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THIS MONTH'S FEATURES



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THE CITY OF GOD, PART II

BY L. CARLOS LARA

More discussion of a fascinating document with both spiritual and practical wisdom.



HOW DO POOR Countries grow RICH?

INTERVIEW

Economist G.P. Manish explains how Austrian capital theory supplements the mainstream growth literature.

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DEAR READERS

The Austrians don't focus on spending in the same way the Keynesians do, but the Austrians do acknowledge the ultimate direction from the consumers.



ECONOMIC DEEP END PULSE ON THE MARKET

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ONE MORE THING EVENTS AND ENGAGEMENTS

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THE SOVEREIGN CONSUMER: "They are the customers who are 'always right,' the patrons who have the power to make poor suppliers rich and rich suppliers poor." —Mises

Probably at no other time of the year except during Thanksgiving and Christmas are we made more aware of the consumer market and its enormous purchasing power. This is because these holidays have within them the impetus for the manufacturing, the buying and the selling of lots of goods. Yet, it is the average person's decision to buy, or not to buy, that ultimately determines what should be produced and in what quantity and quality. When we visit the actual retail stores or shop on-line, we see what people most want and what is available for a price.

According to Mises, it is the masses that make the critical difference in the marketplace. The shops and factories that cater only to the wealthy play only a small role, in fact a subordinate role, in the overall market economy. These operations cannot ever grow to the size of what we often refer to as "big business." Big business, you will notice, always caters to the masses, either directly or indirectly. In a free and unhampered market economy the consumers who make up the masses are supreme.

In the same way, the *IBC Practitioner Program*, the educational course designed for financial professionals that we created with David Stearns and Nelson Nash, indirectly caters to the masses. These graduates are listed on the Nelson Nash Institute's Practitioner Finder https:// infinitebanking.org/finder/ where members of the general public can easily find them. When a member of the general public is ready to set up a privatized banking system developed by a qualified professional who knows how to properly design it, the *authorized IBC practitioner* is the source for its correct implementation.



Of course our job is to not only educate the general public all about IBC and how it works, but to also direct the general public to the *IBC Practitioner Finder* and the financial professionals listed there. All to say that the *IBC Practitioner Program* is the mechanism specifically designed for building the 10%! This is the body of financial professionals who along with the general public will eventually change public opinion and from there — change monetary policy— while showering financial benefits to every individual that participates. These benefits are the impetus that drives this human machinery towards its goal.

As an extra factor for spreading this message, the newly designed *IBC Live Seminar* for general audiences, which launches from Birmingham, Alabama Saturday February 11, 2017 and begins traveling across the country, will increase our educational outreach all the more.

Won't you join us? If you have not yet discovered the financial power of IBC, there is no better time than now to start. IBC is the solution we have all been looking for to help release us from financial bondage. Once it is implemented, you are set free!

Merry Christmas and Happy New Year!

Carlos and Bob



IT WAS THE RUSSIANS!

CIA ENGAGES IN ANONYMOUS OPS TO NEUTRALIZE A HOSTILE REGIME

Last month we warned of the coming crackdown on "fake news," and ironically now the hot story is that Vladimir Putin allegedly ordered actions to sway the US election to Trump. Of course we can't know what happened—and it's impossible to prove a negative—but we want to make sure readers place this new controversy in the proper context. (All of the points we are making here refer to the December 9 Washington Post article by Adam Entous et al. that revived the issue.)

First, there was no new information uncovered by the CIA. As the WaPo story itself said in the opening paragraph, the "news" was that people in the CIA apparently *changed their belief on what the motivation was of the Russian government*. Months before the election, they had thought the Russian government was trying to undermine Americans' faith in their electoral system. Now, after the election, some people in the CIA apparently thought that the motivation for these same actions was more specifically to help Trump win. But to repeat, there was no new evidence discovered; the "bombshell" story was simply that people in the CIA apparently had changed their interpretation of the motivation behind activities they had known about for months.

Second, we kept saying "apparently" in the paragraph above, because *the entire WaPo story quotes from anonymous officials*. Since not a single person in the CIA (as of this writing) has come forward to go on the record with these claims, we should be circumspect in passing along "facts" about an alleged "consensus within the CIA" that we have no way of verifying. (Remember: the CIA's day job activities include spreading disinformation and undermining regimes that they don't like. So we're not being unreasonable by raising the possibility that some anti-Trump people in the CIA could be lying to further their political agenda.)

Third, even the WaPo story admits that they have no direct link from the alleged hackers to Putin. They admit that the Russian government, were it to try something like this, would always use an intermediary to maintain "plausible deniability" (their term). Furthermore, the



whole WaPo story is based on *secret evidence*—the reader is told what *anonymous officials* say about *what the CLA believes* about *secret evidence that cannot be shared with the reader.* This is all in the original WaPo story; go look it up if you think we're exaggerating.

Fourth, even if everything in the story were true, let us keep in mind that the "interference" with the US election does not refer to, say, Russian agents falsifying ballot counts, or bribing American voters to pull the lever for Trump. Rather, the entire claim is that Russians stole emails from the Clinton team, and then passed them on to WikiLeaks so that the American people could see just how corrupt the Clinton team was.

In closing this blurb, let us repeat that we are talking about the information in the Dec. 9 WaPo article that set the media (social and mainstream) ablaze with claims that "Putin hacked the election" and that Trump would now be an illegitimate president. There may be more specific evidence that has or will come to light in the aftermath, but our point is that the flimsiest of anonymous allegations was enough for the establishment to embark on a McCarthy-esque rampage, since they still just cannot believe that Hillary Clinton lost the election.

SHILLER RATIO SHRILL

POPULAR MARKET METRIC SCREAMING OVERVALUATION

CNBC quotes analyst Alan Newman that the popular "cyclically adjusted P/E (CAPE), a valuation measure created by economist Robert Shiller now stands over 27 and has been exceeded only in the 1929 mania, the 2000 tech mania and the 2007 housing and stock bubble," and that even if market earnings rose 10 percent, the adjusted P/E ratio would still be very high by historical standards.

Now we should take these figures with a grain of salt. The Shiller measure ignores interest



rates, and (other things equal) low interest rates would imply a higher P/E ratio, as the present spot-value of a future flow of earnings is bid higher (because of a lower discount rate).

However, the whole *point* of Austrian business cycle theory is that artificially low interest rates—fueled by monetary inflation, *not* by genuine saving—mislead investors into starting unsustainable projects. In that respect, to dismiss the red lights from metrics such as Shiller's CAPE ratio because of unprecedentedly low interest rates, is akin to saying the *Titanic* was in no danger because icebergs are only natural when the water is freezing.

In any event, we remember that during the housing boom years, many analysts were saying that there was no bubble, because low mortgage rates allowed buyers to "get more house" with a given monthly payment. Yes, the logic was correct as far as it went, but if one thought those mortgage rates were *artificially* low, then the argument was hardly decisive.

TREASURY DUMP CONTINUES

CHINA FALLS BELOW JAPAN IN RECORD SELL-OFF

The financial blog Seeking Alpha reports that the latest data show Japan now is the single largest foreign holder of US Treasuries, because China continues to sell its dollar-denominated assets to prop up its currency against the strengthening USD. More generally, foreigners have sold \$304 billion in Treasuries over the previous seven months. (The latest data—valid as of the end of October—are available at: <u>http://ticdata.treasury.gov/Publish/mfh.txt</u>.)

One might wonder whether the reported "dumping" of US Treasuries reflects actual selling, as opposed to a decline in market value due to rising yields. It is our understanding that these official reports of Treasury holdings are accounted according to nominal face value, and are not "marked to market."

RATE HIKES & THE LABOR MARKET

By: Robert P. Murphy

RATE HIKES AND THE LABOR MARKET

As THIS ISSUE WAS GOING TO PRESS, THE Fed announced a modest rate hike, and surprised markets by projecting three more in 2017. With the official unemployment rate at 4.6 percent, the move seemed appropriate. However, there is still a structural weakness in the labor market that the headline number masks. This weakness only reinforces my argument from last issue that even good policies from a new Trump Administration can't avoid the crash that the Fed has made inevitable.

Bond Yields Rising Since Trump Election

The Fed's hike this month (in December 2016) was rendered all but inevitable with the spike in bond yields since Trump's surprise election:

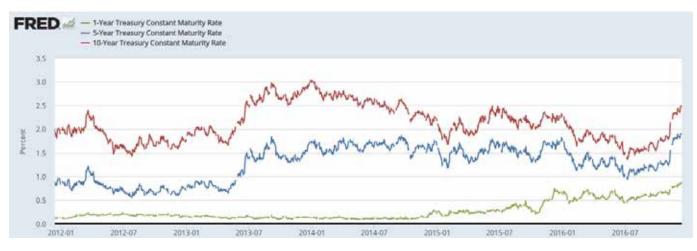


FIGURE 1. Nominal Yields on 1-, 5-, and 10-Year Treasury Securities, 2012-Present, Daily



Incidentally, we can see that the surge in bond yields since the election has been due to an increase in both the expected "real" growth in the near future, as well as an increase in expected price inflation: Notice that the 5-year TIPS yield was negative for much of the year, but it too jumped on Trump's election, eventually moving into positive territory. Specifically, it went from negative 0.24 percent to negative 0.03 a

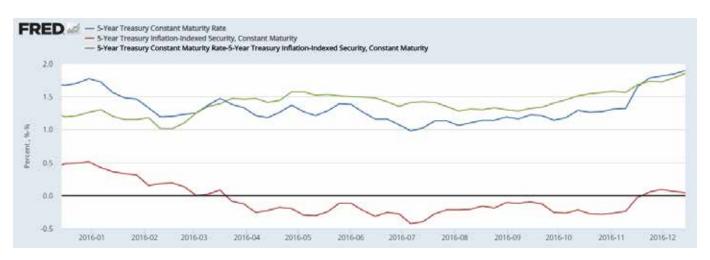


FIGURE 2. Expectations of 5-Year "Real" Growth and Price Inflation Rates, Weekly

In Figure 2, the blue line charts the yield of the regular (nominal) 5-year Treasury. I have plotted the chart in weekly averages to make it easier on the eye, and from this vantage point the 5-year yield jumped from 1.32 percent the week of the election to 1.65 percent a week later—an increase of 33 basis points.

The red line shows us the yield on TIPS, i.e. Treasury Inflation Protected Securities. These are bonds where the Treasury adjusts the principal in accordance with movements in the CPI, such that the investor earns the face value rate applied to the inflation-protected principal. Thus the yield on a TIPS bond (assuming you trust the government's CPI numbers) represents an inflation-adjusted yield, or a "real" yield. week later—an increase of 21 basis points.

If you look at the disparity in jumps namely, a 33 basis point increase in the nominal yield, versus a 21 bp jump in the real yield—the difference is accounted for by a jump in expected price inflation. This is the green line in Figure 2.

In summary, in the week following Trump's election, the yield on 5-year Treasuries rose about 33 basis points. Twenty-one of those bps were due to an increase in expected real growth, while the remaining 12 bps were due to increased expectations of price inflation.

For purists, let me make two caveats before leaving this section. First, there are some technical issues in trying to back out "the market's expectations" of price inflation using the TIPS yields. But for our purposes here—where we're just trying to get a gen-

eral idea of what drove the surge in bond yields after the election—we can safely look at TIPS yields for our starting point.

Second, let me state that I think investors are wrong when they (apparently) predict that a stronger economy leads

to higher price inflation. I think they get this view from a Keynesian belief that now "aggregate demand" will be higher, and thus spending pressure will push the economy up but also prices.

Yet on the contrary, as an Austrian economist I do not think the economy is "driven by spending." Indeed, other things equal, if a new president comes in with pro-growth tax and regulatory policies, I would predict lower price inflation, because (a) more goods being produced will tend to lower the dollar-price per good and (b) the reduction in unemployment will lead the Fed to create

> fewer dollars. With fewer dollars chasing more goods, we would expect (other things equal) the dollar price of goods to be lower.

The Tepid Labor Market

Figure 3 below shows

the official unemployment rate, going back decades for context.

As Figure 3 shows, the headline unemployment rate has fallen steadily since its peak in 2009, and at this point is lower than it was at any point during the entire 1980s. Since most Republicans associate the Reagan years with prosperity, this seems like a good sign, right?

However, as many critics have noted since



FIGURE 3. Civilian Unemployment Rate, 1950 – Present

The headline unemployment rate has fallen steadily since its peak in 2009, and at this point is lower than it was at any point during the entire 1980s. the Great Recession began, the official, headline numbers don't include all of the people who left the labor force altogether. In other

words, to be counted as "officially" unemployed in the headline number, you need to be in the labor force and actively seeking work.

There are various other metrics I could use to paint a much bleaker picture of the labor market. But let me choose just two. In 1994, among Americans aged 16 to 19, 52.7 percent of them either had a job or were seeking work. In 2014, among this same demographic, only 34.0 percent were doing so.

from the Bureau of Labor and Statistics.

As the table indicates, the percentage of

Americans who are in the labor force—which means they are just looking, not that they necessarily have a job has fallen dramatically in the twenty years from 1994 through 2014. The drop is particularly pronounced among younger people. For example, in 1994, among Ameri-

cans aged 16 to 19, 52.7 percent of them either had a job or were seeking work. In 2014, among this same demographic, only 34.0

First, consider Table 1, which I reproduce

	Participation rate			
Group	1994	2004	2014	2024
Total, 16 years and older	66.6	66.0	62.9	60.9
16 to 24	66.4	61.1	55.0	49.7
16 to 19	52.7	43.9	34.0	26.4
20 to 24	77.0	75.0	70.8	68.2
25 to 54	83.4	82.8	80.9	81.2
25 to 34	83.2	82.7	81.2	81.3
35 to 44	84.8	83.6	82.2	81.7
45 to 54	81.7	81.8	79.6	81.0
55 and older	30.1	36.2	40.0	39.4
55 to 64	56.8	62.3	64.1	66.3
55 to 59	67.7	71.1	71.4	74.2
60 to 64	44.9	50.9	55.8	58.8
60 to 61	54.5	59.2	63.4	67.1
62 to 64	38.7	44.4	50.2	53.2
65 and older	12.4	14.4	18.6	21.7

SOURCE: http://www.bls.gov/emp/ep_table_303.htm

percent were doing so—a staggering drop of 18.7 percentage points, or some 35 percent of the original amount.

likewise might postpone retirement because they feel great and want to keep producing.

However, I think it is safe to say that it was a bad economy causing most of the shifts

On the other hand, we see that labor par-

ticipation rates went up among the older demographics. For example, looking at Americans aged 65 and older, back in 1994 only 12.4 percent were working or looking for work, whereas in 2014, 18.6 percent were. That's an amazing fifty percent increase of the original amount.

In 1994, among Americans aged 16 to 19, 52.7 percent of them either had a job or were seeking work. In 2014, among this same demographic, only 34.0 percent were doing so. we see in Table 1. Especially with the hikes in the minimum wage that occurred in 2007, 2008, and 2009¹, coupled with the stock market gyrations in 2008, I think it is safe to say that many young people find it much more difficult to get a job now than in 1994, and that many

Now in general, we wouldn't know whether these trends were signs of progress or calamity. For example, in a society with fantastic wealth accumulation and better medical care, it might make perfect sense for children to postpone work more and more, as more of them went to school for longer. And people older people are worried that they can't afford to retire.

Next, I turn to the employment-population ratio as the second metric I will use to document how misleading the official unemployment rate is:



FIGURE 4. Civilian Employment-to-Population Ratio, 1950 – Present, Monthly

with artificially low rates, the worse the eventual crash will be. Better to get it over with.

The longer we persist

Figure 4 looks at the civilian population (i.e. people not in the armed forces or institutionalized) and counts the fraction who are employed. For example, a large portion of the population are in college or are retired, so they aren't employed; they show up in this statistic, and keep it lower than 100 percent.

As Figure 4 shows, the ratio of the civilian population who are formally employed fell off a cliff during the Great Recession, hitting a low not seen in decades. (The main reason for the steady ascent in the figure since the 1980s is the rising participation of women in the official workforce.)

Now it is true that the aging of the population partly explains why the ratio charted in Figure 4 should "naturally" have declined in the last couple of decades, but the sharp drops after the dot-com and housing busts demonstrate that the change is largely economic, not demographic.

Most important: The paltry uptick of the line in Figure 4 since 2010 shows just how tepid this "recovery" has been. The official unemployment figures are masking just how weak the U.S. labor market is.

A Crash Is Still in the Cards

The reader should not misunderstand me: I am not disputing that the Fed must raise rates. This isn't because I think the economy is "ready for a rate hike," but rather be-

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cause my knowledge of Austrian business cycle theory tells me that the longer we persist with artificially low rates, the worse the eventual crash will be. Better to get it over with.

To give an illustration of why the stock market is still overvalued, consider the latest version of a chart I've been showing LMR readers for years: slightly higher price, thus effectively paying interest to the counterparties for their temporary investment of reserves.²

At any given time, the more of these reverse repos that are in effect, the lower will be the amount of reserves owned by the private sector, and thus the lower the monetary base will be. It is all a sophisticated way for the Fed to temporarily "sell off bonds and

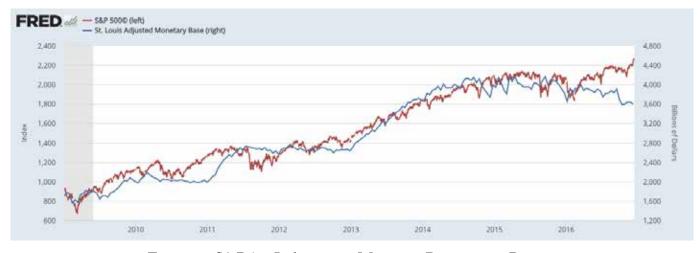
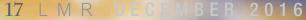


FIGURE 5. S&P500 Index versus Monetary Base, 2009 - Present

As I've explained in previous posts, even though the Fed is not (currently) selling off assets to raise interest rates, nonetheless its rate hikes will tend to push down the "monetary base" (the blue line in Figure 5). This is because the Fed is raising rates (partly) through "reverse repos," in which the Fed temporarily sucks reserves out of the system by selling Treasuries to designated counterparties. The reverse repos (which is short for "reverse repurchase agreement operations") have a built in feature whereby the Fed agrees to repurchase the Treasuries at a suck money out of the system" without officially doing so, because the operation automatically unwinds itself.

However, the effect in terms of monetary "tightening" is largely the same. As Figure 5 shows, the gap now between the S&P500 (red line) and the monetary base (blue line) is the widest it has been since 2009. We should not be surprised if the stock market drops sharply in the near future. Remember that it fell last January, after the original Fed rate hike in December 2015.





Conclusion

Although the official unemployment numbers made the Fed's rate hike "obvious," in reality the labor market is still very weak. Something is structurally wrong with the U.S. economy, and unfortunately the Fed's current and planned rate hikes may bring the flaws to everyone's attention. It is all a sophisticated way for the Fed to temporarily "sell off bonds and suck money out of the system" without officially doing so, because the operation automatically unwinds itself.

References

2. For the Fed's explanation of its reverse repo operations, see: https://www.newyorkfed.org/markets/rrp_faq.html.

^{1.} For a history of the federal minimum wage level, expressed in nominal and "real" terms, see: https://www.dol.gov/featured/minimum-wage/chart1.

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CITY OF GOD

PARTII

BY L. CARLOS LARA

The City of God, Part II

[Editors' note: Although the professional output of "Lara-Murphy" is devoted to financial matters, especially in the coming storms we think it is important to occasionally remind our readers of our own personal view on the true path to security. To understand how Carlos' reading of this particular book was actually due to considerations of economic and political events in 2016, see the podcast discussion at: <u>https://laramurphy.com/podcast/episode-30-city-god-versus-city-man/</u>.]

ST. AUGUSTINE OF HIPPO IS RECOGNIZED as one of the great doctors of the Latin Church, yet he is equally admired and respected by the great reformers, such as Martin Luther and John Calvin. This mutual acknowledgment by the scholars of both sides of church doctrine is due in large part to Augustine's centrality in Christian history and the development of Christian thought during the Middle Ages.

The City of God, a compilation of 22 books written between 413 A.D and 427 A.D., is considered to be a timeless classic and among

the world's greatest theological works. Written in defense of the Christian faith during the collapse of the Roman Empire, Augustine was able to pour into these texts his entire life's perspective on the ancient pagan religions of Rome, the arguments of the Greek philosophers, and the sacred wittings found in the canonical Bible. His conclusion was that there is a city with heavenly origins rising up alongside the kingdoms of the earth, one that transcends politics and world governments—a city that will never fail and never end. It is a city that has eternal foundations whose builder and maker is God.

BACKGROUND

In Part I of this article we explored the origins of this city from the renderings in the book of Genesis as Augustine interprets them. Basically, we learned that it all begins with the angels. These are very special beings created by God who are endowed with the capacity of free choice. In effect, Augustine from the outset is establishing that these an-



Augustine was able to pour into these texts his entire life's perspective on the ancient pagan religions of Rome, the arguments of the Greek philosophers, and the sacred wittings found in the canonical Bible.

Augustine's account of creation makes logical sense.

gels did not coexist eternally with God, but that they too were created (out of nothing) during the six days of creation soon after the creation of the heavens and the earth.

Then astonishingly, when Genesis states that God said, "*Let there be light,' and there was light,*" Augustine boldly asserts that this particular act of God's was the creation of the angels! (The other forms of light, namely the sun, the moon and the stars, were not created until the fourth day. Man was created on the sixth day.)

The statement, which immediately then follows in Genesis, says, "And God separated the light from the darkness." Augustine, just as remarkably, claims that this statement implies the separation of the good angels from the angels that would fall away and become the enemies of God—a fact that God foreknew and was a part of his eternal plan. Augustine's writings provide me, for the first time in my life, a coherent explanation of where the speaking serpent (a fallen angel) that came to tempt Eve in the garden came from. Augustine's account of creation makes logical sense. But what Augustine is really trying to establish from these opening verses in Genesis is the origins of the inhabitants of the two cities, the worldly city and the city of God.

In this Part II and conclusion, I will attempt to explain Augustine's view on a subject that has confounded the human mind since time immemorial right up to our own present day—the subject of *evil*. We all certainly know what evil is and what it does, but why does it exist? Where does it originate? Most importantly, did God create it, or has it always existed as an enemy of God and the good he stands for? If God did create evil why did he create it?

GOD IS THE ONLY FIRST PRINCIPLE

For our present purposes and to begin unraveling this mystery it is important to know

> We all certainly know what evil is and what it does, but why does it exist?

that Augustine was for ten years in his life as a young man a disciple of "Manichaeism,"¹ which was a religious sect derived from the Gnostic beliefs and pagan elements that existed before the time of Christ. Gnostics and (later) the Manichees encouraged asceticism because fundamentally they were "dualist."² "Their central idea (of Manichaean thought) was that there are two powers in the universe, 'two first principles,' good and evil, eternally at war."³

This religious movement was widespread during Augustine's time and easy to embrace by most Romans and their beliefs in pagan gods. But it was also easy to embrace by Christians who had no better way to decipher the nature of evil contrasted with an omnipotent God who is wholly good. Christians of that day dangerously concluded that Manichaeism best explained the genuine inward consciousness they felt of actually being involved in a literal war between good and evil.

I can certainly see how this could happen because I have personally struggled with similar misconceptions as exemplified by the Apostle Paul in the book of Romans when he says. "For I know that nothing good dwells in me, that is, in my flesh. For I have the desire to do what is right, but not the ability to carry it out. For I do not do the good I want, but the evil I do not want is what I keep on doing.

Christians of that day dangerously concluded that Manichaeism best explained the genuine inward consciousness they felt of actually being involved in a literal war between good and evil.

Now if I do what I do not want, it is no longer I who do it, but sin that dwells within me."⁴

According to Gnostics and the Manichees, the evil god was the creator of all matter, while the good god was the creator of all things spiritual. Consequently, all material things, including the body, were to be mistrusted, hence arose the philosophy of asceticism. Later in life, after he became a Chris-





tian, Augustine came to understand the error of this misguided belief and he wrote many books and sermons refuting Manichaeism. *The City of God* is one of those books.

By demystifying evil, Augustine refuted Manichaeism. His first and central point was that God is the only 'first principle' and that He created everything that exists out of nothing. Of all the visible things that exist, the world is the greatest, but by the same reasoning we understand that of all the invisible things the greatest is God. Yet the existence of the world is proved by observation, whereby the existence of God is determined by belief. To know that God made the world we have no greater testimony than that of God himself.

Augustine completely disproves Manichaeism by an elaborate process of deductive reasoning using the Holy Scriptures, which he confirms is the 'Wisdom of God' passed on inwardly and soundlessly to holy souls (friends of God and prophets) about His works at creation and how he accomplished them. The angels also are messengers of God who announce His will to those who are fit to know it. Augustine's conclusion and pivotal point is that there was no Time depends on motion and change, without these there is no time.

time before the world began. The beginning of time and the beginning of the world occurred simultaneously.

Time depends on motion and change, without these there is no time. Consequently, there is a clear distinction between eternity (where there is no change) and time. From this, as difficult as it may be for us to understand, Augustine infers that God had created nothing before he created the world referencing the statement in Genesis, "*in the beginning*." At the time of creation there was no past simply because there was nothing created to provide change and movement, which is an attribute of time. In other words, the world was not created *in* time but *with* time.

From there he goes on to confirm that Genesis makes it clear that the world and everything God created in it was *good* and that on the 7th day He rested. Consequently evil has no origin in God's creation. "There is no such entity in nature as evil, evil is merely a name for the privation of good."⁵ Looking for evil's origin is futile and is like trying to see darkness or hear silence. The main point to draw from this is that the nature of God is not only unchangeable, but is also completely incorruptible. Nothing can do God any harm for all of God's creation is under his supreme sovereignty. Hence, "all things that do not belong to God's own being, though inferior to God, are nevertheless good and the creation of God's goodness."⁶ This is Augustine's second and greatest point.

EVIL IS NOT NATURAL— SIN IS AN ACT OF THE WILL

In this second main argument, which is the emphasis that all of God's creations when made were *good*, including that of the nature of the angels that fell away. Augustine underscores that it is the turning away from God that is the perversion. That turning away is what damages the good nature and causes it to lose its former status. Here we have to understand that the angels who fell away actually had the ability to remain good (remember they possessed complete freedom of choice), but they chose otherwise.

Evil, Augustine says, is not natural. Sin is an act of the will, but not of the good nature as created by God. Wickedness is contrary to nature. All evil can do is harm nature. For example, money is not evil and is not the cause of greed. It is the fault of the soul who perversely loves money more, or without a thought given to the omnipotent God.

"When we ask the cause of the evil angel's misery, we find that it is the just result of their turning away from Him who supremely is, and their turning towards themselves, who do not exists in that supreme degree. What other name is there for this fault than pride? The beginning of all sin is pride. Thus they refused to keep watch for Him who is their strength. They would have existed in a higher degree; but in preferring themselves to Him they chose a lower degree of existence."⁷

"But how can this be?" Augustine asks himself. "How can a nature which is good, however changeable, before it has an evil will, be the cause of any evil, the cause, that is, of that evil will itself?"⁸

Evil, Augustine says, is not natural.

In this next statement, Augustine finalizes and concludes the only possible explanation for these pressing questions.

"Those other angels were created good but have become evil by their own bad will; and this bad will did not originate from their nature, which was good. It came through the voluntary falling away from the good, so that evil is caused not by good, but by falling away from good.

Either they received less grace of the divine love than did the others, who continued in that grace; or, if both were created equally good, the one sort fell through their evil will, while the others had greater help to enable them to attain to the fullness of bliss with the complete assurance that they will never fall away."

GOD'S PROVIDENCE THROUGH THE OPPOSITION OF CONTRARIES

Every Christian knows that no new "Devil" will ever come from the original body of good angels, in the same way they know that the Devil will never return to the fellowship of the good angels. Most Christians know that scripture identifies *Lucifer* as the name of the most glorious of the angels who became the Devil (Satan). When the Devil, who was good when God created him, became evil by his own choice, God caused him to be cast down to a lower station and turned Satan's choice, and that of the rest of the angels who followed him, to good use.

Augustine explains that the Devil's temptations are proven to exist for the benefit of God's people, even though the Devil and his angels are just out to hurt them. God, by virtue of his foreknowledge, knew exactly how he would put these bad angels and the future of their evil state to good use in redemptive world history. He says that there is a kind of beauty in the way the world's history is unfolding, which is derived from the antithesis of contraries. "Good confronts evil, life confronts death: so the sinner confronts the devout. And in this way you should observe all the works of the Most High; two by two; one confronting the other."¹⁰

CONCLUSION

I must confess that I regret having to end this article and the dissemination of some of the profound themes found in this tremendous volume; they are too many to mention here. I have only touched on two of its subjects. Perhaps you will agree that they were the most critical ones to understand about the origins of the inhabitants of the city of God, which was the overall theme of this great work.

What I hoped to clearly convey to the reader in this narrative, from my own understanding of Augustine's writings, is that the eternal city of God consists of both men and angels. It should be obvious that most of the emphasis has been placed on the angels



Augustine explains that the Devil's temptations are proven to exist for the benefit of God's people, even though the Devil and his angels are just out to hurt them. and more specifically the two classes of angels and their beginnings. I should also add that we should pay careful attention to the fact that the element of free choice, which was given to the angels, is supremely significant and not at all like our own freedom of choice.

Even the free choice given to the first humans, Adam and Eve, was unlike the free choice given to the angels, and more importantly, the freedom of choice we currently posses. Theirs was one intertwined with obedience to a direct command from God, which carried with it the penalty of eternal death if they chose to disobey. We all know they did. Furthermore, different from the angels, Adam and Eve had a *tempter*.

As to whether our freedom of choice is one of complete *free choice* as in that of the angels or *limited choice* is an entirely different debate and one that clearly divides Christendom to this day. But the one thing in which most Christians agree and understand is that every human born into the fallen world, beginning with Cain and Abel, is under the penalty of eternal death because of Adam and Eve's disobedience.

I cannot write a better closing to point to man's only hope than to default again to Augustine of Hippo's own words:

"God speaks to the highest of man's constituent elements, the element to which only God himself is superior. ... For man is rightly understood to be made in the image of God. ...And yet the mind of man, the natural seat of his reason and understanding, is itself weakened by longstanding faults, which darken it. ... And so the mind had to be trained and purified by faith; and in order to give man's mind greater confidence in its journey towards the truth along the way of faith, God the Son of God, who is himself the Truth, took manhood without abandoning his godhead, and thus established and founded this faith, so that man might have a path to man's God through the man who was God.

As it is there is one road, and one only, well secured against all possibility of going astray; and this road is provided by one who is himself both God and man. As God, he is the goal; as man, he is the way."



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DECEMBER 2016

HOW DO POOR COUNTRIES

INTERVIEW WITH G.P. MANISH

HOW DO POOR COUNTRIES GROW RICH?

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G.P. Manish is an Assistant Professor of Economics in the Sorrell College of Business and a member of the Manuel H. Johnson Center of Political Economy at Troy University. He has published articles in *The Independent Review, Review of Austrian Economics,* and *Atlantic Economic Journal,* among others. His areas of interest include development economics and economic history, entrepreneurship and price theory, and the history of economic thought.

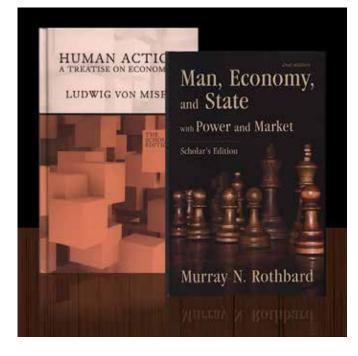
LARA-MURPHY REPORT: How did you become interested in Austrian economics?

G.P. MANISH: I first became aware of Austrian economics while pursuing my Masters' degree in India. The mainstream economics that I was being taught in the classroom left me unsatisfied and led me to investigate alternative perspectives. One of these was that of the Austrian School. Initially I had a hard time wrapping my head around some of the core ideas (I even looked up the word "praxeology" in the dictionary and found no entry!), but through concerted effort gradually began making headway into treatises like Man, Economy, and State and Human Action. Ultimately, two factors played a role in convincing me that this tradition of thought presented a coherent and superior alternative to the edifice of mainstream micro and macro theory: First, its logical tightness, especially the explicit grounding of the analysis of all market phenomena in the fact of human action, and second, the fact that it did not just analyze a state of equilibrium but instead developed a comprehensive and realistic analysis of states of disequilibrium on the basis of these logical foundations.

LMR: One of your specialties is development economics / growth theory. First, can you explain to our readers the revolution that occurred in this area, even purely within mainstream economics? I'm thinking particularly of the work of Peter Bauer.

GPM: When development economics came into its own at the end of the Second

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World War the policy prescriptions offered by its representatives to the developing world were near unanimous: The goal of economic policy should be to pursue rapid industrialization and instituting the program of economic nationalism was the best way to

> "Two factors played a role in convincing me that this tradition of thought presented a coherent and superior alternative to the edifice of mainstream micro and macro theory."

achieve this end. Now, as Michael Heilperin has argued in his excellent book on the subject, economic nationalism, by emphasizing economic self-sufficiency as the pathway to economic growth and modernity, necessarily leads, not just to the rejection of international trade, but also to centralized state control over all aspects of economic activity. Hence, all over the developing world governments nationalized firms, expanded the public sector and set about enmeshing the private sector in a comprehensive set of controls and regulations, all in the quest to rapidly industrialize their economies.

Voices of dissent who objected to the pursuit of these economic policies were few and far between. Arguably the most prominent among them was Peter Bauer. Bauer put forth two fundamental criticisms of the post-War consensus in development economics: First, he argued that the right institutional conditions, which, in his opinion, entailed protecting and enforcing rights to private property, were fundamental to the process of growth and development and second, that the empirical demonstration of this was to be found in the historical experience of the Western, developed economies.

Bauer lamented the fact that development economists refused to cull lessons for the developing world by studying how the West had grown rich, instead choosing to neglect historical analysis. He believed that engaging in such an analysis, along with highlighting the importance of private property to the process of development, would also show that these institutional conditions had emerged in the West over a period of centuries as the result of a broad historical process, leading one to be skeptical of the possibility of converting an underdeveloped economy into a modern industrial powerhouse within a generation or two. "He argued that the right institutional conditions, which, in his opinion, entailed protecting and enforcing rights to private property, were fundamental to the process of growth and development."

One could argue that Bauer's ideas have won out in the long run. Spurred by the failure of the existing policies of development planning and by the re-emergence of market-friendly ideas in the West, the 1980s and 1990s witnessed widespread economic liberalization in the developing world, most prominently in China and India. Moreover, many of Bauer's insights, especially his emphasis on the importance of the institutional prerequisites for development and the importance of historical analysis, have found their way into modern development economics.

LMR: But now can you extend your analysis, and show us what a specifically *Austrian* focus adds to these developments in economic thinking about development among poor countries?

GPM: The concept of the capital structure lies at the heart of the Austrian contribution to the field of development economics. Treating capital goods, not as a homogenous entity, but as an array of heterogeneous goods of different orders, provides the development economist with the theoretical lens to understand the process of economic

development. Growth, in this view, can be seen as an extension and lengthening of the capital structure, a process of expanding the division of labor vertically.

To take an example from the simple scenario of a Robinson Crusoe economy: A poor, underdeveloped Robinson will be fishing with his bare hands, climbing trees to acquire fruit, etc. The developed economy of a wealthy Crusoe, on the other hand, will be characterized by a much richer structure of capital and longer processes of production. In such a scenario Crusoe will have a raft and a net to fish, an axe to fell trees, bow and arrows to hunt game, etc.

When conceptualized in this way, private property emerges as the key to the process of growth and development. For as Mises and Hayek famously argued, the meaningful allocation of resources in an economy with a complex structure of production requires economic calculation based on money prices





for the various factors of production. A capital structure where the various parts dovetail or fit together, i.e., one where there is a smooth flow of goods through the various stages of production and into consumption, only emerges in an economy with an intel-

> "Socialist China and India can record high rates of GDP growth and yet be characterized by stagnating or retrogressing average standards of living."

lectual division of labor, where numerous entrepreneurs, in their private capacity and guided by money prices, bid for and exchange the available means of production. The institution of private property in all goods and services is, of course, the necessary precondition for the emergence and existence of such an economy. Moreover, the concept of the capital structure also helps us understand how tightly regulated, centrally controlled economies such as those of the erstwhile Soviet Union as well as socialist China and India can record high rates of GDP growth and yet be characterized by stagnating or retrogressing average standards of living. This is the result of the emergence of a capital structure where the constituent parts do not fit with one an-

other. Modern factories that produce a wide variety of capital goods are constructed but there is no smooth flow of goods through the various stages of production into the final stage of consumption. As a result, the factories do not result in a flow of consumer goods of greater quantity and quality. Such a structure only emerges where factor markets are crippled by socialization or a bevy of regulations.

LMR: We think our readers will be particularly interested in your summary and assessment of what's happening in India, with the currency recall. What do American readers—especially those who are skeptical of the government's motives—need to take away from this episode?

GPM: In an effort to get rid of "black" money, i.e., income on which taxes have been evaded, the Indian government decided to demonetize the 500 and 1000 rupee

notes and replace these with new 500 and 2000 rupee notes. This demonetization was not carried out over a period of time but overnight and with no forewarning. Moreover, in typical fashion, the government has handled the entire process of exchanging the demonetized notes for new ones in a ham handed fashion. The new 2000 rupee note, for example, is too wide



for the existing ATM machines! Moreover, banks found they did not have adequate cash to meet the demand for the new notes. As a result, limits have been placed on how much money can be exchanged in a day and people have been forced to wait in line for hours to do so.

It is highly unlikely that this measure will have its intended effect. According to most estimates, only around 6% of black money is actually held in the form of cash. The vast majority of it is funneled rather quickly into luxury apartments and cars, gold, offshore bank accounts, etc. Moreover, recent reports indicate that as much as 83% of the old notes have found their way to the banks, a figure higher than the initial expectations of the government. Thus, the majority of those who were holding black money in the form of cash seem to have found a way to convert it into the new, "white" money! Moreover, the measure does not address the root cause of the emergence of black money, most of which emerges as a result of individuals trying to evade the plethora of controls and regulations that still characterize the Indian economy.

> "This demonetization was not carried out over a period of time but overnight and with no forewarning. Moreover, in typical fashion, the government has handled the entire process of exchanging the demonetized notes for new ones in a ham handed fashion."

The measure does, however, impose huge costs on the average Indian. Overnight, approximately 86% of the cash in circulation was effectively destroyed; a significant monetary shock to an economy, where, by most

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estimates, nearly 90% of all transactions involve the use of cash. The bulk of this cash, moreover, circulates in the informal and rural sectors of the economy, where the market participants are predominantly those with low incomes. The richer sections of society, meanwhile, were the least affected due to their widespread use of debit and credit cards, online wallets, etc. Thus, it was the relatively poorer Indians who suddenly found themselves with an insufficient stock of cash and were forced to wait in line for hours to replenish their cash holdings, the end result being a significant negative shock to their real incomes.

There are two main takeaways from this fiasco: First, it is an excellent, if unfortunate, illustration of the perverse dynamic of interventionism that Mises and Hayek emphasized. Each government intervention, since it does not achieve its objective and instead has all sorts of perverse consequences, gives rise to further interventions that aim to rectify the problems brought about by the initial intervention. In the case of India black money exists primarily as the result of the maze of controls and regulations that still envelops many sectors of the economy. The majority of these controls, however, were introduced during the socialist days, when they were seen as steps on the road to economic development. Now, in order to deal with the perverse consequences of these interventions, the government has intervened further with its decision to demonetize and the various steps that it has taken and continues to take to deal with the fall-out of this policy.



"The Fed has, it seems, backed itself into a corner."

Second, this episode teaches us that the government is no friend of the poor. Politicians, in pursuing their grandiose schemes will not balk at throwing the lives of the poor into outright chaos.

LMR: You also work on Austrian capital and business cycle theory. What do you see happening in the next few years? Do you think the Fed is going to tighten?

GPM: I think the Fed will raise interest rates and tighten in the short run. It might not, however, do so consistently over the medium to long run. The Fed has, it seems, backed itself into a corner as a result of the unconventional monetary policy that it has pursued over the last few years, primarily because these steps have not been very effective in stimulating economic activity. Now it needs to tighten but will have to abandon this process if there is any hint that it might result in falling stock and/or asset prices.



NOTE: MANY OF THESE EVENTS ARE OPEN TO THE PUBLIC. CONTACT US FOR FURTHER DETAILS.

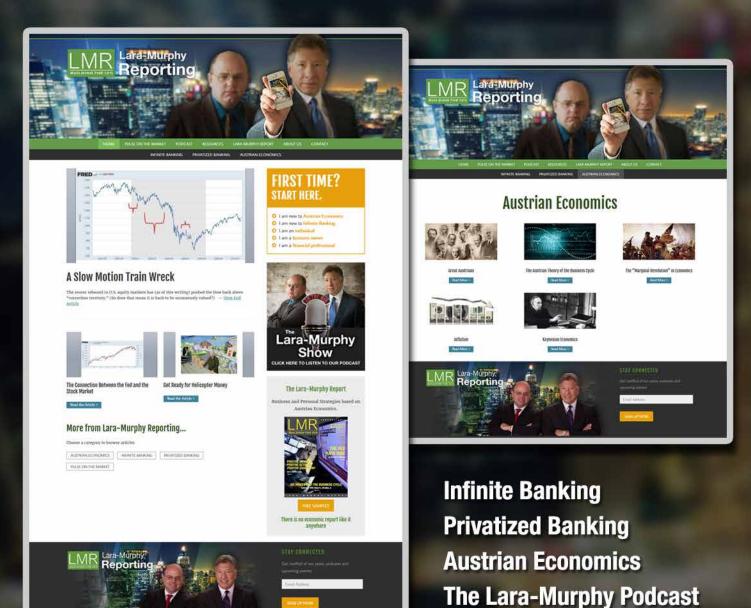
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