What Risks Lie Ahead in 2024?

What if This Time is Different?

What if This Time is Different?What if, before the world ever heard of coronavirus, every valuation multiple suggested the U.S. stock market was one of the most expensive in history? What if these valuations assumed – and required – continued economic growth, robust increases in company earnings, and sustained and substantial stock buybacks? What if those assumptions were completely wrong?

What if the current stock market rally assumes a “Vshaped” economic recovery with lockdowns ending soon, companies rehiring employees, pharmaceutical companies developing a vaccine, and a quick “return to normalcy”? What if those assumptions are wrong?

What if lockdowns drag out, companies enter bankruptcy en masse, unemployment remains high, and households stop buying? What if retail businesses only reopen with limited capacity? What if retail businesses cannot be profitable at such capacity levels? What if landlords stop receiving rents from tenants and start losing tenants? What if some industries like hospitality and airlines take years to recover? What if even hospitals lose money since elective surgeries are nonexistent? What if even universities bleed red ink as full-tuition paying foreign students don’t return? What if other such industries perceived to be immune from this crisis fail as their most lucrative revenue streams cease to exist?

What if banks refuse to grant forbearance to landlords and companies? What if defaults skyrocket? What if banks are incapable of even understanding the damage to their loan portfolio? What if banks raise lending standards so few qualify for loans? What if banks start charging higher interest rates as they perceive increased risk? What if banks have already increased rates on their variable loans? What if banks simply stop lending? What if banks fail?

What if public pension funds fail and states cannot bail them out? What if cities file for bankruptcy? What if states must sustain prolonged unemployment benefits? What if state governments' fiscal measures create debt levels which can never be repaid? What if these debt levels increase so much that their interest payments cannot be serviced? What if states go bankrupt?

What if the Federal Government's own estimates are right, and it borrows almost $4 trillion this year? What if it's more? What if the U.S. government is already insolvent? What if the lender of last resort really is the last resort? What if printing more green pieces of paper doesn't solve these issues?

What if a recession actually started before coronavirus had infected anyone? What if an inverted yield curve, a deteriorating Cass Freight Index, and an unprecedented breakdown in the repo market suggest a recession started in late 2019 or was imminent in early 2020?

What if such a recession, rather than being a typical downturn, was one of monumental magnitude – even worse than that of the Great Recession? What if recessions are caused by increases in the money supply which artificially lower interest rates, thereby deceiving individuals and companies into making poor investment decisions? What if the Federal Reserve's unprecedented (at the time) monetary expansion from the 2008 crisis sowed the seeds of an even greater recession today? What if all of this is happening in addition to the economic damage caused by coronavirus containment measures? What if such a recession was just getting started? What if it lasts for years?

What if a comparison of today's financial market valuations with deteriorating economic fundamentals suggests this is greatest stock market bubble in all of U.S. history? What if bonds are not safe when money is lent to bankrupt companies and insolvent governments? What if bonds don't protect an investment portfolio? What if stocks and bonds prove highly correlated – to the downside?

What if, after an initial bout of deflation, inflation kicks into overdrive? What if the 1970s suggest stocks and bonds can lose ground for a decade or more relative to inflation? What if most financial advisors only give lip service to inflation risk to their clients? What if their clients own no precious metals, farmland, rental real estate, or cryptocurrencies to protect them from inflation?

What if mainstream financial advisors were ultimately wrong when they said "This time is different" during the heady bull market years? What if they advise clients never to panic and never to sell? What if it is time to panic? What if it is time to sell?

What if equities crash and it takes years to recover like it has seven times over the last 100 years? What if the stock market collapses and it takes over 20 years to break even as it did after 1929? What if retirement-age workers can no longer afford to retire?

What if this time is not different?

What if most financial advisors are telling clients to buy the dip? What if they are telling investors the markets always rebound and the economy always quickly recovers? What if investors are conditioned to believe them based upon their experience with the 2008 crisis?

What if this time is different?

About WindRock

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How GDP Metrics Distort Our View of the Economy

05/15/2015 Christopher P. Casey

GDP purports to measure economic activity while largely divorcing itself from the quality, profitability, depth, breadth, improvement, advancement, and rationalization of goods and services provided.

For example, even if a ship – built at great expense – cruised without passengers, fished without success, or ferried without cargo; it nevertheless contributed to GDP. Profitable for investors or stranded in the sand; it added to GDP. Plying the seas or rusting into an orange honeycomb shell; the nation's GDP grew.[1]

Stated alternatively, GDP fails to accurately assess the value of goods and services provided or estimate a society's standard of living. It is a ruler with irregular hash marks and a clock with erratic ticks.

As proof, observe this absurdity: in 1990, Soviet GDP equaled half of US GDP, according to the 1991 *CIA Factbook*. No one visiting the Soviet Union in 1990 would believe their economy came close to 50 percent of the quality and quantity of the goods and services produced in America. GDP-defined production may have been strong, but laying roads to nowhere, smelting unusable steel, and baking barely edible breads stretches the definition of “production.” And this describes the goods which were actually produced. There is no accounting for the opportunity cost of forfeited essential goods and services.

How can this be? Why does GDP poorly reflect economic size and vitality? The blame largely resides with three fallacious concepts embedded within GDP “measurements”:

(1) intermediate goods (e.g., steel) must be eliminated to avoid “double counting”;
(2) government expenditures consist of viable economic activities; and
(3) imports should be netted against exports.

The Overstatement of Consumption

Which transactions should be included within GDP? Since most products consist of other products, GDP architects attempt to avoid “double counting” transactions by largely including only final goods and services produced. By their methods, the production of a car is counted (as an increase in inventory), but the metal, rubber, and plastic purchased in its creation is not. But the rules behind what makes a transaction “final” are arbitrary. The logic could just as easily justify including the sale of an automobile to a consumer and disregarding its previous production. In addition, any “final” transaction during a given time period does not necessarily include intermediate goods produced in that same time period: metal, rubber, and plastic purchased today will likely be for a different car produced or sold in a different (future) time period.

Regardless as to the arbitrary nature of determining final sales and notwithstanding the problem of temporally matching intermediate goods with their associated final sales, the exclusion of certain “intermediate” transactions simply excludes massive volumes of economic activity. Thus, GDP understates the economy as a whole while grossly overstating its consumption component relative to business investment. A better measure of overall production was employed in 2014, after years of urging from Mark Skousen, when the US Commerce Department began publishing Gross Output which incorporates intermediate transactions. Using Gross Output, the commonly cited statistic of consumption accounting for 70 percent of all economic activity quickly falls to a mere 40 percent.

The Treatment of Government Expenditures as Productive

If GDP purports to measure economic activity which *benefits* society, the inclusion of government expenditures is dubious. GDP "produced" in the Soviet Union is no different than GDP "produced" by any government – the difference is but one of scale. All government spending is to some degree malinvestment, for as Murray Rothbard noted:

> *Spending only measures value of output in the private economy because that spending is voluntary for services rendered. In government, the situation is entirely different … its spending has no necessary relation to the services that it might be providing to the private sector. There is no way, in fact, to gauge these services.*

The absence of voluntary action renders prices impotent, and without true price discovery, benefits cannot be ascertained. This does not mean all goods and services provided by government would cease to exist; rather, some production (e.g., hospitals, schools, roads, etc.) would revert to the private sector. To the extent government expenditures for goods and services would be produced by the free market, the true government contribution to GDP may be positive but overstated (it currently approximates 20 percent of US GDP). A more accurate depiction of economic activity would reduce if not eliminate the contribution of government expenditures. Or perhaps, as Rothbard argued, the higher of government receipts or expenditures should actually be deducted from GDP since "all government spending is a clear depredation upon, rather than an addition" to the economy.

The Problems of Subtracting Imports from Exports

As Robert Murphy has noted several times, the netting of imports against exports in determining GDP seriously understates the contribution of trade to overall economic activity. To wit, an economy which exports $1 and imports $1 will have the same GDP contribution (zero) as one which exports $100 billion and imports $100 billion. Obviously, the latter economy would be far worse off with the sudden cessation of trade.

A fixture of GDP is the mercantilist mentality of treating exports positively and imports negatively. Why are exports additive to GDP while imports are deductive? If the goal of GDP is to measure the goods and services provided to people within a geographic region, *imports* – not exports – are the benefit. Exports are but payment for imports. The problem and confusion arises because the GDP calculation unrealistically excludes other forms of payment: it should make a difference if imports are funded with increasing debt levels or if funds are accumulated from previous years of compensated exports. If China converted over $1 trillion in US debt instruments into imports of American goods and services, its people benefit today, but under GDP accounting, the negative impact of imports would offset greater consumption and/or government spending (the increase in GDP was previously realized in the years during which exports created a trade surplus).

GDP is Designed to Advance the Keynesian Agenda

Simon Kuznets (1901–1985) revolutionized econometrics and standardized measurements of GDP, with his research culminating in his 1941 book, *National Income and Its Composition, 1919–1938*. While not a Keynesian per se, the nature and timing of his research fueled the Keynesian revolution since central planning requires economic statistics. As Murray Rothbard noted:

> *Statistics are the eyes and ears of the bureaucrat, the politician, the socialistic reformer. Only by statistics can they know, or at least have any idea about, what is going on in the economy. Only by statistics can they find out … who "needs" what throughout the economy, and how much federal money should be channeled in what directions.*

GDP's faulty theoretical underpinnings and politically motivated acceptance distort the performance and nature of an economy while failing to satisfactorily estimate a society's standard of living. In fact, Kuznets partially understood this. In his very first report to the US Congress in 1934, Kuznets said "the welfare of a nation [can] scarcely be inferred from a measure of national income." Yet the blind usage of GDP persists. That its permanence and persistence only serves the Keynesian policies of greater consumer spending, increased government expenditures, and larger exports through currency debasement should not be considered coincidental. Unfortunately, the resulting economic stagnation, debt accumulation, and price inflation are as inevitable as they are predictable.

Note: The views expressed on Mises.org are not necessarily those of the Mises Institute.

Endnotes:

Starting in December of 1991, the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce emphasized gross domestic product (GDP) over that of gross national product (GNP) as a measurement of production within the U.S. The difference between GNP and GDP lies in the treatment of income from foreign sources: GNP measures the value of goods and services produced by U.S. nationals, while GDP measures the value of goods and services produced within the boundaries of the U.S., regardless as to the nationality of ownership. For purposes of this article, the differences between each measurement are unimportant and therefore "GDP" is utilized synonymously with GNP.

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How This Plays Out: An Interview With James Rickards

The pandemic and corresponding draconian containment efforts have created an economic and financial situation unseen since the Great Depression. Everyone wants to know whether the economy will rebound quickly or if we will experience a prolonged recession.

How does this play out?

Noted financial expert James Rickards foresaw such economic calamity last year when he wrote Aftermath: Seven Secrets of Wealth Preservation in the Coming Chaos.

Mr. Rickards joins WindRock to discuss:

- Why the current financial situation is unlike the 2008 financial crisis;
- What impact the recently passed CARES Act will or will

not have on the economy and various investments;
- How far equities may still fall despite their recent rally; and
- Which asset classes investors should consider to shield themselves from economic and financial calamity.

April, 2020

Should Investors Consider Cryptocurrencies?

Christopher P. Casey

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Absolutely! We have been writing about and advising clients on cryptocurrencies since 2014. Cryptocurrencies possess the breakthrough capabilities of blockchain peer- to-peer technology, namely: digitizing assets for better security, transparency, and transactional efficiency. No matter what the application, the underlying thesis behind all blockchain varieties is the same: a disruptive technology which cuts out the middleman to provide exponential benefits. Bitcoin, in acting as a monetary substitute while sporting a market capitalization approaching $1 trillion, is simply the first cryptocurrency to be validated by the marketplace. It should be considered by every financial advisor.

Why? As always, simply look to demand and supply. Bitcoin now has a strong institutional infrastructure with futures offered by the CME and Bakkt (in part owned by the NYSE’s owner, Intercontinental Exchange), newly viable custodian options, and better regulatory certainty. Accordingly, institutional demand has taken off, ranging from dynamic hedge funds, to entrepreneurial Tesla, to mainstream mutual funds, and even to insurance companies like MassMutual. Retail investors have followed suit given easier access and increased security due to custodial “cold wallets” and theft insurance. Largely driving bitcoin demand for all parties is the recognition of bitcoin as a legitimate inflation hedge.

And given the Federal Reserve’s newfound commitment to increased inflation, they should. One needs only to look to Federal Reserve balance sheet growth for an ominous warning: according the Federal Reserve, its assets (from printing money out of thin air) increased over 76% from $4.3 trillion in mid-March 2020 to $7.6 trillion today. How does that increase in the supply of dollars stand in relation to the supply of bitcoin?

The answer: in sharp contrast. The most bitcoins which can be “mined” (created) are limited to 21 million (and over 18 million exist today). Just as importantly, the rate of bitcoin creation is decreasing as rewards for mining bitcoin are periodically diminished by 50% (known as a “halving”). Constrained supply combined with rising demand should result in continued, albeit potentially volatile, long-term bitcoin price appreciation.

Detractors often characterize cryptocurrency investing as “speculative” given its dramatic volatility. Have individual stocks not experienced similar declines? It should be remembered that bitcoin has existed for over 12 years and, despite dramatic drawdowns along the way, has proven itself resilient.

Critics also dismiss bitcoin and other cryptocurrencies since they lack “tangible” value. But how much tangible value is there in most software companies? How about financial derivatives? How about the dollar?

Yes, there will be winners and losers in the cryptocurrency universe. It is very comparable to investing in the early days of the Internet. But bitcoin and cryptocurrencies are legitimate investments and deserve consideration in every investor's portfolio. RIAs who refuse to consider them are doing their clients a disservice.

About WindRock

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Fractional Reserve Airline Seats

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Every year, airlines deny thousands of passengers seats on flights due to overbooking. Airlines use sophisticated modeling to manage overbooking to maximize profits given the reality of passenger no- shows. Legally permissible under their "contract of carriage" with passengers, fewer than one-tenth of one percent of all passengers lose seats due to overbooking. 1 But when Dr. David Dao was violently removed from a United Airlines flight in Chicago, it did far more than generate a public relations nightmare; it exposed the absurdity of fractional reserve banking.

If an airline had 100 seats and overbooked by 10, then 91% of their seats are "reserved". U.S. banks need only retain an effective 10% of demand deposits on hand for withdrawals while Canadian banks have no reserve requirement. Baring general capital requirements, the remainder can and is typically lent to borrowers. If an airline used 10% fractional reserve seating, the number of stranded passengers would approach 900 for a 100-seat airplane. The refugee-like look of an airline gate under such a situation would be no different than the typical bank run during the Great Depression.

Unfortunately, just as passengers lack legal recourse when denied seats, demand depositors cannot seek redress when their withdrawals are refused. As Murray Rothbard detailed in **The Case Against the Fed** and his other books on the history of banking, it was unfortunate 19th-century case law ceased recognizing a deposit as a bailment (the custody of another's possessions). As Rothbard opined, the legal cover given fractional reserve banking cannot mask the fraudulent nature of lending against demand deposits. And no "contract" between a depositor and a bank can legitimize fractional reserve banking, just as naming something a "square circle" cannot create such a shape.

Even people versed in Austrian economics fail to understand the nature of fractional reserve banking. In an August 17, 2014 Forbes article entitled *The Closing of the Austrian School's Economic Mind*, columnist John Tamny wrote:

"This alleged "multiplication" of money all sounds so frightening at first glance, but for those who think there

might be some truth to the "money multiplier," DO try it at home among friends. Hand the first friend $1,000, and let him lend $900 to the person next to him, followed by an $810 loan to the next tablemate. What those who try it will find is that far from creating $2,710 worth of access to the economy's resources, there will still be only $1,000; the original holder of $1,000 with $100 in his possession, $90 in the second person's hands, followed by $810 in the third."[2]

And yet this illustration proves the opposite of Tamny's conclusion, for the money supply is not just the physical dollars on the table. If the arrangements between the participants allow for withdrawals *on demand*, then each person would assume their cash balances equaled their cash on hand *as well as* their "demand deposit" with the next person. The money supply would absolutely equal $2,710 with only $1,000 in physical currency.

Although few understand fractional reserve banking, even fewer appreciate its repercussion. So while Dr. Dao could passively resist fractional reserve airline seats, none of us can escape the business cycles and price inflation caused by fractional reserve banking.

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Don’t Forget About the Trade War

Christopher P. Casey

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Before coronavirus and impeachment, the Sino- American trade war stubbornly remained on the mainstream news circuit while largely governing the direction of financial markets. With each rumor of concession or tweet of condemnation, stocks gyrated and bonds jittered. Each round of negotiation was been matched by salvos of tariffs, export controls, lawsuits, complaints, declarations, and threats. At its peak, the U.S. imposed tariffs on $550 billion of Chinese imports while China retaliated with tariffs on $185 billion of U.S. goods.[1]

With its early 2018 inception, many mainstream pundits and commentators agreed with President Trump that the trade war would be beneficial (or at least benign) and short (otherwise it would not be “easy to win”).2 But the trade war, albeit in fits and starts, continued, escalated, and now largely sits in stalemate – despite the “Phase One” agreement – with no clear visibility of resolution. Even with a recent reprieve, the trade war will likely continue for the foreseeable future with great risk to economies and financial markets.

Why Trump Will Likely Continue the Trade War

Some argue that President Trump is actually in favor of free trade but wishes to renegotiate various trade treaties. That is, by embracing protectionist policies, free trade can later be broadened on more “appropriate” terms. For example, some of the stated NAFTA renegotiation objectives included the elimination of “unfair subsidies, market-distorting practices by state owned enterprises, and burdensome restrictions on intellectual property.” But this interpretation is contrary to significant evidence which indicts Trump as a devoted protectionist.

Trump’s overall political philosophy is revealed by his pre-Presidential talk show confessions. The future President hit the talk show circuit extensively in the 1980’s and 1990’s by appearing on such shows as David Letterman, Oprah Winfrey, Phil Donahue, and Larry King. These interviews provide an insightful look into his core beliefs. Consistently, the most passionate commentary concerned foreign nations “taking advantage” of the U.S. – either by failing to contribute more to their own national defense or by running significant trade surpluses (U.S. trade deficits). In these interviews, the ire from the latter of these was usually directed (given the time) at Japan. Today it is China.

Trump clearly views trade in a zero-sum, mercantilist manner with the country possessing a deficit as “losing” and “down.” In mid-2019, the President tweeted the following:

When a country . . . is losing many billions of dollars on trade with virtually every country it does business with, trade wars are good when we are down $100 billion with a certain country and they get cute, don’t trade anymore-we win big. It’s easy.[3]

Four other facts buttress Trump’s position as an ardent protectionist. First, protectionism is theoretically consistent with President Trump’s immigration position. If one believes immigrants take away American jobs, then logically one would also fear cheaper foreign goods which destroy the profitability of American companies – and by extension, cost U.S. workers their jobs.

Second, while the protectionist measures enacted so far have been focused on China, they have also, to a lesser extent, been levied against allies (e.g., Canada, Europe, etc.). This is why, when signing the new U.S.-Mexico- Canada Agreement in January, President Trump noted the agreement was “finally ending the NAFTA nightmare.”[4]

Third, President Trump, almost immediately upon taking office, pulled out of the Trans-Pacific Partnership negotiations. While one could easily argue this agreement actually hindered free trade given its excessively burdensome and complex rules and regulations, the rationale given for withdrawing was a protectionist argument: the preservation of American manufacturing.[5]

Fourth, he has surrounded himself with advisors notorious for their protectionist policy advocacy. Most notable among them are economist Peter Navarro who authored the book Death by China and Commerce Secretary Wilbur Ross.

Today’s political climate only serves to facilitate Trump’s protectionist philosophy. In addition to this year’s election and the likely need to secure Rust Belt electoral votes, anti-China rhetoric and positioning are popular with both political parties and the deep state.

Why China May Wait for the 2020 – or 2024 – Election

As any future trade agreement will decrease free trade (at least compared to the pre-trade war environment), any likely agreement will be, by definition and on the whole, deleterious to both countries to the advantage of certain industries, businesses, and/or occupations (including political offices). China singularly understands the benefits of free trade and stands to lose its prosperities as well as be burdened by any ancillary labor, intellectual property, or environmental provisions. It is in their interest to delay and forestall any agreement.

This strategy coincides nicely with two Chinese concepts: “saving face” and a “holistic” negotiating style. The concept of “face” refers, loosely, to the Sino- cultural understanding of respect, honor, and social standing. President Trump, with bombastic boasts and brash bargaining, only forces President Xi and Chinese leadership into steadfast positions.

It is culturally, and thus politically, difficult for the prospects of any agreement if it appears to be an American victory. This applies to both intra-regime circles (leadership struggles) and with the government vis-à-vis the populace. The former is exacerbated by the pageantry and intrigue of next year’s Communist party centenary. The latter of which is intensified by leadership’s keen sensitivity to Chinese society’s long- held belief in the “Mandate from Heaven” (the loss of which is frequently signaled by Heaven through such natural disasters as epidemics – especially untimely given both the onset of coronavirus and the perception of an inept government response).

Holistic negotiating style, or *zhengti guannian*, is a well-known and often frustrating exercise for any westerner having done business in China. As described in a Harvard Business Review article:

. . . the Chinese think in terms of the whole while Americans think sequentially and individualistically, breaking up complex negotiation tasks into a series of smaller issues: price, quantity, warranty, delivery, and so forth. Chinese negotiators tend to talk about those issues all at once, skipping among them, and, from the Americans’ point of view, seemingly never settling anything.[6]

This concept has already manifested itself in the trade war; it is not uncommon for U.S. to believe an agreement has been reached only to be met by silence or denials from the Chinese.

Will the Trade War Cause a Recession?

If the trade war escalates, can it *directly* cause a U.S. economic recession? Many mainstream pundits, citing the infamous Smoot-Hawley Act of 1930, warn as such (which is odd, especially since the Great Depression was well underway before it was enacted let alone took effect).

But tariffs may *indirectly* cause a recession. As recessions are caused by malinvestment (investments unjustified by the natural level of interest rates) created through artificially suppressed interest rates, then rising rates may serve to expose this malinvestment and force its liquidation (e.g., business closures, layoffs, bankruptcies, etc.) – also known as a recession.

Currently, U.S. Treasury debt held by China approximates $1.1 trillion.7 Curtailing future purchases and/or programmatically selling these holdings may increase interest rates dramatically (from where they would otherwise be, all things being equal). Many pundits cite the unlikelihood of this by noting such sales would decrease bond prices and thus the value of China's U.S. Treasury holdings. But the impact on U.S. interest rates need not result from a "liquidation" by China; rather, since all prices are determined at the margin, decreased demand or increased supply (sales) by China – evenly seemingly insignificant, may raise rates.

If the trade war turns to financial warfare tactics, both sides are more likely to receive recession than resolution.

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Donald Trump’s Whig is Showing

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On February 28th, while addressing a joint session of Congress, President Trump quoted Abraham Lincoln and praised his economic philosophy:

The first Republican President, Abraham Lincoln, warned that the “abandonment of the protective policy by the American Government [will] produce want and ruin among our people.”

Lincoln was right – and it is time we heeded his words. I am not going to let America and its great companies and workers, be taken advantage of anymore.[1]

In channeling Lincoln, Trump underscored the reversion of the Republican Party to its economic roots, which embraced protectionism, state-sponsored infrastructure spending, and central banking. While a new party in Lincoln’s day, its economic philosophy derived directly from the Whig Party and its champion, Henry Clay.

Thomas DiLorenzo’s excellent book, **The Real Lincoln**, chronicles and exposes the Republican-Whig economic platform, known then as the “American System” (the local flavor of mercantilism).[2] While it is unlikely Lincoln addressed the issue of slavery before 1854, he constantly discussed and advocated the American System. As early as 1832, he called for an “internal improvements system and a high protective tariff.” The “improvements” specifically referred to the infrastructure of the day: railroads, shipping, and canals. The Republican Party, in its 1860 platform, devoted three of its 17 “declarations” to advocating the American System. Declaration 12 called for duties on imports to “encourage the development of the industrial interests of the whole country.” Declaration 15 advocated “appropriations by Congress for river and harbor improvements of a national character.” And declaration 16, after noting the importance of a railroad to the Pacific Ocean, recommended “that the federal government ought to render immediate and efficient aid in its construction.”[3]

Wigs may come in and go out of fashion, but the economic policies of Whigs endure. Unfortunately, the dangers of Whig economic folly and fallacy do not diminish with time.

Protectionism seeks to increase trade surpluses or lower trade deficits by taxing imports (tariffs) or banning or limiting the quantity of imports (quotas). A simple examination of any individual import transaction quickly exposes the folly of protectionism. If an American buys a Japanese car, the Japanese auto manufacturer then owns U.S. dollars. These dollars can be used in three ways:

- Increase dollar holdings;
- Sell the dollars to another foreign country for goods, services, or capital (in which case the buyer of U.S. dollars faces the same three choices); or
- Purchase U.S. goods, services, or capital (e.g., real estate or Treasuries).

When looked at this light, unless the Japanese auto maker maintains the dollars in perpetuity (in which case America literally received a car for green-dyed paper), the export of dollars must be matched by an American export or an investment by the foreigner in America. Arbitrarily dividing the former as trade while the latter as a capital flow creates the appearance of trade deficits and capital surpluses.

Historically, American imports have been largely financed through foreign investments in America. Chronic American trade deficits are offset by repetitive capital surpluses. In a free market, there is nothing inherently wrong with such a situation.

Protectionism may alter (a.k.a. distort) trade balances and capital flows, but only at the expense of the wealth of all trading partners. This can be readily discerned if protectionism is taken to its logical extremes. Would the American standard of living be enhanced by a self-imposed blockade or with trade barriers erected between each of the 50 states? If these extreme policies would bring economic “want and ruin”, then enacting lighter versions of the same policies brings but less damage.

Underlying such common-sense arguments is the law of comparative advantage, ascribed to but only loosely championed by David Ricardo. Most economists of Adam Smith’s era believed in the doctrine of absolute advantage: the idea that countries should specialize in their best or most efficient product. In **An Austrian Perspective on the History of Economic Thought**, Murray Rothbard described the importance of the law of comparative advantage:

The law of comparative advantage . . . is . . . indispensable to the case for free trade. It shows that even if, for example, Country A is more efficient than Country B at producing both commodities X and Y, it will pay the citizens of Country A to specialize in producing X, which it is most best at producing, and buy all of commodity Y from Country B, which it is better at producing but does not have as great a comparative advantage as in making commodity X.

In other words, each country should produce not just what it *has an absolute advantage in making, but what it is most best at, or even least worst at, i.e. what it has a comparative advantage in producing.*[4]

The law of comparative advantage describes how all countries, regardless as to productive capabilities or wealth, benefit from trade.

The Fallacy of Trump's State-Sponsored Infrastructure Spending

The magnitude of the new administration's infrastructure proposals will be substantial and far more important than the form it takes (e.g., outright budgetary spending, loan guarantees to private firms, tax incentives, etc.). In his recent speech to the joint session of Congress, President Trump called for "legislation that produces a $1 trillion investment."[5] From the canals and railroads of Lincoln to the airports and pipelines of Trump, history has repeatedly demonstrated the product of state-sponsored infrastructure spending: boondoggles.

How can government officials determine how many runways an airport requires or how long or to where a pipeline should extend absent prices? Without private property, which

generates prices and correspondingly, profit and loss, an economic fog descends which clouds all decision making. In this context, government officials determining infrastructure spending are no different than a Soviet official deciding how much wheat to plant, which shoes and shoe sizes should be produced, or how much caviar to pull from the Caspian Sea. And the results will be the same.

Central Banking Supports Protectionism

and State-Sponsored Infrastructure Spending

Protectionism and state-sponsored infrastructure spending are hallmarks of the Trump administration's economic policy, and two of the three planks of the American System. The third, central banking, is no longer an active political issue, but it is pivotal in supporting and expanding the others by facilitating and coordinating monetary inflation.

Monetary inflation covertly creates and enhances protectionism by increasing exports at the expense of importers and consumers. Likewise, in substituting monetary inflation for taxation, central banking obscures the true costs and payers of state-sponsored infrastructure spending. If one substitutes exporters and crony capitalists for the Royal Air Force in Winston Churchill's famous quote, it well summarizes the benefits and costs of the American System: "Never . . . was so much owed by so many to so few."[6]

Conclusion

In 1858, Lincoln famously echoed the Bible in stating "a house divided against itself cannot stand."[7] American society, with the election of President Trump, is surely divided against itself. But a society's level of division directly corresponds to the level of government interference in the economy. The more a government interferes and diminishes the overall level and growth rate of wealth, the greater will be the divided house. Without the American System, divisions would dissipate as free trade, private financing of infrastructure, and sound money reward all of merit and raise the standard of living for all.

Today, the American System is, sadly, once again American.

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Endnotes:

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2 DiLorenzo, Thomas J. *The Real Lincoln* (New York City, New York: Three Rivers Press, 2002).

3 Republican Party Platform of 1860. 17 May 1860. http://www.presidency.ucsb.edu/ws/?pid=29620

4 Rothbard, Murray. *An Austrian Perspective on the History of Economic Thought* (Edward Elgar Publishing, Ltd:1995).

5 "President Donald J. Trump's Address to a Joint Session of Congress."

6 Churchill, Winston. "The Few". 20 August 1940. https://winstonchurchill.org/resources/speeches/1940-the-finest-hour/the-few/

7 Lincoln, Abraham. "House Divided". 16 June 1858.

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Adding Austrian Economics

In thinking about the title of this presentation, it occurred to me that some people may be uninterested. That is, attendees may feel they manage their own investments, and are therefore unthreatened by wealth managers ignorant of Austrian economics.

Velocity Lacks Veracity

Velocity is not a substitute for demand, but rather of volume. Lots of goods and services may transact at low prices just as they may trade at high prices.