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BUILDING THE 10%

OCTOBER • 2016

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THIS MONTH'S FEATURES

ECONOMISTS DEFEND THE FED

BY ROBERT P. MURPHY

Even mainstream outlets like the Wall Street Journal are worried about Fed asset bubbles, but many mainstream economists are still toeing the line.

MAN MADE EARTHQUAKES

BY L. CARLOS LARA

Economic recessions aren't 'acts of God' but are the direct result of government intervention in money and banking.

POKER IS ABOUT WINNING MONEY

INTERVIEW

Professional poker player—and student of Austrian economics—Adam Haman comments on the game and the government.

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DEAR READERS

LARA-MURPHY REPORT

Why do the 'sophisticated' people disparage capitalism, when it has done so much to relieve human suffering?

ECONOMIC DEEP END

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ONE MORE THING

EVENTS AND ENGAGEMENTS

Learn more in person from Lara, Murphy, and other Austrian economists, at these upcoming appearances.

ABOUT LARA & MURPHY

L. CARLOS LARA is CEO of United Services and Trust Corporation, a consulting firm specializing in in business advisory services with a primary focus on working with companies in financial crisis. His background in capital formation and business rehabilitation makes him a regular speaker at credit and business conferences.

In 2010 he co-authored the highly acclaimed book, *How Privatized Banking Really Works* with economist Robert P. Murphy.

He is a co-creator of the IBC Practitioner Program for financial professionals and sits on the board of the Nelson Nash Institute.

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"One of the most remarkable achievements of capitalism is the drop in infant mortality. Who wants to deny that this phenomenon has at least removed one of the causes of many people's unhappiness?"

— Ludwig von Mises

We live in a world where capitalism is increasingly seen as unjust. Socialism, on the other hand, is openly embraced as the most righteous ideology. Yet all those who reject capitalism on moral grounds by calling it an unfair system have no idea what capital is. What's more they have no idea how capital comes into existence, nor how it fits in the production process that yields widespread abundance.

Without exaggerating, we (Carlos and Bob) work hard in our professions. But it is fair to say that we do not do it to achieve *"perfect"* happiness. We do it in order to remove as much as possible some felt uneasiness and become happier than we were before we put forth these efforts. We think Mises would agree that this is the right way to be thinking about it. Similarly, he would say that the task of a doctor is not to make a patient happy, but to remove his pain.

Virtually everyone agrees that the poor, sick, and hungry nations need a helping hand. Where we disagree with most contemporary observers is on the means of helping them. There is only one permanent way to relieve their suffering from the lack of the basic necessities of life—*laissez-faire capitalism!*

This is why we love and are so committed to *The Infinite Banking Concept (IBC).* It makes capitalists out of all us who are fortunate enough to come into contact with it. That's why it is the centerpiece of building the 10%. Like Austrian Economics, it's a message worth sharing. IBC is more than a *privatized banking* process; it's a wealth-producing dynamo that not only makes us happy, but it removes financial pain.

Yours truly,
Carlos and Bob

PULSE ON THE MARKET

FBI Whipsaw

DO YOU CARE ABOUT ANY CEO'S SCANDALS?

As of this writing, the latest election bombshell is FBI Director Comey's letter to Congress, informing them that the FBI had come into possession of more emails possibly relevant to the investigation of Hillary Clinton and her time as Secretary of State.

Sometimes free market fans point out that the public doesn't get worked up about "integrity" and other character issues in the private sphere, because those individuals have so much less *power* over us. Likewise, back in the early days of the Republic, Americans weren't nearly as worked up over elections as they are today, because the U.S. President in, say, 1824 couldn't influence your health care or your kids' education, and couldn't tax a huge share of your income.

However, these observations are not totally accurate. It really *would* be a disaster if you had corrupt and/or incompetent people as your car mechanic, heart surgeon, bookkeeper, or restaurant chef. But the reason we don't seem to worry so much about these private individuals is that there is *choice* and *competition*. The voluntary, competitive market process tends to weed out the "bad apples" so that the established professionals in various occupations are relatively honest and know how to do their jobs.

Furthermore, the public doesn't need to keep close tabs on the affairs of CEOs and CFOs of major corporations, because the *shareholders* have the first priority in doing so. If it turns out that a few big shots in corporate management are taking bribes from vendors, so that the company ends up producing an inferior product, then yes that ultimately hurts consumers. But the people it hurts *most* are the shareholders of the company, which is why they will set up procedures to try to monitor their purchasing agents and so on. It's not a perfect system, to be sure, but it's much better at "self-regulation" and "self-policing" than our system of democracy with outlets like CNN and Fox News as the custodians of truth and justice. Remember Hayek's famous chapter in *The Road to Serfdom* entitled, "Why the Worst Get On Top." Note, he was talking about the political realm, not physics or the grocery business.

OBAMACARE BLOWOUT

MASSIVE PREMIUM HIKES FOR ACA EXCHANGE PLANS

The Obama Administration has announced large premium hikes for the health insurance plans offered through the Affordable Care Act (aka "ObamaCare") marketplace exchanges. The benchmark "silver plan" will rise, on average, 22 percent in 2017. But the hikes will be far higher in particular states. In Arizona, for example, the premium on the benchmark plan will rise a *shocking 116 percent*—yes that's right, more than doubling in a single year.

We have written extensively on the Affordable Care Act in the *LMR,* and one of us (Murphy) has co-authored an entire book with ER doctor Doug McGuff on what happened to U.S. health care. (The book is *The Primal Prescription.*) But to quickly summarize some of the key factors lying behind the massive sticker shock:

First and most fundamental, actuarial reality is setting in. When the federal government passes a new law saying health insurers can't turn away sick people, *and* can't charge them a higher premium than otherwise comparable healthy people, *of course* that is a recipe for disaster. What has happened is exactly what the critics warned: We are seeing the opening stages of a "death spiral" in which the pool of insured consists disproportionately of sick people, which makes premiums rise and causes healthy people to stay out. This only exacerbates the problem, leading to health insurers pulling out of the system because they can't charge a high enough premium to cover their expenses.

However, there are other particulars behind the timing of the rate hikes. There were several provisions in the ACA legislation that would mask its full effect on private insurers, at least initially. For example, there was a cost-sharing "risk corridor" program, by which the feds would cushion the blow to private insurers if they ended up losing a boatload of money. Furthermore, the "individual mandate"—backed up by steadily rising fines for people who have the audacity to not buy one of these "affordable" health insurance plans—ramped up over time. So for all these reasons, private insurers could be more timid with their rate hikes coming out of the gate, to see how the numbers shook out.

But at this point, many of the temporary measures are phasing out (or an obstinate Congress has balked at covering industry-wide losses), and so private insurers are having to actually get in the black. This is also a factor in why the customer service from health insurers is going to continue to worsen. They have to cut costs somewhere.

Naturally, the cheerleaders for ObamaCare are doubling down, saying its failures prove that "the free market doesn't work" in health insurance. They are calling for a "public option" or even a "single payer" system. As Mises observed long ago, there can be no isolated act of intervention into the economy. It sets up unintended consequences, which lead to calls for further intervention.

Fed Hike After Election?

IS TRUMP RIGHT ABOUT YELLEN?

Many analysts—particularly those featured at ZeroHedge.com and other contrarian websites—think that, despite his bluster, Donald Trump was on to something when he accused Yellen's Fed of deliberately holding down interest rates in an effort to help elect Hillary Clinton.

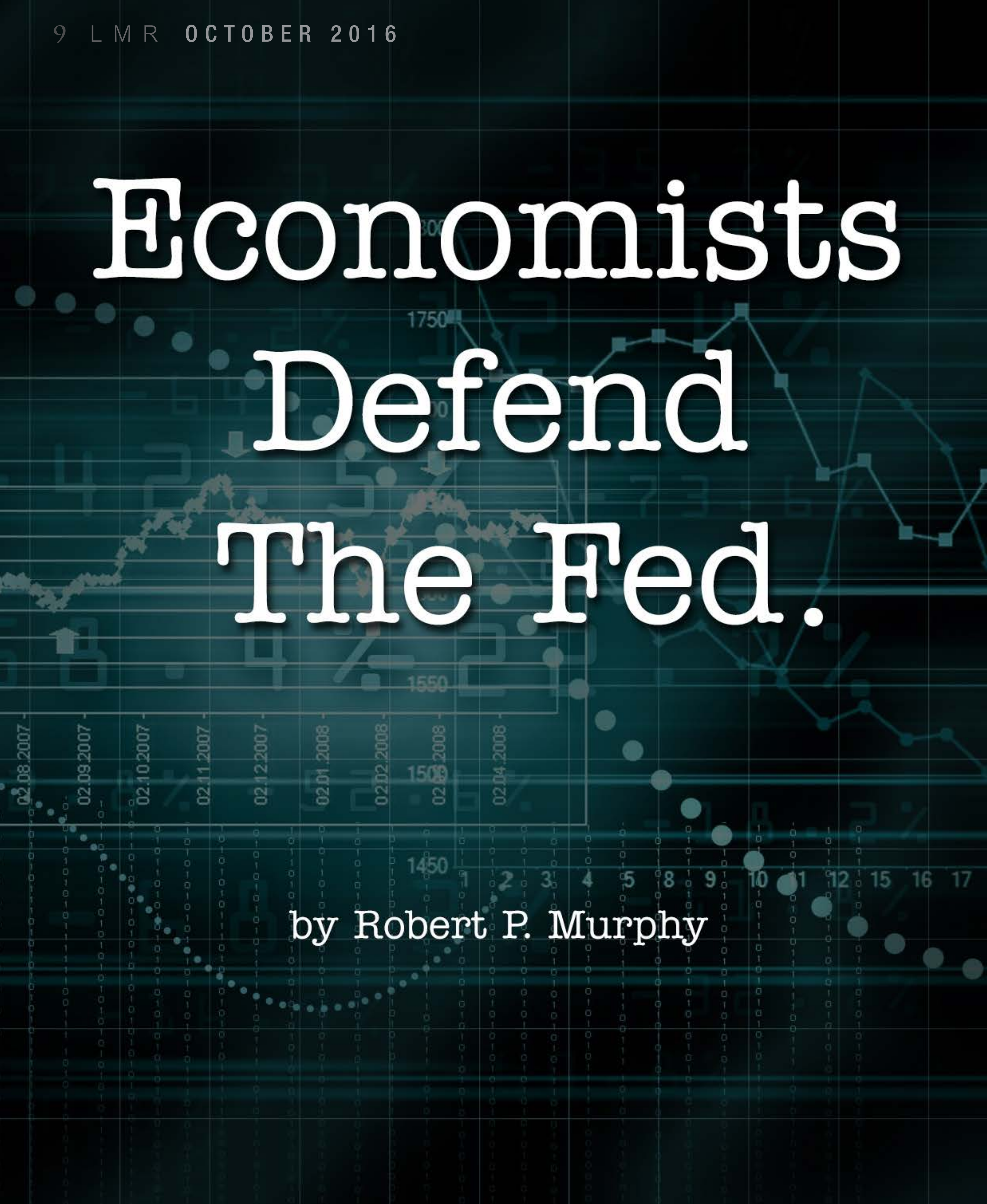
It's hard to know for sure on such matters, but the Fed's most recent statements do keep alive the prospect of a tightening in the near future. If indeed the Wall Street / central bank nexus prefers Hillary Clinton to Donald Trump—not because Trump is a hard-money man, but simply because Clinton is more predictably establishment—then it would make sense for the Fed to postpone any tightening (beyond their December 2015 rate hike) until after the election.

In contrast, if one thought the central bankers wanted Obama to win back in 2008, then it would have made sense for them to let the crisis occur just before that election. (Remember

Lehman failed, and AIG was bailed out, in September 2008.)

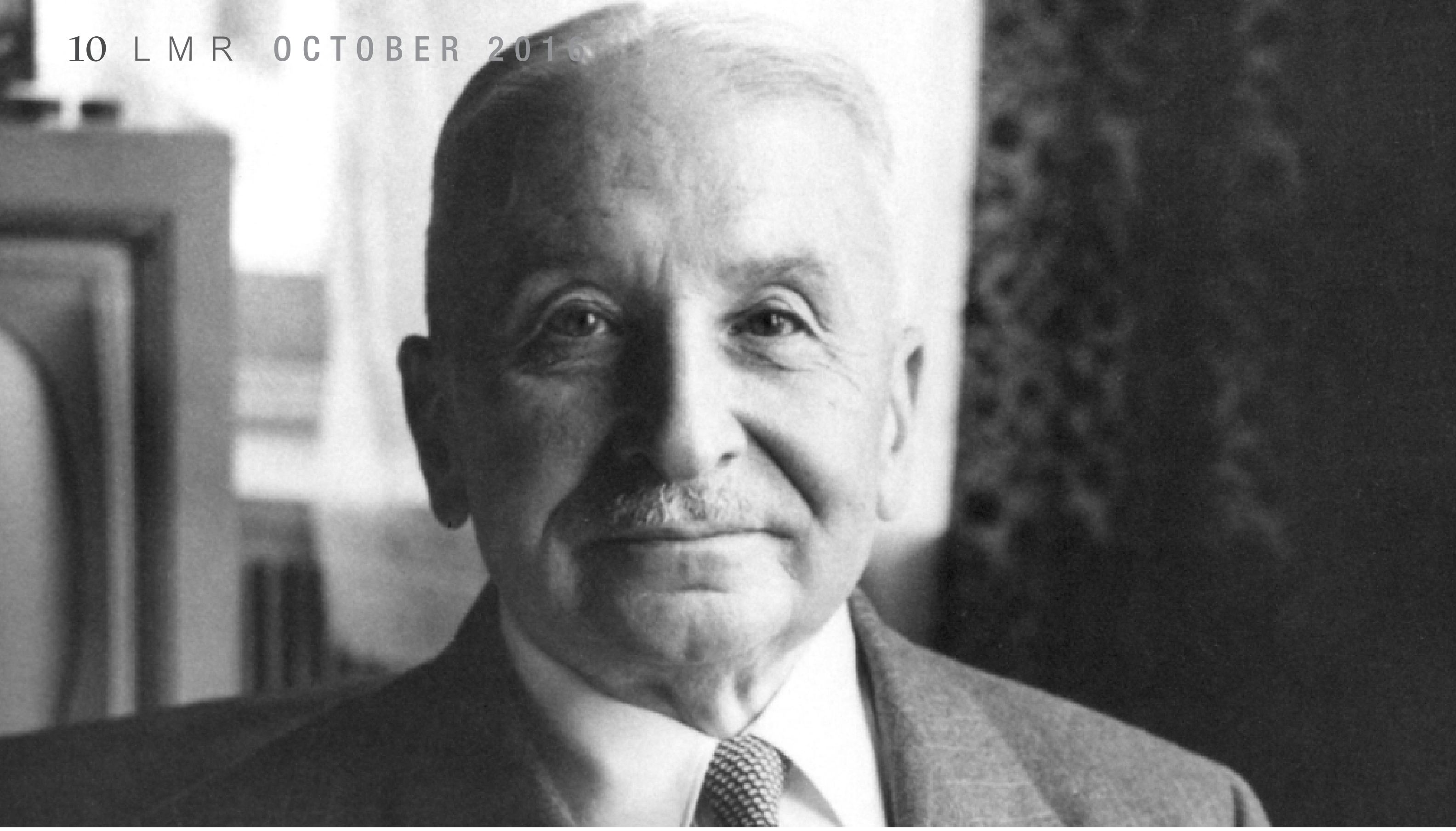
To be clear, not even central bankers can alter the laws of economics. If artificially low interest rates and "easy money" have pumped up a giant asset bubble—which we think they most certainly have done, since 2009—then that bubble must eventually pop. However, the central bankers *do* exercise a great deal of discretion over when the bubble pops. For example, if the Fed were to announce "QE4" and begin buying another trillion dollars of Treasuries, then that would probably goose the stock market for a while and postpone the day of reckoning.

Yet make no mistake, the longer the Fed waits before tightening, the harder the eventual crash will be. For those who have yet to see it, please watch our video, "How to Weather the Coming Financial Storms," available at the main page at: http://lara-murphy.com.



Economists Defend The Fed.

by Robert P. Murphy



The financial press' discussion of Fed policy since 2009 has continued to confirm the superiority of the Austrian School of economics over its rivals. It's true that the Keynesian and Chicago School approaches enjoy more popularity in academia and among the ruling elite, but a growing number of analysts are realizing the flaws in their macro frameworks. As I first noticed in my grad school days, mainstream economists literally cannot even entertain the Austrian theory of the business cycle, because their mathematical models are not nuanced enough to handle Mises' claims.

As I first noticed in my grad school days, mainstream economists literally cannot even entertain the Austrian theory of the business cycle, because their mathematical models are not nuanced enough.

In this article I'll summarize a recent Wall Street Journal article by Mary O'Grady, which is refreshingly Austrian-friendly in its themes. Then, perhaps ironically, I'll show how a Chicago School economist featured on a classical liberal blog, felt the need to critique her article as being not just wrong, but nonsensical. The whole episode underscores the importance of the Austrian School, because even the relatively free market Chicago economists often work with an abstract model and miss the Austrian insights.

O'Grady Criticizes the Fed

In her October 23 piece at the WSJ[1], O'Grady argues that the Fed's loose monetary policy has failed:

> *Fed policies of zero interest rates and bond buying—quantitative easing—have not only failed to stimulate business investment. They have discouraged it through the misallocation of capital. This is contractionary because it starves entrepreneurship and thus productivity growth.*
>
> …
>
> *Conventional wisdom holds that the Fed has flooded the market with credit by aggressively buying bonds and creating bank reserves on the Fed balance sheet. Yet when the Fed buys assets—such as government debt or mortgage-backed securities—it only records a short-term liability on the balance sheet. The reserves are on the books but don't create any more credit in the real economy than if the Fed never made the purchase. Meanwhile it creates shortages of medium- and long-term assets in the market.*
>
> …
>
> *The most creditworthy companies are using cheap money not in productivity-increasing ventures but to pay dividends, buy back stock or engage in other financial transactions. Fed policies, as Mr. Malpass wrote, are "reducing the credit available to smaller businesses and hurting GDP growth rather than stimulating it."*

What I love about O'Grady's analysis—which relies in part on David Malpass' note to clients—is that she treats interest rates as *prices* which help coordinate the distribution of resources in the economy. This is how Austrians view the market process, and such a view is necessary to understand how artificially low interest rates can stimulate *malinvestments* and an unsustainable boom period.

She treats interest rates as prices which help coordinate the distribution of resources in the economy.

In contrast, Keynesians and even Chicago School economists tend to think about aggregate investment—as a single dollar amount spent in the whole economy—rather than the *particular projects* in which businesses invest.

What O'Grady is arguing in the quota-

tion above is that the Fed's artificially low interest rates have made it possible for the politically connected big businesses to access cheap credit, while smaller entrepreneurial operations are starved for funds. By stressing the "real economy" O'Grady shows that she thinks the mere creation of money by Federal Reserve bookkeeping operations is artificial, not corresponding to genuine saving by households or firms.

To put it succinctly: If the Fed pushes down the fed funds rate from (say) 3 percent to basically 0 percent, and holds it there for years, then the private sector engages in less genuine saving than it otherwise would have performed. At the same time, projects that were not profitable at a 3 percent "cost of capital" will now be funded if the fed funds rate is only 25 or 50 basis points. There is thus a double-whammy to the "real" economy, where there is a smaller pool of real savings and that pool is being siphoned into many uneconomical projects.

She thinks the mere creation of money by Federal Reserve bookkeeping operations is artificial, not corresponding to genuine saving by households or firms.

The result over the years is that the economy's capital structure becomes distorted, slowing long-run growth. And this is exactly what we have observed since 2009.

Scott Sumner Responds

Now maybe O'Grady is right, or maybe she's wrong, but her thesis at least *makes sense.* To repeat, she is simply arguing (perhaps not as eloquently) one aspect of the broader Austrian critique of "easy" Fed policy.

The reader can (I hope) understand why I was so surprised to see Scott Sumner, a leading free market monetary economist, launch a harsh salvo against O'Grady's article from the pages of EconLog,[2] which is a popular site for classical liberal commentary. It's hard to reproduce Sumner's analysis here, because he basically keeps quoting snippets from O'Grady's column and saying that she hasn't shown how the Fed is stifling growth. Yet, to *me* at least, it was crystal clear what her argument was. I'll quote some excerpts from Sumner to give an idea of how mystified he was, and to shed some light on his own mental model:

> There is thus a double-whammy to the "real" economy, where there is a smaller pool of real savings and that pool is being siphoned into many uneconomical projects.

> *[W]hy would an asset bubble reduce investment? The usual theory of asset bubbles (which I do not buy) says they boost investment (tech in 2000, housing in 2006, etc.) Again, no explanation [from O'Grady].*
>
> …
>
> *And that's it. An assertion that Fed policies are hurting business investment, but no explanation of how this is occurring. What is the mechanism? How does Fed policy discourage person A from extending credit to person B? You go all the way to the end of the article with a provocative headline, and the author doesn't even attempt to back up this unconventional claim. What a let down! I like contrarian arguments—I wish the WSJ had provided the contrarian argument that they promised in their headline. I can't criticize an argument that is not made.*
>
> *This is the sort of article one gets when an ideology has reached the point of intellectual bankruptcy. The ideology is "Monetary policy is always and everywhere too expansionary." If you adhere to that ideology, eventually you'll have to tie yourself up in knots, attributing problems to "easy money" that are obviously not due to easy money. We've reached that point with the*

The maintenance of our standard of living—not to mention sustained growth—relies on entrepreneurs making millions of decisions, month in and month out, to plow gross receipts back into the business.

Wall Street Journal.

We are in strange times indeed when a free market monetary economist featured at a prominent classical liberal blog is accusing the WSJ of intellectual bankruptcy when it runs an article saying artificially low interest rates are misallocating capital and thus stifling long-term growth.

I think the big problem here—the reason Sumner and O'Grady were having a failure to communicate—is that she was focused on the specific *forms* of investment, whereas Sumner was just looking at "investment," period. And this isn't surprising, since Sumner thinks it's helpful to evaluate policy using a model in which the economy can be represented as the intersection of two straight lines on a chart. (I'm not attacking a strawman; Sumner literally wrote that in an earlier post.[3])

The Composition of Investment Is Critical

The maintenance of our standard of living—not to mention sustained *growth*—relies on entrepreneurs making millions of decisions, month in and month out, to plow gross receipts back into the business. The issue is not merely one of total investment (whether we are looking at gross or net), but also the *composition* of investments.

> This is why Ludwig von Mises took pains to explain that his theory of the business cycle was one of malinvestment, as opposed to overinvestment.

This is a very simple yet often overlooked point. Consider a silly example: If Americans want to "colonize" a previously uninhabited forest, several things need to happen. Loggers need to roll in heavy equipment and clear out the trees. Then factories need to produce more lumber, shingles, panes of glass, bricks, nails, screws, paint, and so on, and all of these supplies must be shipped to the area. Then the relevant workers, with the proper balance of skills, must drive to the area.

I'll stop the fable here, but I hope the reader sees the point. There's a lot more *specifically* involved in the real world, than to simply declare, "Last quarter the economy invested $1 billion in new housing in this region." What if, instead of the various assortment of supplies I described above, the factories just cranked out $1 billion worth of nails, and shipped them to the forest? Would that huge stockpile of nails have kept people dry during the next rainstorm?

And yet, the types of models that our elite economists use, in both the Ivory Tower and in the halls of power, aren't granular enough to worry about shingles and paint. You'd be lucky if the models distinguished between commercial real estate in San Francisco and an oil rig in the Gulf of Mexico.

Incidentally, this is why Ludwig von Mises took pains to explain that his theory of the business cycle was one of *malinvestment,* as opposed to *overinvestment.* Mises' colleagues often thought he was arguing that "easy money" and low interest rate policies would cause businesses to invest "too much," when on the contrary his main point was that these false prices would cause businesses to invest *in the wrong things.* To go back to my silly example: The problem with a big pile of nails isn't "overinvestment," it's malinvestment. You can't build a bunch of houses with just a big pile of nails.

Conclusion

It's true that many people—including me—were warning the public about high consumer price inflation because of reckless Fed policy since 2008. On that score, we were wrong (at least in the time frame many of us thought would be relevant). However, the Austrian theory of the business cycle has never been about rising prices per se.

Instead, Mises and Hayek warned that "easy" monetary policies distort *relative* prices, and in particular make real interest rates lower than they should be. This gives a false "green light" to investment projects that should not be started. Because the monetary inflation hasn't created real resources, this temporary boom is an illusion and will come crashing down.

Years of false interest rates in the U.S. since 2008 have undermined the economy's structure of production. We are metaphorically sitting in a forest with a big pile of nails and no shelter—while the storm clouds are forming on the horizon.

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MAN MADE EARTHQUAKES

BY L. CARLOS LARA

We customarily think of a flood, hurricane, volcanic eruption, or an earthquake as an act of God, or what we often refer to in legal contracts as a *"force majeure."* What we actually mean when we use such terms is that these operations of nature are directed by the hand of the Almighty hence they are unpredictable, uncontrollable, and catastrophic. Protection from events such as these is extremely limited or virtually non-existent.

Man has set in motion a catastrophic *economic* earthquake.

In a recently published annual report on the insurance industry published by the *U.S. Treasury Department pursuant to Title V of the Dodd-Frank Wall Street Reform And Consumer Protection Act* (September 15, 2015), I was intrigued by a section having to do with earthquakes. What it described about them was so unusual that it made me think of another real life parallel that I want to draw out here.

First of all, the report's primary point about earthquakes was that obtaining insurance protection against them is rare. Protection against the shaking and cracking that can destroy buildings, as well as personal possessions, is offered by a very few number of carriers. Rarely do these insurance companies even market the product. Additionally, it is an expensive type of insurance with the deductibles on the order of 15% -25% of the replacement value of the property.

I was intrigued by a section having to do with earthquakes.

Its second main point was that there was a noticeable increase in earthquake activity in the U.S. in recent years. This increase had caused the take-up rate for the voluntary purchase of this type of insurance to go up. But the part that most piqued my interest was that the increase in earthquake activity was occurring in areas where earthquakes don't normally occur like Oklahoma and Pennsylvania. The report cited the cause as "hydraulic fracturing."

If you are not familiar with it, hydraulic fracturing (often called "fracking") is a process used to increase oil or gas flow to a government approved well from petroleum–bearing rock formations. According to the scientists at the U.S. Geological Survey (USGS), the wastewater that is a byproduct of hydraulic fracturing is injected into these wells with such force that it coincides with these unexplained earthquakes in areas where they were previously unobserved.[1] Assuming that this theory is correct, then in a very real sense these earthquakes would be man-made.

That's when I picked up its resemblance to the processes in business cycles. According to the Austrian perspective, economic convulsions don't just happen on their own—they too are created. The government's report argues that the powerful wastewater injections involved in hydraulic fracturing are actually causing earth-shattering tremors leading to the destruction of property. In a very similar way, manipulated interest rates and excessive injections of artificial money in the trillions by central bankers correspond directly with the destructive forces now brewing in our economy. Man has set in motion a catastrophic *economic* earthquake; only this time it will be more devastating than the one in 2008. At any moment in the near future it's going to blow.

The new monetary policy of central banks is so distorted it has affected all of the market gauges.

Even The Market Indicators Have Gone Haywire

One of the most telling manifestations of the giant bubble that has been blown up and the fears of an approaching financial calamity is what mainstream economists are now saying about their own tried and tested market signals. Not only can they not read them anymore, they don't trust them. That's because the new monetary policy of central banks is so distorted it has affected all of the market gauges. In fact many mainstream analysts are now admitting that a financial storm is definitely on its way and that the traditional market indicators unfortunately are broken. For a sample, consider the following quotations I've taken from various mainstream sources:

"It's not hard to see the potential flash points on the horizon—the U.S. presidential election; Deutsche Bank AG's mounting legal charges; the day central banks stop buying bonds. Yet when it comes to gauging risks in the world's financial markets, these days investors are flying more or less blind."[2]

" I have a hard time believing what the actual information content of these indicators is," said Aaron Kohli, a fixed-income strategist in New York at BMO Capital markets, one of 23 primary dealers that trade with the Federal Reserve."[3]

"My concern is that when something comes to bite us in the butt, its not going to be something we've traditionally looked at, said Peter Tchir, head of macro strategy at Brean Capital LLC."[4]

"The proverbial canaries, such as the yield curve, the Libor-OIS Spread, or even the vaunted VIX—sometimes referred to as the 'fear gauge' is leading its followers astray. So when volatility spikes, it will spike harder, and when volatility collapses, it collapses harder."[5]

What we do see as a very clear indicator is that the fear of the coming financial storms has conservative fund managers everywhere moving into cash. According to Bloomberg, *"investor cash levels have risen to levels not seen since 9/11. Fears of a bond market crash, a breakdown in globalization and perhaps a new crisis in the Eurozone are pushing everyone towards liquidity."*[6]

The fear of the coming financial storms has conservative fund managers everywhere moving into cash.

We at the ***LMR*** actually agree with this conservative direction at this time and we said so in our recent educational video entitled, "How to Weather The Coming Financial Storms". In this presentation we laid out a simple three-part plan for businesses and households. If you have not seen this report you can view here: https://lara-murphy.com/video0916/

How Bad Can It Get?

It's important to recognize that market crashes have different levels of intensity and will not necessarily impact everyone across the board. But before we actually break these different levels down for you, let's also realize that there are always individuals among us who for one reason or another remain completely unaware of the potential ramifications of market crashes and fail to take the minimum precautionary measures to protect themselves. These people do get hurt. Caught up in the euphoria of the unsustainable boom, they are blinded to what lies ahead. Once the crash arrives and they are devastated by it, they are shocked and can't believe they never saw it coming. Every historical boom and bust has evidence of substantial collateral damage to the naïve public. Since our aim is to educate the general public, our hope is that no one who reads the ***LMR*** ever winds up being part of these sad statistics.

Our hope is that no one who reads the *LMR* ever winds up being part of these sad statistics.

As to the storm's severity, our first suggestion for determining the potential impact of these crashes on our own personal economy is to simply catalogue them as "types" as in a storm A, B, or C. This will go a long way in understanding what to expect from each.

For example, an "A" type storm is a stock market or real estate market crash similar to what we experienced in 2008. Most of us have experienced these types of crashes before and so we know what they are like. If you are a regular reader of the ***LMR*** you should know by now how to protect yourself from these.

In a "B" type of financial storm the most important financial instruments in our economic system, such as the U.S. Treasury or the U.S. Dollar, actually implode. This would in effect be a form of government default on its bonds and the other would be a currency crash—two very serious economic outcomes. Although this type of monetary breakdown has occurred in many other countries around the world many times and for centuries, it has never actually happened here in this country (unless we count the implosion of the U.S. Continentals or the U.S. Greenbacks during the Civil War, and some argue that the abandonment of the gold standard implicitly defaulted on U.S. government bonds). The U.S., after all, is still a young country. But just because an explicit default on government debt has never occurred here it certainly does not mean that it cannot happen at all. Finally, there is a storm "C."

In a "C" type storm the destructive descriptions grow more horrifying because they involve civil unrest and perhaps even a world war. It's not hard to imagine how these types of crises can quickly develop and get out of hand. Some of these developments actually have taken form in our own lifetimes. Of course the destruction of human life and property is always staggering.

One other extreme form of panic is the belief that all these chains of events is a precursor to the end times. Here the views are very closely aligned with religious beliefs. They are in essence theological analyses based mostly on sacred writings. But what's notable is that large bodies of worldwide advocates support these beliefs thereby giving them enormous power. For that reason they cannot be ignored. Obviously too, all of this is much more difficult to shield ourselves from.

As you can see, categorizing our world into these three broad categories allows us a way to assess the potential damage and to make better decisions on how best to protect ourselves. Using this perspective, Bob and I developed the three-part protection strategy discussed in our storm video that can help insulate you in case we should enter any one of these types of storms—A, B or C. For a full written exposé of the strategy to go along with the video presentation check out the May and June 2015 *LMR* entitled, "How To Weather The Coming Financial Storms" (Parts I & II) in the free resources section of our website https://lara-murphy.com/resources/

In a "C" type storm the destructive descriptions grow more horrifying because they involve civil unrest and perhaps even a world war.

Blaming It All On "Animal Spirits"

The business cycle has been a source of confusion for economic thinkers for well over 200 years. In fact periodic crisis in capitalism actually formed the basis for Karl Marx's writings in *Das Kapital (1867).* But it was John Maynard Keynes who determined that it was the fluctuations in aggregate demand that actually caused the business cycle. The remedy was more spending.

Animal spirits is the actual term John Maynard Keynes used in his 1936 book *The General Theory of Employment, Interest and Money.* In it he describes man's emotions that guide human behavior, arguing they could be measured in terms of consumer confidence and trust—key elements in the economy. The original passage states it this way:

"Even apart from the instability due to speculation, there is the instability due to the characteristic of human nature that a large proportion of our positive activities depend on spontaneous optimism rather than mathematical expectations, whether moral or hedonistic or economic. Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be

The business cycle has been a source of confusion for economic thinkers for well over 200 years.

The masses act naturally as individuals, not in the aggregate inside of a formula or calculation.

taken as the result of animal spirits—a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities."[7]

The term itself is drawn from the Latin *"spiritus animales,"* which is interpreted as the spirit that drives human thought, feeling, and action. Consequently, Keynes is partly right in expressing a known truth and how it plays out with humans in an economy. Where the mistake is made, according to the Austrian perspective, is in attempts to mathematize human nature.

The failure is in understanding that in a free market economy, the masses act naturally as individuals, not in the aggregate inside of a formula or calculation. Each person makes subjective decisions in pursuit of his own self-interest, which miraculously results in promoting the well being of all society. It follows then that individuals ought to be free to do just that.

In reality only a select few of the politically connected seem to be inheriting the riches of the Kingdom.

As far as the business cycles, Austrians argue that they are deliberately caused by excessive issuance of credit by commercial banks in fractional reserve banking systems. The increase of the money supply creates a boom, which creates malinvestments because of the artificially low interest rates. Eventually the boom, which cannot be sustained, will crash.

Keynesian economists, who advocate centralized oversight (if not outright planning) as the ideal method to steer the economy to continuous health, have convinced the world that it's the better way. Consequently, today we have the powerful combination of central banks and government interventions driving the economies of the world and directing all human affairs—while our individual freedoms continue to deteriorate.

Historian Clarence B. Carson reminds us that economics, especially the variety taught by Europeans in the late 1800s, became entangled with the development of sociology as a discipline and the spread of socialist doctrines.[8] As a result socialist ideas have greatly altered what is taught as economics in our universities today. Therefore, it should not come as a surprise to see that our current economic policies and political agendas seek after even more government control over the means of production. Sadly, a growing number of young people in the United States now openly embrace socialism.

Conclusion

In the aftermath of two World Wars,

progressives in the U.S. and other nations embraced the idea of international organizations as a way to foster global justice, elimination of poverty, ignorance, hunger, and the prevention of future wars. According to several great historians and authors such as Murray N. Rothbard, Gary North, and Carol Quigley, this was actually a European idea conceived by one man well over one hundred years ago. The idea's intent was to literally establish the *Kingdom of God on earth*. It only had one questionable caveat. The plan was secretive. If you are interested, the ***LMR*** actually did a three-part series in 2013 on this one topic entitled, "Who Runs The World?"

This secret society went on to establish "inner" and later "outer circles" known as Round Tables which have over the years grown into international organizations with more familiar names such as *The Commonwealth of Nations, Chatham House, The Royal Institute of International Affairs, The United Nations, The Council of Foreign Relations, and the Institute of Pacific Relations,* none of which is secretive today.

What we do know is that there is enormous power and wealth backing these institutions. Even President George W. Bush described his objectives for post-Cold War global governance in cooperation with post-Soviet states as a "New World Order."[9] Or how about Goldman Sach's CEO, Lloyd C. Blankfein statement in 2009 in response to his $16 billion in year-end bonuses? "We have a social purpose," he told the Times of London—meaning that banks serve a vital public benefit. *"We're very important. It's a virtuous cycle." He is, he told the Times, just a banker "doing God's work."*

In spite of all their benevolent intentions, ignorance, poverty, hunger, and wars still remain and in certain parts of the world have actually increased. In reality only a select few of the politically connected seem to be inheriting the riches of the Kingdom all at the expense of the rest of us. ◆◆◆

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Poker is about WINNING MONEY

Interview with Adam Haman

Adam Haman is a professional poker player of 25 years and an amateur economist, historian, philosopher and space pirate. He lives in Las Vegas, NV with his wife Jennifer.

EDITORS' NOTE: Adam Haman and his wife Jennifer were both attendees on the recent "Contra Cruise," an educational vacation event sponsored by Tom Woods and Bob Murphy in connection with their podcast "Contra Krugman." We thought it would be a refreshing and entertaining change of pace to feature Adam in this month's *LMR*.

Lara-Murphy Report: How did you become interested in Austrian economics?

Adam Haman: I graduated from Arizona State University with a BS in Finance in 1992. In my sophomore year, I read Ayn Rand's *The Fountainhead* and in short order had consumed everything she'd ever written. While I didn't agree with her on everything, she did help crystallize my views on the merits of the free market. I was simultaneously studying economics as part of my degree. The subject, as it was presented to me in school, was a muddled mess. "Micro" economics had some valuable concepts and insights, but riddled throughout the subject were baseless assumptions, unsupported conclusions, and claims to knowledge that made the nascent epistemologist in me cringe. I hated it. Perhaps the worst aspect was the "competitive market" model which was completely divorced from reality and appeared useful only as a pseudo-intellectual justification to have the government remove one's competition from the field – if you were sufficiently politically connected. I

> "'Micro' economics had some valuable concepts and insights, but riddled throughout the subject were baseless assumptions, unsupported conclusions, and claims to knowledge that made the nascent epistemologist in me cringe. I hated it."

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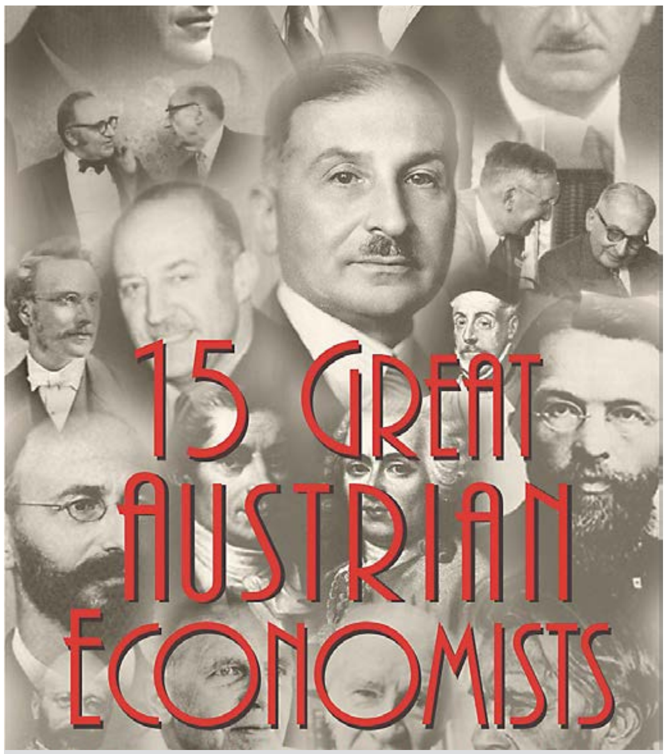
sought out econometrics classes to discover the "science" in this dismal science and that field was even worse. On Day 1, we emphasize that correlation doesn't equal causation, then we spend the rest of our time using regression analysis to implicitly violate that truth.

I graduated school with the belief that most of economics, at least most of the "macro" variety, was actually religion or polemics masquerading as science – not something that humans could use to actually understand their world. The next few years, I focused my studies on poker and just went about living my life, occasionally reading a book or two to better understand libertarian political philosophy. I just wasn't interested in economics. Then in the late '90s or perhaps early 2000s, I stumbled upon Austrian economics. I'm not positive, but I think my first exposure to the subject was in one of the "Uncle Eric" books by Richard Maybury, "What Ever Happened to Penny Candy?"

I dived in and was immediately hooked. I read Rothbard, Mises, Hayek and Hazlitt. I discovered mises.org and devoured everything I could find. This was what economics was always supposed to be! Algebra is incredibly useful, of course, but my favorite fields of math are geometry and trigonometry. Start with unassailable axioms and using careful logic, you construct beautiful (and useful) edifices of mathematical truth. No epistemological errors here! And Austrian Economics approached its subject the same way! No pretense of knowledge! No idiotic



"I dived in and was immediately hooked. I read Rothbard, Mises, Hayek and Hazlitt."

"Poker is about winning money."

assumptions designed to produce desired conclusions! And the science explained human action beautifully – including actions that have nothing to do with dollars and cents. Wondrous! If I had heard about this in school I honestly believe I would've continued my education and I wouldn't have to check-raise people for a living!

LMR: You are a professional poker player, so let's first talk about the game itself for a bit. On the recent Contra Cruise, you said that novices will often ask you, "If I'm dealt such-and-such, what is the proper move?" But you explained that this is getting off on the wrong foot. What's the right framework to think about playing poker?

AH: Poker is about winning money. Your primary objective is to figure out how to get your opponents to put money into the pot and for you to then win that money. The cards are just a tool. Your ability to bet, call, fold, and raise are tools. The rules and structure of the poker game you are playing are important parameters. The most important thing, though (and the beginning of all poker analysis) is the characteristics of your opponents. How do they play? How much money do they have in front of them? What tendencies do they have? What mistakes do they make? How can you exploit those mistakes? Once you've answered those questions in the context of the form of poker you are playing, you are finally ready to look at a particular hand or poker situation and decide which action (or more properly "line" of actions throughout the hand) is appropriate. That's why the correct, sophisticated, and frustrating answer to the novice's question you referenced is always, "It depends."

LMR: Continuing with this line of thought, you are saying that playing poker is more than just calculating the odds based on the cards you can see. You also derive information from looking at the other players. Can you give some examples? Maybe things more obvious than, "If a guy is all of a sudden really eager to play, it's probably because he got his straight"?

AH: You are referring to the art and science of physical "tells" in poker and a full answer could fill several volumes. I'll try to give a few examples that can give you a sense of

"You are referring to the art and science of physical 'tells' in poker and a full answer could fill several volumes."

"Dressing sloppily usually indicates disorganized thinking. Stacking chips neatly usually indicates cautious, conservative play."

what kinds of information it's possible to glean just from observing players and their mannerisms. If you have nothing else (yet) to go on, start with stereotypes. They will be wrong of course, but they are right often enough to make them a good starting place. Old people play more conservatively than young. Women are more timid than men. Dressing sloppily usually indicates disorganized thinking. Stacking chips neatly usually indicates cautious, conservative play. What people are wearing tells volumes. The guy in the business suit with a Rolex and a martini will play much differently than the young kid in the tracksuit with the headphones, sunglasses and backpack. Once you are in a hand with somebody, watch their behavior. Posture slumped or upright? Leaning forward or back? Brow furled in a scowl or relaxed and calm? Do they appear generally baffled? Interested or disinterested? Watch their hands. Do they put their chips in the pot calmly and smoothly, or jittery and nervously? How fast are they breathing? As you get more familiar with people you play with regularly you can even spot tells that are unique to specific individuals. I know a man that covers his mouth with his hand only when performing one action – bluffing. I wish he'd do it while coughing, but hey… this is a powerful tell.

LMR: So now you've told us how a pro sizes up a table full of amateurs. But what happens when you sit down to play with other professionals? Do you all simply mask your "tells" as best you can? Or do you intentionally try to send out a false signal? What about the adage, "Sometimes you have to fold with a winning hand so you can win with a losing hand"? Is that literally true?

AH: I think I first heard that "adage" in the Robert Redford movie, "Havana". It's rubbish, of course. I literally have no idea what the writer is even intending to say. When you find yourself at a table with other professionals, the best thing to do is get up and go seek greener pastures. If for some reason you can't do that, you're in for some tough sledding. If all players in a poker game are equally skilled, in the short run, luck will determine who gets the money. In the long run, all players will lose their share of the house

"When you find yourself at a table with other professionals, the best thing to do is get up and go seek greener pastures."

rake. Not fun. In reality, the skill level won't be exactly even, and the better players will be trying to exploit the small mistakes made by their less proficient peers. In general, tells will be less important than in a normal game, and the level of aggression will probably increase – leading to increased variance and larger financial swings. Again, not so fun. If I were in such a game, I wouldn't try to send out false tells, but I would probably try to emulate weak lines of play that other pros would be trained to exploit. Of course when doing this, I won't have the hand they are expecting to see. I will try to "flip the script" on as many profitable seeming situations as I can think of. This type of strategy variation is called "thinking one level higher than your opponent". As you can imagine, it can get very complicated very quickly. My best advice is my first advice: Seek greener pastures.

LMR: Often we will have to explain to the public why components of the financial system (such as insurance or futures contracts) are not examples of gambling. For example, insurance is arguably the *opposite* of gambling; you're not "betting your house will burn down," when you take out fire insurance, rather you are simply taking an uncertain future where you *might* lose big, and replacing it with a known future where you lock in the "loss" of paying a fixed premium. Similarly, even though there is a sense in which a futures contract on oil is a "zero-sum game," even so it helps for hedging purposes if a crude producer sells oil futures contracts while an airline buys them. Yes, depending on which way the market price of oil moves, the issued futures contract imposes gains and symmetric losses on the two parties, but given their overall operations, this merely serves to hedge their exposure to this risk. (Specifically, the crude oil producer locks in the price at which he sells his future output, and the airline protects itself from volatile fuel costs.)

But when it comes to literal gambling, you can't argue that it's not, well, gambling. And it certainly seems as if *here* is a zero-sum game, by definition. (It's even a negative-sum game, if we take the house's cut into consideration.) Of course from a libertarian perspective, people are free to do what they like, so long as they don't violate others' property rights. But we wonder, could you try to justify *economically* the free market in "gaming" as the industry calls it? What are the downsides, for example, to the U.S. gov-

"Honestly the behavior of most market participants looks to my uninvolved eye like the behavior of people in a sports book. Pure gambling, in other words."

ernment's prohibition of online poker?

AH: It should be easy to understand the value of futures markets and insurance "bets" in the financial markets. It allows those with positions in such areas to smooth out their expected costs (or revenues) and allows people to better manage risk—to increase stability and certainty in an uncertain world. It can even be argued that speculators with no underlying position to protect can serve a function of stabilizing prices over time through superior foresight – gaining profits in the process. But honestly the behavior of most market participants looks to my uninvolved eye like the behavior of people in a sports book. Pure gambling, in other words. I'm not saying necessarily that that's what it is – but it sure looks like it.

"Poker of course, is pure gambling. No question. And it serves no economic purpose whatsoever – except that it is voluntary behavior by market participants."

Poker of course, is pure gambling. No question. And it serves no economic purpose whatsoever – except that it is voluntary behavior by market participants. And of course, that's all markets are. What is the economic purpose of Twinkies? Or Beanie Babies? Or Pokemon? Or General Hospital? Or any other thing people pay for that looks stupid and wasteful to others? Poker is a thing that humans like to do. For those who lose, it is an entertainment expense. Is entertainment a legitimate market purpose? As far as the downside to the US government's prohibition of online poker, the downside is a loss of people's freedom to do something they wanted to do (and the loss of the industry that formed to satisfy those desires). If the feds outlawed professional football, you might ask the same question. Who is harmed? I'll tell you who. All other humans who liked the thing that was outlawed and were willing to pay for it as well as all those who profited from the endeavor.

Harrumph. ◆◆◆

EVENTS & ENGAGEMENTS

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

OCTOBER 29, 2016
SPOKANE, WA

Nelson Nash, Lara, and Murphy put on IBC Workshop

NOVEMBER 1, 2016
WASHINGTON, DC

Murphy talks about the business cycle at American University

NOVEMBER 5, 2016
DALLAS, TX

Murphy discusses the dangers of voting at Mises Circle

NOVEMBER 15, 2016
HILLSDALE, MI

Murphy lectures on Austrian Economics at Hillsdale College

NOVEMBER 15-17, 2016
ST. LOUIS, MO

Nelson Nash, Lara, and Murphy teach IBC at Freedom Advisor event

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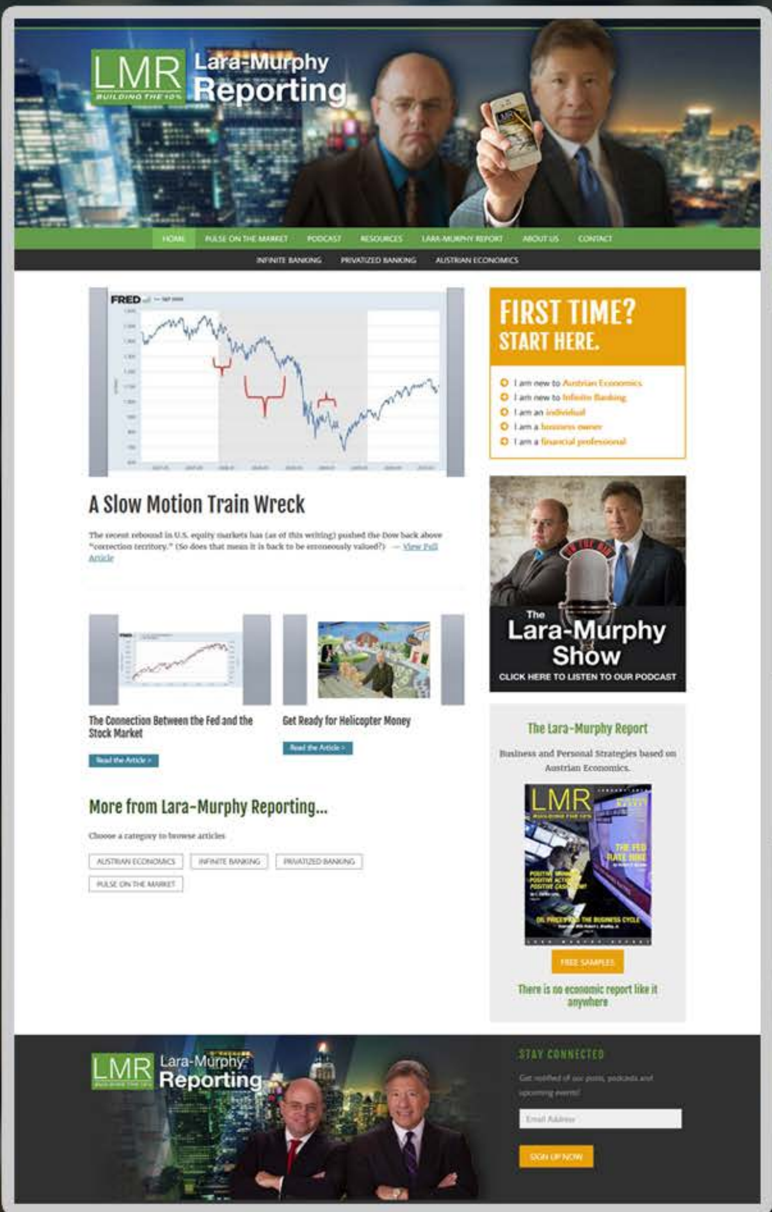

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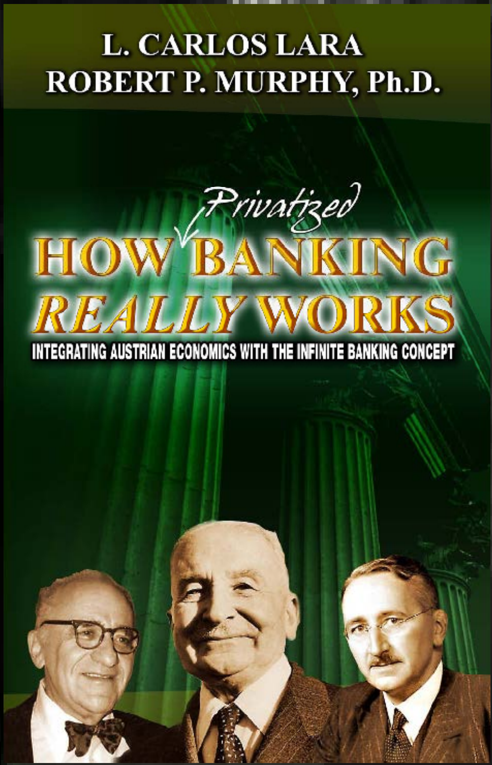
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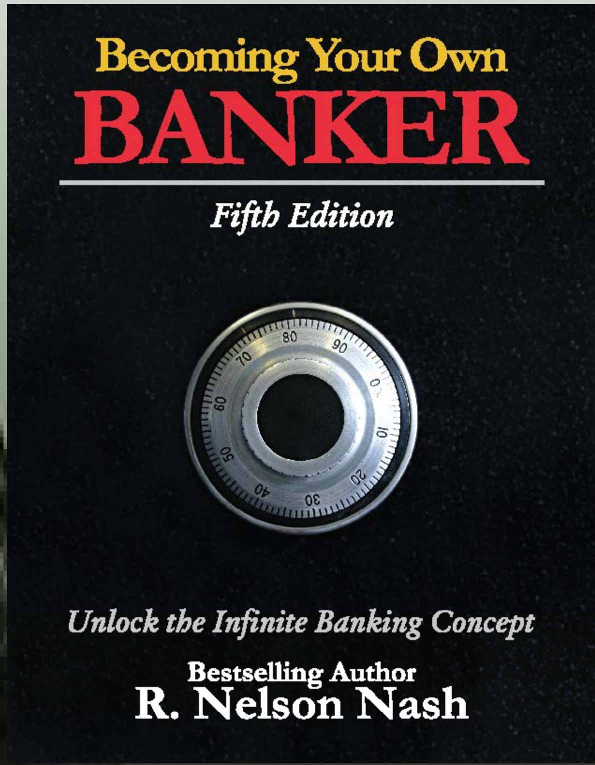
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