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***"I'm tired of seeing government spend money it doesn't have—
to fix problems created by people spending money they didn't have."***
...Viewer of ABC News

Previous by Author:

THE U.S. DOLLAR AN OWNER'S MANUAL

SOCIAL SOVEREIGNTY

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Introduction

After the onset of the Great Recession, deregulation was widely and correctly identified as the source of the financial imbalances that culminated in the 2007 crisis—however, effective regulation results outside of the purview of government from forces of competition and market-based choices. Most of the regulation or governance of the economy stems not from proactive legal and political institutions but from market-enforced discipline. Regulatory ineffectiveness resulted from the legal environment erected instead.

The layering of more regulatory legislation to prevent future economic excesses constitutes the usual reaction to financial crises and distress. Some September 2008 policy actions were defended as an emergency tool, such as the shoring up of the depository collapse that might have culminated over only a few hours in a loss of trust in financial accounts and the freezing of the electronic payment system.

Allowing depository institutions legal protection from the consequences of lending the money that depositors expect to be held in trust produced a gaping chasm in liquidity. It was necessary to back up those deposits immediately or face the all too possible breakdown of the payment system along with a cascade of disruptions. But less understood is that given the gradual erosion of bank liquidity and decades of credit inflation, such monetary expansion created unstable conditions. Funds sourced from unwarranted leverage were not costless to the economy because they had emergency FDIC-Treasury assurances. Money infused into the economy produces a tax on the public at large, with precisely the damage that a counterfeiting cabal would effect. The process reduced the dollar to less than a tenth of its value over the post-WWII decades. The damage was already a fact before the crisis.

Unfortunately, the other policy fixes after 2007 resulted in unprecedented Trillion dollar financial flows propping up some of the culprits themselves, especially in those sectors erected on top of all of the phantom credit base.

Economic propositions, strictly speaking, relate cause and effect. They need not imply instituting policy. One could benefit economic output by increasing one tax rate and reducing another without implementing the change. One may want to reduce the economy's output; one may dislike people altogether and hope their economy collapses. But the economics would not be any different. Like geometry, you get a given result for a given set of assumptions.

In practice, economic policy discussions seldom avoid normative political views. The central theme in textbooks on macroeconomics revolves around applying theory to governing the economy by overriding the market and implying macroeconomic policy for specific normative outcomes such as increasing employment.

Yet, the economics of a policy action is invariant to interpretations of the advisability of its implementation. Hence, the economics must be logically consistent, just as a proof in geometry is or is not correct.

Free markets achieve superior results. However, corporate power, partially attributable to various privileges such as limited liability and state power to interpose corrective measures, leads to unnecessary policy capture.

Another way to describe free markets is the freedom to exchange with others. The fact that no exchange occurs without ex-ante perceived benefit to both parties implies a system that results in a larger pie, not just a way of dividing the pie.

Overly authoritative regimes tend to foreclose on the ability to employ the leveling force of competition. Ordinary people can associate in innovative ways effectively and efficiently through the market to supply their needs. Examples of unplanned emergent order abound, from common law to the development of mathematics, golf rules, and insurance. These resemble the results usually attributed to government but which, upon examination, need not be. Such social (in contrast to political) organizing emerges under freedom of choice. But benefits are not seen at first glance, it being mentally easier to visualize that a new legislated or decreed law will do the needed work.

In our look at the economy, we refer to some economic ideas of less well-known perspectives, including Marxist, Georgist, and Austrian, to assist explication.

In brief, Marxism never broke out of the pre-marginalist classical economics that explained price by classes of commodities and saw the source of value to be productive effort (ultimately labor) instead of desires of the user or consumer.[1[1]]

1

And followers of Henry George, in maintaining that just title to land (and natural resources) should reside in the whole of mankind, were in favor of taxing exclusively land and nothing else (hence the single tax), while for expediency, allowing titles to remain in their present hands, with structural improvements such as houses and buildings to be free of taxation.

However, by taxing the entire imputed rent from land, the Georgist ultimate reduced-state position, while viable, neglected beneficial allocation and coordination provided by entrepreneurs, who possess foresight of changing land values in a changing world with uncertainty. Georgists widely opposed market intervention by the state elsewhere for good reason. Yet they championed empowering the state with an absolute public claim on resources and land.

Some proposed a Georgist-oriented revenue-neutral tax reform without moving closer to or further from the free market. Some also assigned a leading role to land value cycles in the business cycle with valuable insights as to why.

In balance, Austrians supplied more developed answers to the shortcomings of classroom neoclassical theory. Although good ideas were too often overlooked or required repeating, both the Georgists and Austrians applied methodological individualism. Geo-Austrians synthesized both.

Austrian methodological individualism translates to a micro rather than macro approach to economics. Still, it incorporates the cautious use of aggregates and averages in analyzing macroeconomic phenomena. Moreover, it recognizes the reality of public or collective interests and actions when carefully defined as individually based.

Here remains the essence of the debate over financial regulation in the aftermath of the Great Recession of 2008.

Our inquiry draws chiefly on the economics of Böhm-Bawerk, Mises, Hayek, Rothbard, and Reisman, which comprise the core of Austrian economic theory. We will highlight some of these to shed light on our financial future.

While it is impossible to forecast the timing of economic events, it is possible to eliminate some unlikely outcomes and elevate others through the consistent application of causal logic.

Conventional following in economics saw a need for a central bank and government management of the economy to moderate fluctuations in economic activity. We can now examine this proposition by considering the free-market and free-banking perspectives.

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In 1913 Congress established the Federal Reserve System (Fed) as a central bank purported to moderate what seemed to be naturally occurring financial crises. But now the evidence is in: before the centralization of the control of money and banking by government intervention, these occurrences were not prolonged or as severe as after 1913. Under the Federal Reserve, we have experienced a Great Depression, suffered the stagflation of the 1970s, a recession in the early Eighties, and a financial panic and Great Recession beginning in 2007. [2]

Some critics of the Fed have proposed turning over the power to expand the money supply to the Treasury out of the hands of the Fed. While limiting control by the

Fed (a quasi-private institution), we will see that this is no substitute for a truly market-disciplined monetary system based on free banking and dollar convertibility. [3]

Considering capital and monetary policy stimulus in the post-crash economy, we can surmise that the Fed can't rescue a collapse by inflating liquidity because this money would go to short-term investments, which could produce a steep positive yield curve (short rates lower than long rates). These higher rates would depress the loan market.

Market sentiment is different once the boom has collapsed. The economy tends to seek short-term liquidity and avoids investing in long-horizon projects.

Unlike a credit-stimulated boom, inflation in short-duration investments and deflation in longer-term investments occurs. Investing in longer-term instruments of a financial nature may not be investment in capital or business ventures. Hence it may fail to help employment aided by a faster turnover of capital; the effect is similar to the Keynesian liquidity trap early in a correction.

Quantitative easing, without more saving and an improved business outlook, is like pushing on a string. So in 2008, the attempt at stimulus was ineffective. Note that by 2015 long-term rates were coming down as the stimulus took effect in longer-duration investments.

Eventually, lower interest rates and easing for longer-term capital have their effect. For example, the 2014-15 slide in oil prices revealed overstimulated, longer-duration investment in capital-intensive projects in oil infrastructure due to low interest rates in preceding years stimulating over-production of oil.

But this blunt, massive provision of investible liquidity and credit in the capital markets from quantitative easing inhibited recovery in other sectors by redirecting resources into investments not chosen by market signals.

When the economy is most slack in labor usage, capital would be more remunerative in enterprise types that take advantage of this slack. For example, the labor-intensive cultivation of berries requires financing to hire labor with little funding for fixed or durable physical capital. In contrast, barley cultivation on identically fertile plots of land in the same region uses little labor but employs more capital in large-scale machinery (Mason Gaffney 2009).

Where both would generate similar profit rates, the former uses a much higher mix of labor to physical capital while using the same amount of funds.

In this example, directing funds to sustain the less labor-intensive enterprises that were predominant before the crash directs land usage and funds away from the production techniques that relieve unemployment and towards those that tie up funds in long-term capital equipment. The policy of replacing older autos, requiring more labor using maintenance than new replacements, was precisely the wrong policy for reducing unemployment.

A central planning committee faces policy limits by what Hayek calls the fatal conceit due in part to a lack of price signals. Planners may not know where these policies have gone wrong other than that unemployment and economic malaise have been inordinately prolonged.

It has been thought that the end of a period of lowered interest rates caused the cessation of expansion and boom. Logic would then argue for reinstituting low rates to correct the recession. On the contrary, low interest rates cannot return us to the boom of the expansion. The expansion was a period of ongoing ever-worsening alignment of complementary productive processes, elevating measures of misdirected employment, GDP notwithstanding.

Austrians have emphasized the folly of thinking of the economy as either enjoying more or less economic activity. Their more sophisticated chain of reasoning complies with common sense. We can consume capital on the one hand and invest in the wrong capital projects on the other. Each of these may elevate measures of current GDP, but each subtracts from the ability to deliver supplies of usable goods and services in the future.

The correction must not only re-value these misappropriations but also liquidate them at a loss and terminate whole enterprises the most out of line with balanced production. In addition, the workforce must be relocated and retrained.

A community could begin a project to build a tunnel to access what requires a problematic journey over a mountain. It could employ many engineers, train workers in demolition and excavation, and invest in heavy equipment. But if halfway through the mountain, the community runs out of the means to support its workers, then when they return to their original activities, they have nothing to show for their work and are worse off from depleting their resources. Yet, while engaged in the project, they were experiencing a boom in employment and economic activity. Their economists said they were on the right track because they enjoyed high aggregate demand. Still, the authorities dispersed provisions at a rate that depleted granaries faster than could be supplied. The Austrian Business Cycle Theory contains similar insights regarding easy credit upswings in the economy. [4]