Magness Effects" are undeniably real.

To elaborate, even in situations where there is a glaring and widespread shortage of essential food items due to emergency circumstances, the vegan section of the freezer aisle often remains largely untouched. The majority of consumers simply have no desire to consume such products (and the small minority that does may already have well-stocked freezers filled with these items, again benefitting from their long shelf lives).

Yet, there is an underlying economic rationale behind the existence of these Magness Effects. Rather than aligning their product offerings with genuine consumer preferences, most grocery stores seem to allocate prime shelf space to faux-meat products as a way of projecting a particular image of social responsibility. They hope that when customers pass by a prominently displayed shelf of vegan goods, they may infer that the store is actively promoting values like saving the planet or protecting animals. It's akin to establishments that prominently place recycling bins in public view, even though, in reality, the recyclables often end up mixed with regular trash once they're out of sight.

While the vast majority of shoppers are unlikely to open the vegan freezer door and select a package of artificially colored and molded celery stalks masquerading as chicken tenders, a substantial minority perceives this shelf as a testament to the store's corporate social responsibility toward the environment. Meanwhile, the subset of the population that does consume these products maintains an ongoing oversupply relative to their market share. Since there's little demand from others, they can walk into the store during a hurricane, blizzard, or other run on groceries and the artificial meat shelf will appear virtually unchanged from a typical Tuesday.

The news is not encouraging for plant-based meat entrepreneurs. A November 18th Telegraph UK article reports that the plunging fortunes of vegan food makers have occurred alongside the resurgence of interest in real meat. "Smashed burgers" account for a substantial part of the renewed interest, with eateries offering twists on the recipe in towns all across the UK. (Unsurprisingly, it's a style that originated in the United States.) As for meat consumption trends in the US, the USDA estimates per-capita retail weight consumption of 224.6 pounds of red meat and poultry in 2022: 10.3 pounds higher than the average observed from 2012 to 2021.

The desperation of the grass-meat constituency is clear in the headlines of ideologically aligned media supporters. A widely-syndicated16 November Associated Press article implored readers: “Plant-based meat is a simple solution to climate woes — if more people would eat it.”

Yet despite consumers speaking about as clearly as they ever do, an arrow remains in the quiver of the grass-burger constituency. Impossible Foods CEO (and former Stanford University biochemist) Pat Brown recommends a meat tax, drawing comparisons with the levies currently charged on tobacco, marijuana, and sugar products in various jurisdictions. If consumer tastes won’t salvage the market for animal-part-shaped blocks of dyed soy extract, its boosters and beneficiaries are hoping that government interventions will.

In the meantime, the plant-based alternatives industry appears to be facing its first true market test and doing poorly. True, the consumer base for fake meat is not zero. It’s simply a much smaller market than producers perceived, due to the noisy signals and political distortions of Conspicuous Production. The result is a plant-based alternative food industry that far outpaced the interest in what it had to offer, and is now seeing a rapid contraction as the consumer sovereignty corrects those misread signals.

– December 5, 2023

Defending Globalization

DONALD J. BOUDREAUX
Associate Senior Research Fellow

This past September the Cato Institute launched a major new initiative called "Defending Globalization." The brainchild of Cato's prolific international-trade scholar Scott Lincicome, Defending Globalization is a multimedia project designed to explain the benefits of what is described on the project's website as "all aspects of the fundamentally human activity that we call 'globalization.'"

Many people, no doubt, will object to globalization being described as a "fundamentally human activity," a term that conjures images of a natural process that has long been familiar to humans. But the term is accurate. Globalization is what happens naturally when individuals in modern society are left free from government restraint to trade – free to offer to sell, and free to offer to buy, with no one compelled to accept any such offers and, importantly, with no politicians or policemen obstructing the offerers and offerees.

Trading comes naturally to humans. The trading instinct is the root cause of great commercial cities, ancient and modern. In the past, when transportation and communications were very costly and time-consuming, the natural geographic range over which intensive trading regularly occurred was small. But as the costs of transportation and communications fell, and as each of these activities became faster (with the latter becoming instantaneous literally over the whole earth), the natural geographic range over which intensive trading regularly occurs grew. Today, that natural range for many goods and services spans the entire populated area of the globe.

The indisputable truth that today the natural range of trading activity is large – certainly larger than the area of any individual country – comes in an ironic form: tariffs and other government-erected obstructions on trade. Only because people are eager to trade with people in different countries do governments feel the need to suppress this trade.

Stated straightforwardly, this truth is undeniable. Nevertheless, it is denied by the many pundits and politicians who assert that elites impose globalization on ordinary people. The *implication* is that globalization is both detrimental to the masses as well as unnatural. Of course, if these pundits and politicians *really* believed that globalization is unnatural (and, therefore, must be imposed) they'd be content simply to leave ordinary people free to trade, confident that no, or only minimal, cross-border commerce would occur. The very existence of government-erected restraints on international commerce proves that those persons who are responsible for erecting these restraints understand that what must be imposed is not globalization – that would arise naturally – but economic nationalism.

The allure of economic nationalism, alas, isn't only real, it's also powerful. People in different countries and different eras have willingly embraced it. Just *why* so many people are so easily deluded into believing that they are made better off when their access to goods, services, and investment opportunities is restricted by elites has long been a mystery. This mystery is partly solved by public-choice economics: Voters are rationally ignorant, and disproportionate political influence is enjoyed by special-interest producer groups. Another reason is that we humans are likely evolved to see reality as a struggle between "us" and "them," and therefore the interest groups who stand to gain from protectionism find success in portraying actions that benefit foreigners as actions that harm us and our fellow citizens while simultaneously enriching those who mean us harm. Relevant here is the fact that trade restrictions are invariably described by their peddlers as both "protection" of fellow citizens and "standing up to" or "fighting back against" foreigners.

Free trade and globalization, although great benefactors of humankind, are not naturally popular. It might even be closer to the truth to say that free trade and globalization are naturally *un*popular. Thus they are forever in need of sound defense – which is precisely what is supplied by the Defending Globalization project.

I encourage you to read every essay in this project, many of which remain to be published. I've read each that has been published, and attest to their excellence. Here's a small sample of what you'll learn.

From Johan Norberg's contribution, titled "Globalization: A Race to the Bottom – or to the Top?"

> In his book *Globalization and Labor Conditions*, Robert Flanagan summarizes the evidence: "Countries that adopt open trade policies have higher wages, greater workplace safety, more civil liberties (including workplace freedom of association), and less child labor." Flanagan and Niny Khor also document this relationship in "Trade and the Quality of Employment: Asian and Non-Asian Economies," in the OECD report *Policy Priorities for International Trade and Jobs*.
>
> This would be extremely surprising if companies always scoured the globe searching for the lowest-cost country. But they don't. If they did, 100 percent of foreign direct investment would go to the least developed countries, but in fact, no more than 2 percent of all foreign direct investment is heading in their direction. Most investment goes to relatively developed countries, and GDP per capita is the strongest influence on labor conditions. On average, richer countries have higher wages, safer jobs, shorter working hours, and stronger labor rights, such as freedom of association and less forced labor.
>
> The race-to-the-bottom hypothesis got it wrong because it neglected half the cost-benefit analysis. If labor compensation (in the broad sense, including working conditions) were just a gift generously bestowed on workers, it would make economic sense to reduce it as much as possible, but in a competitive labor market, it is compensation for the job that someone is doing, and therefore there is a tight link between pay and productivity. Some workers might be twice as well paid as others, but that does not make them uncompetitive if they are also twice as productive.

From Daniel Drezner's "The Dangers of Misunderstanding Economic Interdependence":

> While contemporary fears about excessive interdependence are real, that does not mean that these fears have been realized. Indeed, a quick perusal of the alleged downsides of interdependence reveal that much of what has been feared has not come to fruition.
>
> For example, consider the allegations about how China gamed the liberal international order to serve its own revisionist ends. It is undeniably true that as China has grown economically stronger, it has also grown more repressive and more revisionist. Neither of these facts, however, falsify the liberal theory of international politics. The liberal argument

> posits that interdependence constrains rising powers from pursuing more bellicose policies than they otherwise would have. It says next to nothing about interdependence triggering democratization. It is possible that China can repress domestically while still acting in a constrained manner on the global stage. Most of China's alleged revisionist actions have been exaggerated. For example, neither the BRICS (Brazil, Russia, India, China, and South Africa) bank nor the Asian Infrastructure Investment Bank have challenged the Bretton Woods Institutions. Claims that the Belt and Road Initiative is an example of debt-trap diplomacy have also been wildly exaggerated; indeed, if anything, China's recent lending practices suggest that it will not weaponize debts from the Global South. While China has built new institutions outside the purview of the United States, none of them contradict the principles of the liberal international order.

And from Daniel Griswold's "The Misplaced Nostalgia for a Less Globalized Past":

> Even these adjusted income data understate the gains enjoyed by American workers in our more globalized era. In *Superabundance: The Story of Population Growth, Innovation, and Human Flourishing on an Infinitely Bountiful Planet*, Cato scholars Marian Tupy and Gale Pooley compare time prices (how many hours people must work on average to acquire various goods and services) across decades and find that American workers have experienced dramatic gains since the 1970s. In particular, they calculate that the number of hours an average U.S. blue-collar worker would have to work to afford a basket of 35 consumer goods fell by 72.3 percent between 1979 and 2019. For example, in 1979, a coffeemaker cost $14.79 while the average blue-collar worker earned $8.34 per hour, meaning he would have to work 1.77 hours to buy the coffeemaker. By 2019, a comparable coffeemaker sold for $19.99 while the average blue-collar worker earned $32.36 an hour, translating to a time price of 0.62 an hour — a 65 percent decline. Using the same methodology, the authors found similar improvements for other household goods: the time price of a dishwasher had fallen by 61.5 percent; for a washing machine, by 64.6 percent; for a dryer, 61.8 percent; for a child's crib, 90 percent; for a women's blazer, 69 percent; and for women's pants, 44.6 percent.
>
> American workers are better off than in decades past not only because familiar goods have become more affordable but also because new types of products have come on the market and spread rapidly.

Again, the above selections are only a slim sample of the impressive abundance of wisdom, insight, and information that await you at "Defending Globalization." Embrace it.

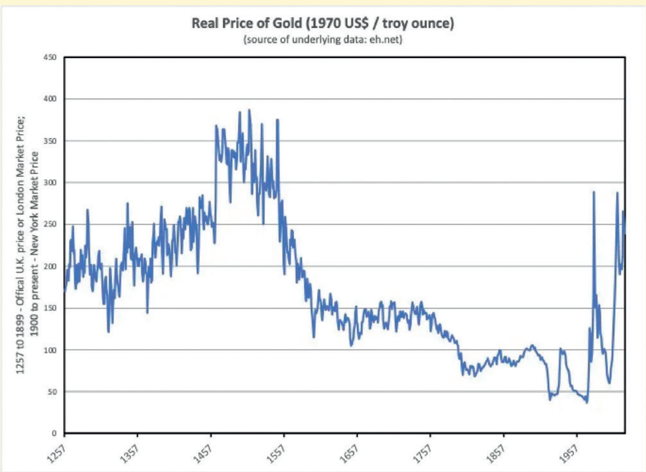
– December 9, 2023

The Golden Constant

CLIFFORD F. THIES

Contributor

Gold is considered by many to be either an inflation hedge or an all-risk hedge. Yet, history — recent and long-term — shows that the real price of gold has fluctuated significantly, even violently in recent times. Here I show the real price of gold (the money price of gold divided by a consumer price index).



Prior to the discovery of the New World (and that the indigenous people of this hemisphere didn't have guns), the real price of gold was gradually increasing. This might reflect that in between discoveries of gold, its real price tended to increase. Then, with the shipment to Europe of gold and silver from the New World, the real prices of these metals fell. This phenomenon is called the Price Revolution by historians.

Following the Price Revolution, the real price of gold was stable for about a hundred years. Then, during the 18th Century, the real price of gold started falling again. This period, during which the real price of gold fell from about 150 to about 100 percent of its 1970 value, has no special name. My guess as to the underlying cause of this decline in the real price of gold was the growth of fractional reserve banks, starting with the Bank of Amsterdam. Fractional reserve banks enabled a roughly constant supply of gold and/or silver to be multiplied into a larger supply of money.

Beginning in the 20th Century, following my shift of reference from London to New York, we see violent swings in the real price of gold. The first swing concerns the outbreak of WWI, and the suspension of the gold standard in Europe. The suspension of the gold standard in Europe resulted in gold flowing to New York, increasing the supply of gold in the US, and driving down its real price.

The real price of gold recovered during the late 1920s upon resumption of the gold standard in Europe. Since the US was then on a gold standard, this rise in the real price of gold was associated with deflation of consumer prices, waves of bank failures, and the Great Depression.

Following WWII and the Bretton Woods Agreement, the real price of gold fell again. The Bretton Woods Agreement can be described as a gold exchange standard. Only the US dollar was directly tied to gold. Other currencies were tied to gold indirectly, by being fixed in their exchange rates to the US dollar. This agreement allowed an expansion of the worldwide money supply sufficient to avoid a post-war deflation.

In 1971, with the US embarking on a path of deficit spending, the Bretton Woods Agreement broke down. With the breakdown of the Bretton Woods Agreement, the US dollar "floated" against gold, meaning that its value sank against gold. The country then moved like the Titanic from iceberg to iceberg, in a bewildering series of ever worse cycles of inflation and recession. Then, Paul Volker came in and, at the cost of a severe recession, guided the Federal Reserve to a path of "non-inflationary economic growth."

As the above chart shows, during the years immediately following the breakdown of the Bretton Woods Agreement, the real price of gold reached a level not seen since the Price Revolution. The demand for gold was fueled by ongoing inflation and fears of its acceleration. But, with the adoption of "non-inflation economic growth" by the Fed, those fears weren't realized, and the real price of gold collapsed.

In recent years, a new source of uncertainty has been driving up demand for gold, and its real price. In 2020, the Trump Administration asked Congress for trillions of dollars to slow the spread of COVID. Since then, the Biden Administration has followed suit with additional trillions of dollars of deficit spending.

Again the real price of gold has risen to historic highs. The fear fueling this increase in the demand for gold is that the "unsinkable" ship of state has been so compromised by debt that it now risks slipping under the waves.

One possible prospect is for the US to suffer decades of high rates of inflation such as characterized Argentina under Juan and Eva Peron and their successors.

Another possible prospect is for a crescendo of hyperinflation to utterly destroy the middle class and set the stage for a dictator such as happened in Germany during the 1920s.

With such possibilities, wouldn't it be prudent to have some gold coins that you could sew into the lining of your coat, for when you must make your escape?

I will close with a story. As a high school student many years ago, I attended a national convention of young conservatives where I met an old lady. She said she was a youth in Russia at the time of the communist revolution there, but was fortunate to escape, going to Cuba. Then, as a mature adult, there was a communist revolution in Cuba. Again she was fortunate, this time escaping to the United States.

"You in America," she said, "will not be fortunate. Because where can you go?"

– December 27, 2023

Despite CPI Uptick, Monetary Policy Remains Tight

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Inflation rose slightly in November, according to the Bureau of Labor Statistics. The Consumer Price Index (CPI) grew 0.1 percent last month after remaining essentially unchanged in October. Year-over-year headline inflation was 3.1 percent; Excluding food and energy prices, it was 0.3 percent in November and 4.0 percent year-over-year. Continuously compounded annual rates, which likely give a better picture of real-time price pressures, were 1.16 percent for headline inflation and 3.41 percent for core inflation.

Prices for used cars and trucks, medical care commodities, shelter, and medical care services went up the most. These more than offset a continued decline in energy prices, especially gasoline prices. The overall picture is a small increase in inflation, accompanied by significant sectoral (microeconomic) changes driven by altered supply-and-demand conditions.

Despite the inflationary uptick, monetary policy remains tight. The fed funds rate target range is currently 5.25 to 5.50 percent. Let's adjust this for inflation using the core year-over-year rates (as opposed to the continuously compounded rates) to steelman the argument. The implied real fed funds target range is 1.25 to 1.50 percent.

As always, we need to compare this to the natural rate of interest. This is the inflation-adjusted interest rate that balances the supply of short-term capital against competing demands for its use. When this rate prevails in the market, the economy is producing as much as it sustainably can, and hence inflation will not accelerate. Estimates from the New York Fed suggest the natural rate is between 1.19 and 1.34 percent.

Market rates in excess of natural rates are evidence for tight money. While there is some overlap in the range, it's important that the bottom- and top-end for the actual fed funds rate exceed their natural-rate levels. Remember, we used the least favorable inflation figure to derive this result. Using the headline (3.1) percent figure, there is less ambiguity. Using the continuously compounded rates, there is even less. And the whole exercise using PCEPI instead of CPI suggests monetary policy is not only restrictive, but significantly so. We have good grounds to believe monetary policy is currently tight.

We see more of the same when we look at the monetary aggregates. The M2 money supply is approximately 3.30 percent lower today than a year ago. The Divisia aggregates are falling between 1.03 and 1.98 percent per year. These figures are particularly important because they weight money-supply components based on liquidity. Although they are shrinking more slowly than in recent months, the net effect is disinflationary.

The FOMC will announce its next interest rate decision this week. I expect they will keep rates unchanged. The slight bump in inflation won't spook them into going even tighter. And despite the cries from financial markets, it's too early to contemplate cuts. Expect more of the same for monetary policy to close out the year.

– December 12, 2023

A Short ESG Guide: Economic Problems

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The Environmental, Social, and Governance movement has wrapped itself in the garb of justice. It is just as much a moral crusade as it is an economic, social, or political one, with the unfortunate effect that those who criticize ESG can easily be sidelined and dismissed as reactionary, selfish, or worse. Be that as it may, I would be remiss not to raise a host of problems that arise from the pursuit of ESG goals.

For the sake of clarity and brevity, I'll tackle ESG problems in three separate columns. This column will discuss economic problems that arise from pursuing ESG goals. The next will explore political problems with the implementation and application of ESG criteria. A third will question the moral status of ESG itself as a matter of justice, compassion, virtue, and freedom. These are deep waters, so I must ask the reader's pardon, as with all the columns in my series, if anything that follows seems rushed or oversimplified.

Costs and (Un)Feasibility of Carbon Offsets

The environmental component clearly has the biggest economic implications. When it comes to "net zero" pledges and the use of renewable energy, pursuing ESG creates massive costs for society and ultimately has limited feasibility, even if it were to be embraced by everyone. Let's consider the cost of carbon offsets first.

Many companies, from Microsoft to Nestle to Hess, plan to achieve their net-zero goals in part by purchasing carbon offsets. No single carbon offset method dominates the scene. Heirloom Carbon sequesters carbon from limestone, and then uses the limestone to pull carbon out of the air. Other companies bury biodegradable materials that *would* release greenhouse gas emissions while decomposing. And of course, you still have the old-fashioned method of planting trees or preserving forests.

But these activities are costly. Hundreds of millions of dollars that belong to shareholders are being diverted to the carbon-offset market. Research, labor, and other resources that could be used to produce goods and services people want are being used to dig holes and fill them up, or to prop up relatively untested technology. And to what end? For these carbon sequestration activities to really impact global CO2 emissions, their scale would have to be far greater — hundreds of billions of dollars annually. Rerouting that kind of capital on an annual basis has immense opportunity costs. Furthermore, there are growing concerns about widespread fraud in carbon-offset markets.

Alternative Energy Woes

More important than the direct cost of pursuing net-zero through carbon offsets is the limited feasibility of phasing out fossil fuels entirely. The main forms of renewable energy being championed currently are wind and solar. Yet wind turbines and solar panels rely on fossil fuels, not only for energy and transportation but for some of the very materials in the product. The importance of petrochemicals has often been overlooked, but can hardly be overstated.

Even if 80 to 90 percent of electricity were being generated from renewable sources, there would still be significant demand for fossil fuels to create plastics, fertilizer, asphalt, and much more. How will we phase out petrochemicals? Eventually people will know that many "environmentally-conscious" or biodegradable alternatives to plastics (such as paper bags), actually use significant resources to produce and are not necessarily better for the environment. The most feasible renewable energy source is nuclear.

One of the ironies behind the economic costs of moving to renewable energy (and products), is that poor countries are often hurt the most because they can least afford to pay unnecessarily high prices for energy and everything else. The current approach to mitigating climate change — government subsidies, tax credits, and mandates — guarantees inefficiency and waste. No one knows which technologies and which companies will be most effective. As a result, government subsidies are just as likely to go to "bad apples" as to good ones. Not only that, but feedback on the productivity and effectiveness of recipients of government largess will be slow and convoluted — allowing unproductive companies to continue operating for years. In a competitive free-market system, prices, profit, and loss would cause the most productive firms to receive more dollars while unproductive firms go out of business.

Principal-Agent Problems

There are economic problems with the Social and Governance criteria too. First, the whole ESG framework is obviously superfluous when companies are obligated to advance the interests of shareholders. Managers and directors have a duty to pursue expanding the bottom line — which also entails considering and curtailing risk. In as much as ESG thinking improves risk mitigation, it will be widely adopted voluntarily. But parts of ESG that don't help mitigate risk will be ignored by companies unless they are required to take note of them.

Economists all the way back to Adam Smith have talked about the principal-agent problems involved in the corporate business structure. The agents (management) act on behalf of the principals, (owners/shareholders). But what is to prevent the agents from using the assets of the company to benefit themselves and their friends? Boards are created to oversee managers and, in most cases, shareholders can vote to fire managers or board members. But even beyond that, shareholders are protected by law from corruption or theft by managers.

Social and governance criteria, in as much as they push "stakeholder capitalism," make the principal-agent problems unmanageable. By creating many more "principals" (stakeholders) with divergent, often conflicting, interests, managers actually can't act in the interest of principals even if they want to, because no single interest exists. What's more, managers can now pursue whatever they want, so long as they can find a relevant stakeholder group whose interests align with theirs.

Potential Paths Forward

Here are three alternative ideas to ESG that we should consider:

- **International development, not international aid:** The countries most impacted by climate change, according to many environmental groups, tend to be poorer and less-developed. Instead of pushing costly and inefficient energy and manufacturing policies, the international community should advocate greater economic development through more open international trade, rule of law, and free markets.
- **Nuclear, not wind or solar:** The only renewable energy source that can scale to the levels modern growing economies need while leaving a small environmental carbon footprint is nuclear. Renewable energy proponents should be throwing all their support into making it cheaper, easier, and safer to build nuclear power plants around the world.

- **Adaptation to climate change, not prevention:** The number of people killed by natural disasters declines as countries become wealthier. A strategy of economic development that supports technological development is better than the incredibly costly and unfeasible approach of prevention.

The economic costs of ESG should not be ignored — they are pervasive and large. Although many different factors are involved, it's likely not a coincidence that the economic output of Europe, which has pushed ESG longer and harder than anywhere else, only grew 11 percent from 2010 to 2022, while the US saw economic growth of over 66 percent over the same period.

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