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The Swiss voters rejected a referendum banning fractional reserve banking. The proposal correctly identified part of the problem with the current system, but its proposed solution would have simply empowered the government.



### TRUMP'S PLAYBOOK FOR THE ECONOMY

BY L. CARLOS LARA

Last year's report from Treasury Secretary Mnuchin seems to be a good guide to the Administration's economic moves so far. What else does it tell us?



### THE "SKYSCRAPER INDEX" AND OTHER SIGNS OF A BUBBLE

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INTERVIEW

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# ABOUT LARA & MURPHY

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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.

ROBERT P. MURPHY is Research Assistant Professor with the Free Market Institute at Texas Tech University. He is co-author of *How Privatized Banking Really Works*. He is the author of *Choice: Cooperation, Enterprise, and Human Action* (Independent Institute 2015) and co-host with Tom Woods of the popular podcast Contra Krugman.

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*"Under interventionist ideas, it is the duty of the government to support, to subsidize, to give privileges to special groups."*

*— Ludwig von Mises*

Interventionism is a word we often write and talk about without realizing that many of our readers may still not quite understand why we speak of it as being one of the main contributors of our flawed monetary policy. Like the word *inflation,* interventionism deserves a Misesian interpretation in order to grasp it fully.

Mises was quick to point out that it's an absurd idea to think we have statesmen in our government working diligently for the common good. In reality, here and worldwide, in nations that do not have an outright dictatorship we have a situation where we no longer have political parties, but instead we have merely *"pressure groups."*

*"A pressure group is a group of people who want to attain for themselves a special privilege at the expense of the rest of the nation."*

Mises goes on to explain that in our own country we still have a Democratic party and a Republican party, but inside these parties are representatives of pressure groups. The only thing that is not being represented in these political parries is our nation as a whole. Today, *"clever diplomacy in congressional politics makes it possible for small minority groups to get privileges at the expense of the majority."*

What's the common denominator between political pressure groups and interventionism, including monetary policy? Mises says that it's in *prices,* from raising the minimum wage to tariffs and other special price measures on goods and services. *"People today do not talk about freedom: they talk about a higher price for peanuts."* In effect, Mises narrows it down to this: *"Pressure*

*group politics explains why it is almost impossible for all governments to stop inflation."*

In our book *How Privatized Banking Really Works* we explained the destructive dual elements of *government intervention* and *inflation* by contrasting the Roman empire of the second century A.D. with our own country in modern times. The truth is that what destroyed Rome is practically identical to the dangers that threaten the United States today as well as all other, so called, free nations.

So, what do we need to do to stop government intervention and the printing press from completely destroying our nation? We must replace this bad idea with good ones; after all, ideas are what ultimately change the course of history. Therefore, we should take it upon ourselves to submit these good ideas to people one person at a time so that our ideas can one day become the majority's ideas. That's really how best to grow the ten percent. A bottom-up movement that one day explodes into the new paradigm.

Thank you for being an ***LMR*** subscriber and a defender of these great truths!

Yours truly,

Carlos and Bob


Market Tariff Tantrums

## STOCKS GYRATE OVER FEARS OF TRADE WAR

With each move and response among the U.S. and its major trading partners concerning tariffs, the stock market fluctuated quite aggressively this month. To be sure, tariffs are bad policy; they are literally taxes levied on transactions between consenting Americans and foreign sellers, and you don't make your country great again through tax hikes. However, especially in conjunction with the large corporate tax rate cut a few months ago, in the grand scheme the trade disputes *probably* won't be too catastrophic.

For one thing, we can hope that Trump's decent economic advisors (like Larry Kudlow) can talk some sense into him, and allow him to save face after some (perhaps symbolic) move by China, etc. in order to walk back from the ledge. Fortunately, Trump all along—as well as his top trade guru, Peter Navarro—have never claimed to be open protectionists. Instead, their argument has been that the U.S. needs to play hardball in negotiations, in order to get other countries to lower their own respective tariff barriers.

Yet beyond that, it would be a mistake to think the real threat to prosperity over the coming years is higher tariffs on select goods. As annoying and inefficient as those items would be, they pale in comparison to the unsustainable structure of production that the Fed's low-interest rate policy from late 2008 forward has produced.

No matter what fiscal policies the Trump Administration enacted, there was going to be a big crash as the Fed tightens credit and raises interest rates. Obviously, levying goofy tariffs on top of the problem will only exacerbate it, but it's wrong to think everything would be fine if only Trump understood the case for free trade. As one of us (Murphy) argues in his book *The Politically Incorrect Guide to the Great Depression and the New Deal,* even the infamous Smoot-Hawley tariffs of the early 1930s didn't "cause" the Great Depression. No, as Murray Rothbard explains in his classic book, *America's Great Depression,* the Fed had blown up a giant asset bubble with easy-credit policies in the 1920s, which eventually popped in the 1929 crash. It was then Herbert Hoover and FDR's unprecedented interventions (primarily in labor markets) that stifled the recovery and gave us the worst decade of economic performance in U.S. history.


Freedom of Association FTW

## PROPERTY RIGHTS REDUCE CONFLICT

A slew of Supreme Court rulings and some other "pop" events have Americans at each others' throats. But from a libertarian perspective on property rights, these matters are all simple applications of the freedom of association. The owner of a bakery should have the right to refuse service to anyone, period, for any reason, including religious opposition to same-sex marriage. A TV network should be able to cancel even a hit show if its star does something the executives think is offensive. The owner of a restaurant (the Red Hen) should have the right to tell a customer to leave if she publicly defends government policies that the owner deplores. A motorcycle company should be able to move some of its operations overseas without being threatened with massive taxes (which Trump did on Twitter).

Finally, we note that the Supreme Court ruling on public sector employees and union dues is much more complex. In a free society, a business has the right to insist (if it so desires) that workers join a union and pay dues, as a condition of employment. There would be no violation of "free speech" here, just as the business could insist that employees wear a uniform, even if a worker thinks it's ugly and "sends a bad fashion message." Perhaps this would be a moot point in a society where labor unions didn't receive special government privileges, but in principle, it's possible that there would be (say) a large association of auto mechanics, and the organization would cut special deals with the owners of repair shops if they agreed to only hire union workers. Such contracts would be legal in a free society with full respect for property rights, even though "closed shops" are illegal under current U.S. labor law. It should go without saying, of course, that in a free society it would obviously be a crime for union members to use the threat of violence to intimidate non-union members ("scabs") from taking jobs at a business that wanted to hire them.

Even though someone who has never been exposed to these ideas might recoil at first, these principles are the only non-arbitrary way to minimize conflict. It is ludicrous to force someone to, say, make a cake that violates his religious beliefs, or to serve food to someone who is collaborating (in the owner's mind) with an evil regime. Yes, in modern America the idea that a business might discriminate against women or minorities out of crude prejudice is offensive…and that's precisely why it's not a real danger. A business that posted a sign saying, "We don't serve Jews" would be bankrupt after a single Twitter post from an angry passerby with a camera phone.


Of course, it's *possible* that a society could have enough racists (misogynists, etc.) that it would be profitable for businesses to cater to such prejudice. But in that case, we wouldn't expect the political process to help the unpopular groups. Instead, the majority would use the power of the State to impose their biases. Remember it was Jim Crow *laws* that enforced segregation. As the work of Gary Becker and other economists has demonstrated, the free market allows discrimination but it makes people pay for it.

Fiduciary Rule Dead?

## APPARENTLY DECISIVE RULING ON DOL FIDUCIARY RULE

Financial professionals have been following with great interest the Department of Labor's revised "Fiduciary Rule" issued near the end of the Obama Administration, concerning the responsibilities under ERISA for those giving financial advice to clients. Naturally, this is a complex issue and those working in the financial sector should check with their respective compliance departments or seek official legal advice for a definitive interpretation. Even so, we can explain the new development by quoting from a June 26 JDSupra article (available at: https://www.jdsupra.com/legalnews/dol-fiduciary-rule-officially-dead-75372/):

*"While those impacted were actively planning for compliance, the Fiduciary Rule faced numerous court challenges. The critics of the rule eventually found a sympathetic court in the Fifth Circuit, where a divided panel issued a decision vacating the rule this past March…After the existing administration indicated that it would not challenge the court's decision, several interested parties, including the AARP and various state attorneys general, unsuccessfully tried to intervene to save the Fiduciary Rule. The DOL then announced that it would not enforce the Fiduciary Rule in anticipation of the Fifth Circuit's final determination…*

*That final death knell came on Thursday, June 21, 2018, when the Fifth Circuit issued a mandate officially vacating the rule three months after its original invalidation. Although the Fiduciary Rule is no longer applicable, the Securities and Exchange Commission ("SEC") has proposed new rules for investment advisors and brokers…"*

Naturally, we will monitor this story and provide further details as they develop.

# LESSONS FROM THE FAILED SWISS "SOVEREIGN MONEY" REFERENDUM

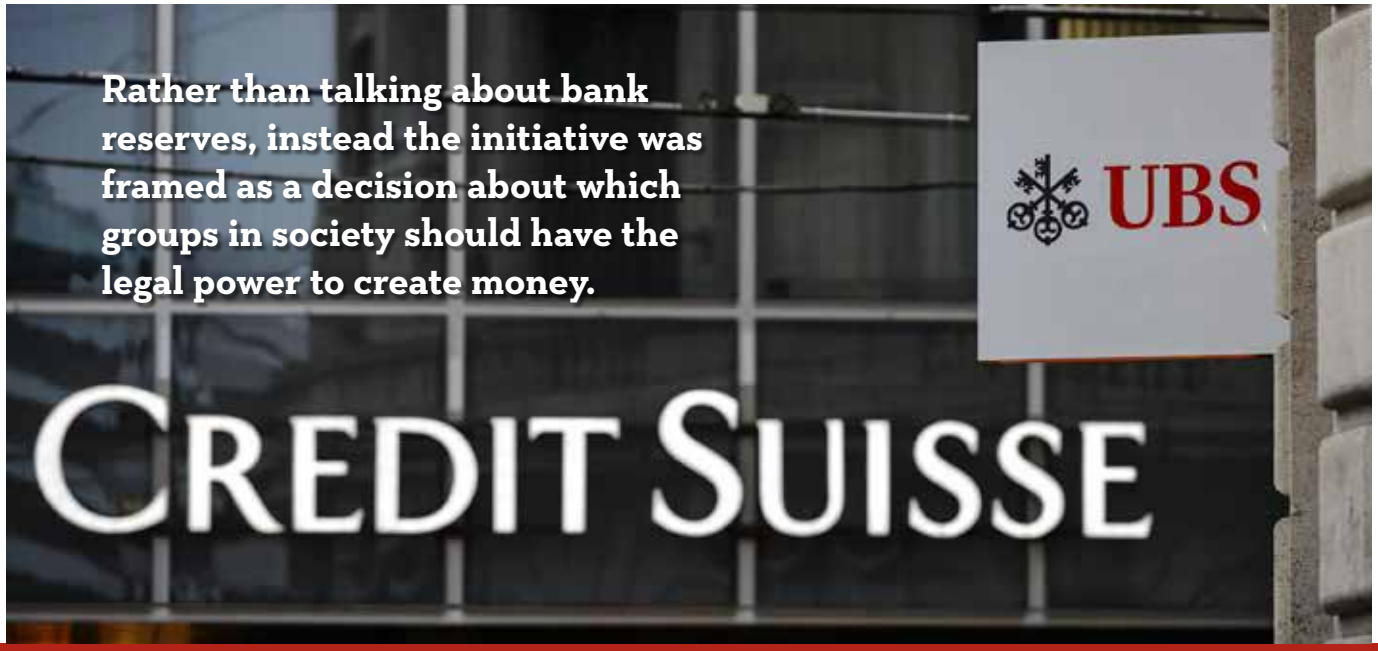

BY ROBERT P. MURPHY

**On June 10, Swiss voters (almost 76%)** overwhelmingly rejected the "Sovereign Money Initiative," which would have effectively outlawed fractional reserve banking in the private sector. For our purposes, what is intriguing is the rhetorical approach that the proponents used to urge support for the referendum. Rather than talking about bank reserves, instead the initiative was framed as a decision about which groups in society should have the legal power to create money. Currently private banks share this authority, whereas the people behind the "Sovereign Money Initiative" wanted that power to rest exclusively in the hands of the Swiss National Bank, i.e. the political *sovereign* maintaining a monopoly on money creation.

As was to be expected, the conventional media and financial pundits went ballistic, mocking the initiative and warning that it would send Switzerland back into the "Dark Ages" if passed.[1] Yet the people behind the initiative *did* have a point: There's a very real sense in which commercial banks, in our present financial and legal environment, have the ability to effectively create money out of thin air, in the act of granting loans. That is very weird, when you understand how it all works. Furthermore, the people pushing the initiative were correct to blame this system for financial crises. Where they went wrong, I will argue, is in reserving money creation to the State. In a free market, hard-money system—such as described by Austrian economist Murray Rothbard—we would avoid the business cycle and runaway inflation. Money would be produced in the private sector just as wheat, computers, cars, and pizzas are handled with no calamities.

## THE "VOLLGELD" INITIATIVE

Here is some sample text from marketing for the Vollgeld Initiative, taken from its official website (which is available in different languages):




**Rather than talking about bank reserves, instead the initiative was framed as a decision about which groups in society should have the legal power to create money.**

**Yes to the Swiss Sovereign Money Initiative!**
*Money safe from finance crises: Only the Swiss National Bank can create money*

**Yes to real Swiss Francs in our bank accounts**

**Yes to what people want: closing a loophole in the law**

**Yes to billions for taxpayers and the real economy**

**The effect of the Swiss sovereign money initiative is what the majority of people would like, and is also what the majority of people think we have today:**

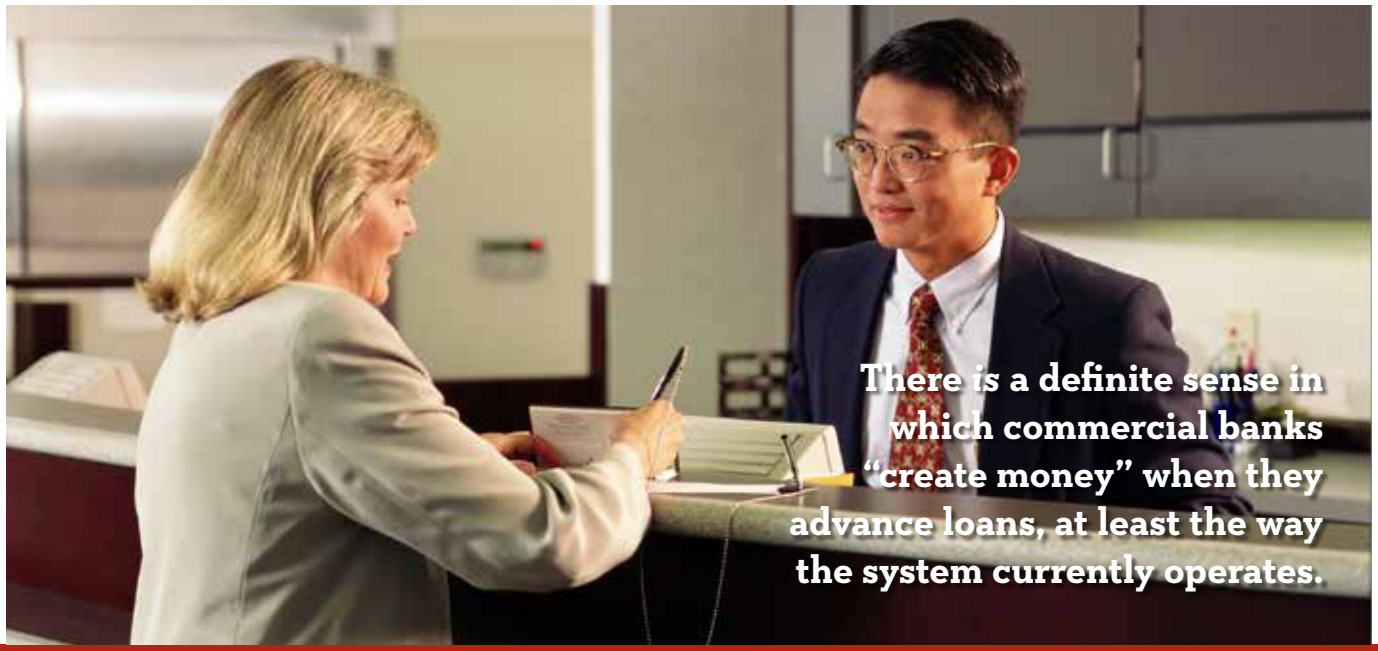
• Only the Swiss National Bank is allowed to create our money – not only coins and bank notes, but also the electronic money in our bank accounts

• Banks are responsible for payment transactions, wealth management and credit brokerage. However, they can't create their own money.

**What is sovereign money?** Sovereign money is full-value legal tender, which is brought into circulation by the Swiss National Bank. Today, only coins and bank notes are sovereign money.

**What is electronic money?** It's the numbers we have in our bank account. At the moment it isn't legal tender, it's only a promise made by a bank to pay us cash when requested.

The Swiss Sovereign Money Initiative has the aim that only the Swiss National Bank will be allowed to create electronic money, as is the case for coins and bank notes today. Electronic money will become sovereign money, a full-value legal tender. This is necessary as, at the moment, cash only accounts for 10% of the money supply in circulation in Switzer-



> land; 90% is electronic money.
>
> The Swiss people voted in 1891 to forbid the banks from printing bank notes, giving this responsibility solely to the Swiss National Bank. We now have to extend this and give the Swiss National Bank the job of creating the electronic money as well. [Text taken from Vollgeld Initiative website, bold in original.[2]]

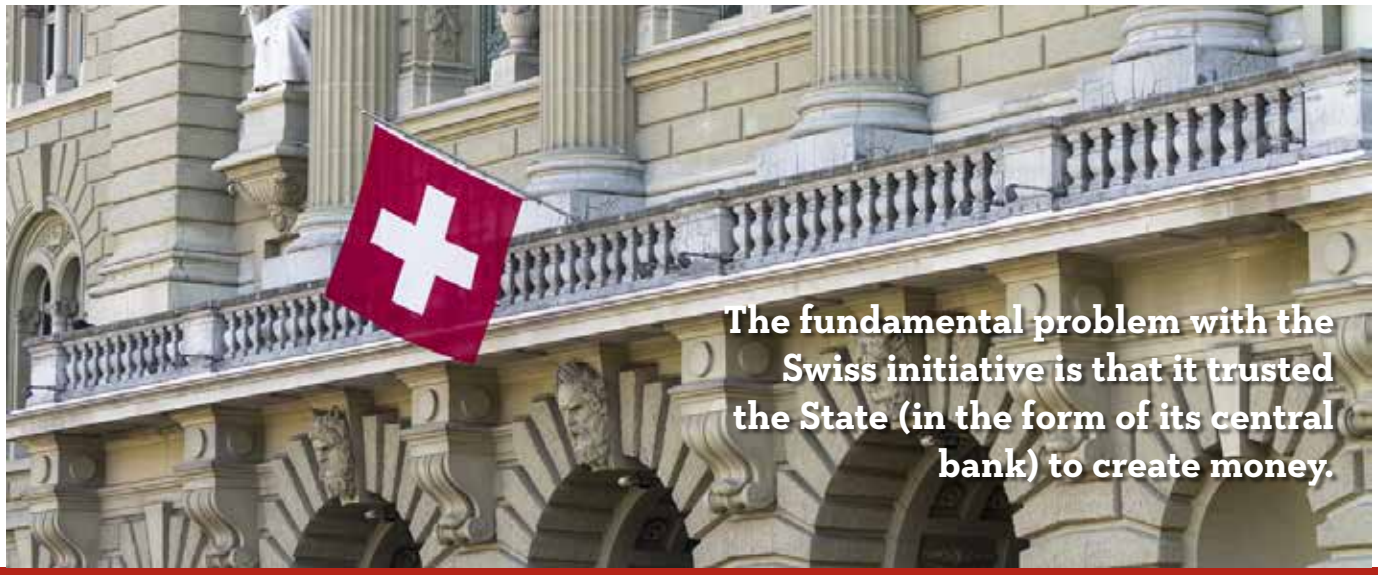
The above marketing pitch captures the main elements of the Vollgeld campaign: Its supporters claimed that by taking away the ability of private banks to create money—and reserving that power with the "sovereign" political institution of the Swiss National Bank—the citizens would be enriched and financial crises would be avoided.

## THESE GUYS AREN'T TOTALLY CRAZY...

Longtime *LMR* readers know that Carlos and I oppose fractional reserve banking. (See our book *How Privatized Banking* ***Really*** *Works* for the full story.) There *is* a definite sense in which commercial banks "create money" when they advance loans, at least the way the system currently operates.

For example, suppose you deposit $1,000 of physical currency (green pieces of paper) into your checking account. Your ATM balance goes up by $1,000. However, suppose further that the bank lends out (say) $900 to some other person. Now *that* guy thinks he has an extra $900, even though you still think you have the original $1,000 in your possession. There is a very real sense in which the bank's loan made the total quantity of money go up by $900. Indeed, economists include checkable demand deposits in monetary aggregates M1 and higher; we are not being metaphorical when we say that fractional reserve banking gives private banks the ability to create and destroy money through the process of granting/restricting credit.

Furthermore, although opposition to fractional reserve banking is nowadays associated with a certain strand of Austrian



economists (namely, the followers of Murray Rothbard), there is a long tradition in economics of insisting on 100% reserves as the way to dampen financial crises. For example, the venerable economist Irving Fisher was known for such a proposal, and indeed "the Chicago Plan" refers to a system of 100% reserve banking.[3]

As I spelled out in my April 2018 *LMR* article following my debate with George Selgin, standard Austrian business cycle theory deals with credit expansion *by the commercial banks*. It's true that a central bank (which of course is the Federal Reserve in the United States) can strengthen the distortionary forces involved, but strictly speaking the boom-bust theory that Mises and Hayek developed has to do with fractional reserve banking. In this respect, the supporters of the Swiss initiative were on to something.

## THE PROBLEM WITH THE SWISS INITIATIVE

The fundamental problem with the Swiss initiative is that it trusted the State (in the form of its central bank) to create money. Yet this merely opens the door to fiat money inflation. A country doesn't become richer simply because the government or its organs creates new units of money. Running the printing press (either literally or electronically through bank credits) merely redistributes wealth to the political class and its cronies.

We see a similar problem with the U.S.-based "Greenbacker" movement. They too detect the corruption in the current arrangement, where the Fed (which is literally owned by private banks) creates money out of thin air which it effectively lends to the

**Remember: the State didn't create money; the voluntary private sector did.**

Treasury, so that it earns interest paid by taxpayers. This is undoubtedly a crazy and corrupt system. But the Greenbackers err when they propose "getting rid of the middleman" and allowing the Treasury to directly create new dollars in order to cover Uncle Sam's budget deficit. The only thing scarier than Ben Bernanke running the printing press is Nancy Pelosi taking over!

Remember: the State didn't create money; the voluntary private sector did. At the peak of classical liberalism (before the first World War), the global economy used gold as the market's commodity money. In our book, Carlos and I explain in detail how a free market in money works. Various individuals from around the world produce new gold and silver from mines, and then private mints can produce either large uniform bars or stamp the metal into name-brand coins signifying weight and fineness. The entire "industry" of money production can be depoliticized.

## CONCLUSION

The recent Swiss referendum is not as "insane" or "backwards" as its critics alleged. There is in fact a long line of respectable


economic opinion that blames fractional reserve banking for financial crises. However, the Swiss referendum was wrong to seek salvation in the political sphere. On the contrary, only by completely privatizing money and banking will we have stable economic growth and hard money.

As I argued in my recent debate with George Selgin, genuinely free-market banking doesn't require fractional reserves. Historically, it has been government privileges (especially the creation of modern central banks and "insurance" funds) that have propped up commercial banks that engage in such risky practices.

◆◆◆

References

1. As we noted in last month's "Pulse on the Market" section, a May 9 Business Insider article by Will Martin explicitly warned that the proposal would send the Swiss financial system into the Dark Ages. Available at: http://www.businessinsider.com/switzerland-referendum-on-banking-changes-2018-5

2. See: https://www.vollgeld-initiative.ch/fa/img/English/neu_151022_Vollgeld-Initiative_Kernbotschaften_translated_22Nov15.pdf

3. For a scholarly history, see Michael Kumhof and Jaromir Benes, "The Chicago Plan Revisited," IMF Working Papers, August 1, 2012, available at: https://www.imf.org/en/Publications/WP/Issues/2016/12/31/The-Chicago-Plan-Revisited-26178.

# TRUMP'S PLAYBOOK FOR THE ECONOMY

BY L. CARLOS LARA

**Not since I first read the Dodd-Frank** legislation and discovered within it the *"bail-in"* agenda for circumventing future systemic risk problems in commercial banks, has a government report captured my attention as much as Trump's Executive Order 13772 on "Core Principles for Regulating the United States Financial System."[1]

I wrote about this report in the July 2017 edition of the ***Lara-Murphy Report*** in an article entitled, "WARNING: Market Volatility Ahead—And Soon!" This was just thirty days after the report's author, Treasury Secretary Steve Mnuchin, had officially released it in June 2017.

Among other things, this report was written to provide the President's rationale for wanting to overhaul the U.S. tax code and scale back the excessive government regulations found in the Dodd-Frank Act. Now, one year later after the report came out, and seeing several of the major suggested changes written about in the report actually take place, I am now convinced that this official essay is actually Trump's *"playbook"* for the economy. So far he has been executing it just as it is written.

First came the monumental GOP Tax Reform Act last year, which was signed into law December 22, 2017 in record time. Next came the replacement of Janet Yellen as Chair of the Federal Reserve early this year. Then last month on May 24, 2018, just as the *report* predicted, President Trump moved ahead with his plans and signed into law a bill that rolls back banking regulation in the Dodd-Frank Act, including the politically sensitive so-called "Volcker Rule."

Seeing several of the major suggested changes written about in the report actually take place, I am now convinced that this official essay is actually Trump's *"playbook"* for the economy.

It was no secret from the way the media portrayed it that President Trump was highly critical—at least at times—of the Fed's prolonged low interest rate policy and its bloated $4.5 trillion balance sheet. Similarly, a news article authored by a Goldman Sachs economist in early 2017 talks about Republicans wishing to normalize the markets as quickly as

possible. *"This could be important for balance sheet policy because many Republican leaning economists have criticized quantitative easing (QE) and have expressed a preference for rapid balance sheet rundown, perhaps even through asset sales."*[2]

But, as I pointed out in my July 2017 article, Mnuchin's report was coming out at about the same time the Fed announced the unwinding of its multi-trillion dollar bond-buying program (QE). This news by itself came as a huge surprise to many analysts who believed the Fed was trapped and couldn't possibly unload its balance sheet without seriously upsetting financial markets. But now Federal Reserve officials were actually making that unprecedented proclamation.

This U.S. Treasury report, although seemingly unrelated to the Fed's announcement at the time, actually reads as though it is working in tandem with it—almost as though it was planned this way from the beginning.

I don't say this simply because I have a natural distrust of government dictates and even more distrust of the actions of Federal Reserve, but mostly because the report itself—which happens to be written by a former Goldman Sachs executive—outlines a very strategic plan to reshuffle the assets within the banking system once again.

Buried inside all the technical jargon, the report describes how the banks could be able to absorb the bulk of the bonds being unloaded by the Fed. Their intentions and the mechanisms with which they will implement their plans point to the main reasons for aggressively amending Dodd-Frank Act at this time.


This U.S. Treasury report, although seemingly unrelated to the Fed's announcement at the time, actually reads as though it is working in tandem with it—almost as though it was planned this way from the beginning.

A year ago, when I first learned of this, I was still trying to make sense of this without really knowing for sure if my assumptions were correct. Today, even though I am still searching, I am more fully convinced that Mnuchin's report and the Fed's unwinding are definitely all part of one and the same strategy. It's possible we may have stumbled

upon the first signs of a broader central banking strategy to reverse nearly a decade of massive stimulus worldwide. We'll see.

## THE TAKE-AWAY TO SECRETARY MNUCHIN'S REPORT

The 149-page report covers a lot of ground relating to the U.S. economy, but the most important and controversial suggested change is in regards to Dodd-Frank's *Tier 1 Capital Leverage Ratio calculation of the Supplementary Leverage Ratio and Liquidity Covered Ratio (LCR)* for *Systemically Important Financial Institutions (SIFIs)*. Yet the media has been eerily silent about any of this. Even now hardly anyone knows of such an Executive Order 13772.

Most of the recent media coverage is about the raising of the bank asset threshold from $50 billion to $250 billion. In effect this virtually releases all but 12 mega-banks from the toughest regulatory requirements of Dodd-Frank, which is indeed a big deal. This will most likely create a rush by banks to merge and consolidate with one another without fear of getting too big and incurring additional regulatory oversight.

But for the remaining 12 "too-big-to-fail" mega-banks, the recommended calculation change in the Mnuchin report actually opens the door for even greater profitability for them because it subtracts from the calculation these three big assets: *(1.) Cash on deposit with central banks,* ***(2.) U.S. Treasury Securities*** *and (3.) Initial margin (collateral) for centrally cleared derivatives* (this last item has connections to the Volcker Rule recommended re-write in the report).

In other words, when these three asset items are included in the calculation as they are presently, it increases the potential for the banks to become easily *"over leveraged"* thereby forcing the bank to either have to sell assets or raise equity in order to continue receiving customer deposits. Both or either of these two options are very expensive for the banks and diminishes their profitability.

It's possible we may have stumbled upon the first signs of a broader central banking strategy to reverse nearly a decade of massive stimulus worldwide. We'll see.

On the other hand, if you subtract these three asset items from the current calculation it positions the banks with the ability to increase their *lending*, *investing* and, more importantly, *purchasing* of additional assets— all things President Trump wants banks to have because it makes them more profitable. The Trump Administration's official rationale here is that profitable banks make the economy more robust and allows them to lend out more money to individuals and businesses.

We can see that the bank is now in a position to be able to purchase up to an additional $500 million more in U.S. Treasuries and still be able to meet its mandatory ratio requirement.

## UNDERSTANDING THE RECOMMENDED CHANGE IN THE TIER 1 CAPITAL RATIO CALCULATION

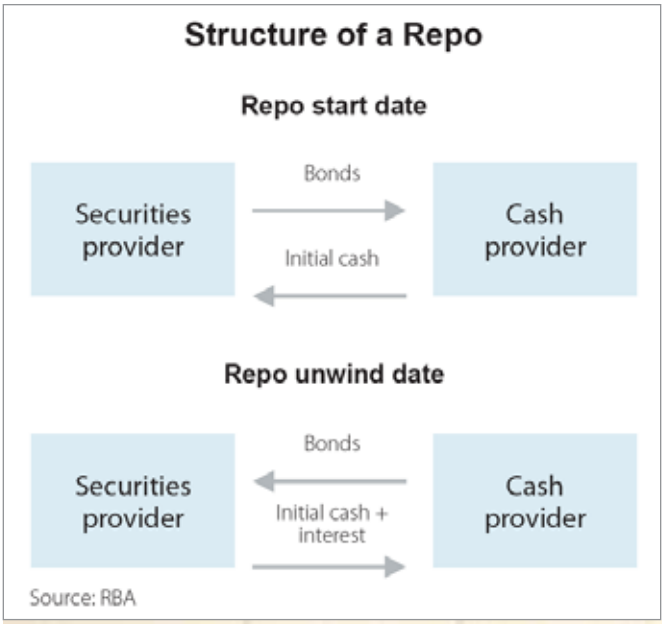
To understand how the suggested change in the calculation actually works, consider the following: The current Dodd-Frank ruling established a 3% minimum ratio requirement for the *Tier 1 Capital Leverage Ratio.* Keep in mind that *Tier 1 Capital* is a bank's core capital, which is made up of the bank's common stock and its retained earnings. This number is then divided by all the bank's other tiered "consolidated assets" in order to arrive at the mandatory ratio of 3%.

Now assume for illustration purposes that $30 million is a bank's Tier 1 Capital and the consolidated assets are $1 billion. We can easily see that after the division the ratio would be 3% and according to Dodd-Frank the bank would be adequately capitalized to withstand the shocks of an economic crisis such as what we had in 2008.

However, if an additional $500 million increased the consolidated assets to say $1.5 billion and using the same core capital of $30 million, notice that the ratio would only be 2%. At that point the bank would be below the Dodd-Frank 3% requirement and would need to either sell assets or raise more equity capital.

But see what happens when we ***subtract*** $500 million from the original $1 billion in consolidated assets and using the same $300 million in core capital. Now if we divide one into the other, the ratio jumps up to 6%! At this ratio the bank is well above the 3% requirement and sufficiently capitalized.

So if the $500 million that is being sub-




But the Repos only give the banks temporary ownership of the security. This "new" strategy, the one in Mnuchin's report, would actually provide the banks permanent ownership of the bonds.

tracted from the consolidated assets happens to be the report's suggested three asset items—*(1.) Cash on deposit with central banks,* ***(2.) U.S. Treasuries*** *and (3.) Initial margin requirement for centrally cleared derivatives;* we can see that the bank is now in a position to be able to purchase up to an additional $500 million more in U.S. Treasuries and still be able to meet its mandatory ratio requirement.

## BONDS, BONDS AND MORE BONDS!

With the Fed needing to shed nearly $2.5 trillion in Treasury bonds over the next three to five years, this change in the Dodd-Frank rules seems to reveal where the Mnuchin report suggests that the bulk of these bonds will ultimately wind up. If I am right, this would in effect potentially solve one of the biggest mysteries of the Fed's Reverse QE conundrum that has had everyone puzzled since 2009. Up to now the big question has been *"who would actually buy all these bonds if they started unloading them?"* And an even more detrimental question was *"would the financial markets sit still long enough for such a strategy to actually work?"*

At the present it appears as though Trump is driving this shake-up of monetary policy using Executive Order 13772, but who can really know for sure. Prior to this, looking back to 2009, the Federal Reserve has been criticized for resorting to paying the banks interest to hold these excess reserves parked with the Fed as a sort of stopgap measure to keep all this liquidity from spewing out into the economy and creating rampant price inflation. Then later the Fed came up with the strategy of using *Repurchase Agreements ("Repos"),* which in effect meant even more interest payments to the banks. But the Repos only give the banks temporary ownership of the security. This *"new"* strategy, the one in Mnuchin's report, would actually provide the banks permanent ownership of the bonds.

But the query grows more ominous when you consider that it's not just the Federal Reserve that is unloading bonds. Foreign governments such as Japan and China are currently dumping them too and $600 billion more in U.S. Treasuries have just been issued by the Trump Administration to offset the recent GOP tax cuts.

We should also keep in mind that all world central banks have been providing their economies similar massive stimulus since the 2008 financial crisis, following the pattern of the Federal Reserve. Now in similar *"copycat"* fashion they too are targeting a similar unwinding process as well. In effect there is a deluge of bonds coming into the

Federal Reserve Statistical Release

H.4.1

**Factors Affecting Reserve Balances**

*Release Date: June 21, 2018*

Release dates | Data Download Program (DDP) | About | Announcements | Technical Q&As

Current release *Other formats:* Screen reader | ASCII | PDF (21 KB)

FEDERAL RESERVE statistical release

H.4.1

Factors Affecting Reserve Balances of Depository Institutions and
Condition Statement of Federal Reserve Banks — June 21, 2018

1. Factors Affecting Reserve Balances of Depository Institutions
Millions of dollars

| Reserve Bank credit, related items, and reserve balances of depository institutions at Federal Reserve Banks | Averages of daily figures: Week ended Jun 20, 2018 | | Change from week ended Jun 13, 2018 | | Change from week ended Jun 21, 2017 | Wednesday Jun 20, 2018 |
|---|---|---|---|---|---|---|
| Reserve Bank credit | 4,279,498 | - | 2,135 | - | 150,748 | 4,276,580 |
| Securities held outright (1) | 4,114,537 | - | 2,851 | - | 134,846 | 4,112,021 |
| U.S. Treasury securities | 2,378,078 | + | 126 | - | 86,848 | 2,378,124 |
| Bills (2) | 0 | | 0 | | 0 | 0 |
| Notes and bonds, nominal (2) | 2,242,161 | | 0 | - | 96,055 | 2,242,161 |
| Notes and bonds, inflation-indexed (2) | 114,860 | | 0 | + | 6,734 | 114,860 |
| Inflation compensation (3) | 21,057 | + | 126 | + | 2,474 | 21,103 |
| Federal agency debt securities (2) | 2,409 | - | 1,699 | - | 5,688 | 2,409 |
| Mortgage-backed securities (4) | 1,734,050 | - | 1,278 | - | 42,310 | 1,731,488 |
| Unamortized premiums on securities held outright (5) | 150,557 | - | 359 | - | 16,056 | 150,291 |
| Unamortized discounts on securities held outright (5) | -13,965 | + | 24 | + | 811 | -13,954 |
| Repurchase agreements (6) | 0 | | 0 | | 0 | 0 |
| Loans | 135 | + | 12 | + | 34 | 162 |
| Primary credit | 8 | - | 9 | - | 10 | 21 |
| Secondary credit | 0 | | 0 | | 0 | 0 |
| Seasonal credit | 127 | + | 21 | + | 44 | 141 |
| Other credit extensions | 0 | | 0 | | 0 | 0 |
| Net portfolio holdings of Maiden Lane LLC (7) | 1,713 | | 0 | + | 4 | 1,713 |
| Float | -160 | + | 19 | + | 103 | -99 |
| Central bank liquidity swaps (8) | 95 | + | 4 | + | 53 | 95 |
| Other Federal Reserve assets (9) | 26,586 | + | 1,015 | - | 849 | 26,351 |
| Foreign currency denominated assets (10) | 21,111 | - | 239 | + | 511 | 21,113 |
| Gold stock | 11,041 | | 0 | | 0 | 11,041 |
| Special drawing rights certificate account | 5,200 | | 0 | | 0 | 5,200 |
| Treasury currency outstanding (11) | 49,671 | + | 14 | + | 713 | 49,671 |
| Total factors supplying reserve funds | 4,366,521 | - | 2,360 | - | 149,524 | 4,363,606 |

Illustration I

bond market. Who is going to buy all these bonds? Are these people crazy?

Perhaps, but I don't believe they are stupid. To me it appears that behind closed doors government and banking officials worldwide have crafted a strategy that places this massive amount of bonds back inside their own banking systems. And another thing that has become equally apparent in this Mnuchin report is that in order to make this happen they first have to change the present liquidity rules starting with the Dodd-Frank legislation here in the U.S., and then followed by the Basel Accord regulations for the rest of the world after that.

Federal Reserve Statistical Release

H.4.1

**Factors Affecting Reserve Balances**

*Release Date: October 05, 2017*

Release dates | Data Download Program (DDP) | About | Announcements | Technical Q&As

Current release *Other formats:* Screen reader | ASCII | PDF (21 KB)

FEDERAL RESERVE statistical release

H.4.1

Factors Affecting Reserve Balances of Depository Institutions and
Condition Statement of Federal Reserve Banks — October 5, 2017

1. Factors Affecting Reserve Balances of Depository Institutions
Millions of dollars

| Reserve Bank credit, related items, and reserve balances of depository institutions at Federal Reserve Banks | Averages of daily figures: Week ended Oct 4, 2017 | | Change from week ended Sep 27, 2017 | | Change from week ended Oct 5, 2016 | Wednesday Oct 4, 2017 |
|---|---|---|---|---|---|---|
| Reserve Bank credit | 4,420,117 | - | 3,656 | + | 1,798 | 4,420,524 |
| Securities held outright (1) | 4,240,352 | - | 6,843 | + | 19,521 | 4,240,384 |
| U.S. Treasury securities | 2,465,435 | + | 1 | + | 1,973 | 2,465,467 |
| Bills (2) | 0 | | 0 | | 0 | 0 |
| Notes and bonds, nominal (2) | 2,337,326 | | 0 | - | 3,746 | 2,337,326 |
| Notes and bonds, inflation-indexed (2) | 109,412 | | 0 | + | 4,284 | 109,412 |
| Inflation compensation (3) | 18,697 | + | 1 | + | 1,436 | 18,729 |
| Federal agency debt securities (2) | 6,757 | | 0 | - | 13,735 | 6,757 |
| Mortgage-backed securities (4) | 1,768,160 | - | 6,844 | + | 31,283 | 1,768,160 |
| Unamortized premiums on securities held outright (5) | 162,394 | - | 468 | - | 14,517 | 162,278 |
| Unamortized discounts on securities held outright (5) | -14,437 | + | 24 | + | 1,026 | -14,432 |
| Repurchase agreements (6) | 0 | | 0 | | 0 | 0 |
| Loans | 192 | - | 41 | - | 3 | 177 |
| Primary credit | 3 | - | 4 | - | 3 | 0 |
| Secondary credit | 0 | | 0 | | 0 | 0 |
| Seasonal credit | 189 | - | 37 | | 0 | 176 |
| Other credit extensions | 0 | | 0 | | 0 | 0 |
| Net portfolio holdings of Maiden Lane LLC (7) | 1,707 | - | 1 | - | 1 | 1,707 |
| Float | -668 | - | 361 | + | 13 | -629 |
| Central bank liquidity swaps (8) | 3,620 | + | 3,583 | - | 3,383 | 3,620 |
| Other Federal Reserve assets (9) | 26,956 | + | 450 | - | 861 | 27,419 |
| Foreign currency denominated assets (10) | 21,165 | - | 141 | - | 312 | 21,111 |
| Gold stock | 11,041 | | 0 | | 0 | 11,041 |
| Special drawing rights certificate account | 5,200 | | 0 | | 0 | 5,200 |
| Treasury currency outstanding (11) | 49,160 | + | 14 | + | 790 | 49,160 |
| Total factors supplying reserve funds | 4,506,683 | - | 3,782 | + | 2,275 | 4,507,035 |

Illustration II

How will all of this actually play out? Will the markets sit still for it? Are there any new surprising developments since the unwinding began last year in October 2017? Well, just this one.

## NO SELLING OR BUYING YET, JUST ROLLOVERS AND ROLL OFFS

Since October 2017 to June 21, 2018 the Federal Reserve's balance sheet has shrunk by $140 billion. You can see the reduction by comparing the June 21, 2018 balance sheet in ***Illustration I*** and the October 5, 2017 balance sheet in ***Illustration II.*** However, there has been no selling or buying of bonds whatsoever, at least not yet. What has actually occurred is that as bonds mature they are redeemed (paid for by the U.S. Treasury) and simply roll-off the Fed's balance sheet. What we know is that the U.S. Treasury uses the Fed as its deposit bank so this redemption transaction is a matter of debiting the U.S. Treasury's bank account. Apart from this the Fed would be outright destroying the money. Some Treasuries, however, are still being rolled over, i.e., reinvested, even though that keeps them on the balance sheet.

(If you're wondering where the money "goes" when the Treasury pays back the principal on a maturing bond held by the Fed… it goes back into limbo. Remember, when the Fed buys bonds and adds them to its balance sheet, it electronically creates bank reserves—"high-powered money"—out of thin air. In mirror-image fashion, if the Fed either *sells* bonds or lets them mature and be replaced by money, those bank reserves disappear from the system as the Fed's balance sheet shrinks.)

Notwithstanding the push by Republicans for the Fed to unwind faster by selling them off outright in the open bond market the Fed is taking a more cautious approach at

**2. Maturity Distribution of Securities, Loans, and Selected Other Assets and Liabilities, June 20, 2018**
Millions of dollars

| Remaining Maturity | Within 15 days | 16 days to 90 days | 91 days to 1 year | Over 1 year to 5 years | Over 5 year to 10 years | Over 10 years | All |
|---|---|---|---|---|---|---|---|
| Loans | 144 | 18 | 0 | 0 | 0 | ... | 162 |
| *U.S. Treasury securities*[1] | | | | | | | |
| Holdings | 30,454 | 75,434 | 305,419 | 1,051,152 | 296,261 | 619,404 | 2,378,124 |
| Weekly changes | + 30,454 | - 30,452 | + 2 | + 18 | + 44 | + 60 | + 126 |
| *Federal agency debt securities*[2] | | | | | | | |
| Holdings | 0 | 0 | 62 | 0 | 0 | 2,347 | 2,409 |
| Weekly changes | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| *Mortgage-backed securities*[3] | | | | | | | |
| Holdings | 0 | 0 | 0 | 147 | 39,881 | 1,691,459 | 1,731,488 |
| Weekly changes | 0 | 0 | 0 | + 4 | - 137 | - 8,113 | - 8,245 |
| Repurchase agreements[4] | 0 | 0 | ... | ... | ... | ... | 0 |
| Central bank liquidity swaps[5] | 95 | 0 | 0 | 0 | 0 | 0 | 95 |
| Reverse repurchase agreements[4] | 243,725 | 0 | ... | ... | ... | ... | 243,725 |
| Term deposits | 0 | 0 | 0 | ... | ... | ... | 0 |

Note: Components may not sum to totals because of rounding.
Not applicable

Illustration III

least here at the beginning of the unwind. But notice that ***Illustration III*** reveals that the maturities of $1.4 trillion of the intended $2.5 trillion reduction target in Treasuries is less than five years, which makes this present Fed strategy plausible. That would only leave $1.1 trillion to sell off at some point in the future, i.e. more than five years from now. Yet this maneuver, which applies a form of risk management, is still a delicate proposition charged with potential financial market upheavals that can occur along the way. Three to five years is a long time.

## COULD IT BE THAT WHAT IS IN MNUCHIN'S REPORT IS "PLAN B?"

We have to keep in mind that the Federal Reserve in all of its history has never been in a situation quite like this before. What they are attempting is a test without knowing what the actual results will produce. Unwinding trillions of dollars in assets off its balance sheet without upsetting markets is no small task. It stands to reason that such a dicey strategy deserves an alternate solution or perhaps more than one. It's possible the strategy in Mnuchin's report is the plan devised to accelerate through asset sales the shrinking of the Fed's balance sheet once Dodd-Frank has been legally amended. In the meantime we implore you, our readers, to stay liquid.

Finally, there is also this other point to consider. Unwinding the Fed's balance sheet implies that it will no longer be adding to it. This would also mean that any future issuance of U.S. Treasuries by the government need to be actually bought by somebody other than the Federal Reserve, which up to this point has been its biggest buyer. With a squandering government such as the one we have, borrowing by issuing more Treasuries is not going to go away anytime soon. Even now the US Treasury has to issue more bonds in order to get the money to pay the Fed for all the treasuries that are currently maturing. For these reasons, and others already mentioned in this article, the Mnuchin report convinces me that the banks appear to me to be the likely buying candidates for these Treasuries.

In the meantime fixed-income investors worldwide are currently starved for yields and U.S. interest rates continue to rise.

## CONCLUSION

In this article, one year later after I first wrote on this very subject, I point out that I am now convinced that Executive Order 13772 on "Core principles for Regulating the United States Financial System," embodied in a 149-page report written by Secretary of the Treasury, Steven Mnuchin, and dated June 2017, is actually President Trump's *"playbook"* for managing the U.S. economy. By reading it we can anticipate what's coming next.

One of the hidden cornerstones of this report are the suggested changes to the liquid-

ity ratios of "too-big-to-fail" mega-banks that will alter their profitability and enable them to be able to purchase large quantities of Treasuries without the need of having to raise additional and very expensive equity capital.

This suggested alteration to the Dodd-Frank Act, among others, coincidently fits the Federal Reserve's need to unwind its balance sheet of $2.5 trillion in U.S. Treasuries and Mortgage Backed Securities over the course of three to five years. Although the most straightforward way to return to normal monetary policy would be to remove those excess reserves through asset sales, the Fed is not currently selling any securities at this time. Instead it is gradually reducing the balance sheet by ceasing to roll over these securities as they mature.

Given the essence of Mnuchin's report, it's possible, and here I am speculating, that once all of the suggested amendments to the Dodd-Frank Act have been formalized and voted into law the pace for reducing the Fed's balance sheet may actually accelerate with outright asset sales taking place and, from what we can see, the big banks are the likely buyers.

> We have to keep in mind that the Federal Reserve in all of its history has never been in a situation quite like this before.

Keep in mind, that the quicker the Fed sheds its balance sheet it's like re-loading its gun to be able to reapply QE once again in case all hell breaks loose in the economy. Systemic risk is real with worldwide ramifications.

The Federal Reserve has never in its history been in the position it now finds itself in 2018. This winding down of the Fed's balance sheet is a controversial and developing story that is occurring at a time when we at the ***Lara-Murphy Report*** are predicting an even worse financial storm than the one in 2008 and that it's coming just over the horizon. Get ready.

Watch the video *How To Weather the Coming Financial Storms* at https://lara-murphy.com/video0916/

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# The "Skyscraper Index" AND OTHER SIGNS OF A BUBBLE

## Interview with Mark Thornton

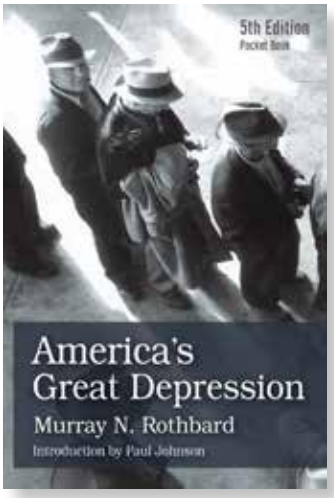
Mark Thornton is Senior Fellow at the Mises Institute. He serves as the Book Review Editor of the *Quarterly Journal of Austrian Economics.* His publications include *The Economics of Prohibition* (1991), *Tariffs, Blockades, and Inflation: The Economics of the Civil War* (2004), *The Quotable Mises* (2005), *The Bastiat Collection* (2007), *An Essay on Economic Theory* (2010), and *The Bastiat Reader* (2014).

Dr. Thornton served as the editor of the *Austrian Economics Newsletter* and was a member of the Editorial Board of the *Journal of Libertarian Studies* and several other academic journals. He has served as a member of the graduate faculties of Auburn University and Columbus State University. He has also taught economics at Auburn University at Montgomery and Trinity University in Texas. Mark served as Assistant Superintendent of Banking and economic adviser to Governor Fob James of Alabama (1997-1999), and he was awarded the University Research Award at Columbus State University in 2002. He is a graduate of St. Bonaventure University and received his PhD in economics from Auburn University. In 2014, he debated in opposition to the "War on Drugs" at Oxford Union.

Dr. Thornton has been featured in many print outlets including *American Spectator, Barron's, Bloomberg, Christian Science Monitor, The Economist, Forbes, Investors' Business Daily, Le Monde, New York Times, USA Today, Wall Street Journal, Economic Times* (India), *Financial Times* (Norway), and *Tejarat-e-Farda* (Iran).

**Lara-Murphy Report:** How did you discover Austrian economics?

**Mark Thornton:** I was an economics major at St. Bonaventure University from 1978-1982 when Austrian economics was dead and there was virtually no access to books about the Austrian School of economics. However, I did read Rose and Milton Friedman's book *Free to Choose* and in wrestling with some of book's inconsistencies I first realized that I had developed some pretty radical views. Later I discovered a poster near my advisor's office door that read: "Adam Smith was right, pass it on" advertising an Institute for Humane Studies summer conference. I applied for it and was accepted and that is where I met Austrian School economist Roger Garrison. He gave the economics lectures which I very much




**"I obtained a copy of Murray Rothbard's America's Great Depression and the book provided a superior explanation of the economic depression of the 1970s and early 1980s and I was hooked. Upon graduating I took a leap of faith and entered the masters of economics degree program at Auburn University where Roger Garrison was teaching."**

enjoyed and I wanted to learn more about the Austrians. When I returned to college, I took a course on business cycles that did not mention the Austrians in class or in the textbook. I then took a course on the history of economic thought that somehow—amazingly—also managed to sidestep the Austrians. I found this very curious. I also took a course on international economics from Scott Sumner which I thought was excellent. He had a copy of *Human Action* in his office and I asked him if he would give me an independent readings class on Mises's *Theory of Money and Credit*. I did not do great on my report for the class, but Scott did a good job of explaining key gaps that I had missed. Sometime later I obtained a copy of Murray Rothbard's *America's Great Depression* and the book provided a superior explanation of the economic depression of the 1970s and early 1980s and I was hooked. Upon graduating I took a leap of faith and entered the masters of economics degree program at Auburn University where Roger Garrison was teaching.

**Lara-Murphy Report:** The main reason we wanted to interview you for this issue is your work on the business cycle. But before we get into that, let's ask you about *another* one of your research areas: drug prohibition. Can you make a brief case for why even social conservatives should care about this issue?

**MT:** I did my dissertation on the economics of prohibition at Auburn University with the help of financial assistance from the Mises Institute which moved to Auburn in 1983. This topic was chosen because I had discovered a phenomenon in illegal drugs markets that would later be dubbed the "Iron Law of Prohibition" while writing a paper for one of my microeconomics classes. On one side of my family, my relatives were all pharmacists and on the other they were all saloon and liquor store owners, so I figured it sort of like going into the family businesses (at the height of the War on Drugs).

**"On one side of my family, my relatives were all pharmacists and on the other they were all saloon and liquor store owners, so I figured it sort of like going into the family businesses (at the height of the War on Drugs)."**

Social conservatives should be very concerned and leery about the War on Drugs. I understand their concerns about drug use and the disruptions to family life and community. However, these problems pale in comparison to the problems caused by the policy of prohibition. Plus, the outlawing of alcohol and drugs does virtually nothing to address their concerns. It only makes things much worse. Let us look at some of things prohibition does do:

1. Whether it is the alcohol prohibition in the 1920s or the War on Drugs today, prohibition of significant goods causes the majority of bribery and corruption of our public officials and law enforcement. This undermines respect for the rule of law and law and order.

2. Prohibitions are a leading cause of violence. In order to enforce contracts and

sales territories in black markets people turn to violence and murder. Street gangs and their violence are also tied to the market for illegal drugs. The murder rate doubled during the alcohol prohibition in the 1920s and then returned to normal when it was repealed in 1933.

3. The War on Drugs is the leading cause of incarceration in the US. This is the reason prisons are so overcrowded that violent offenders, such as rapists and murderers, are often prematurely released from their sentences.

4. My contribution, the "Iron Law of Prohibition," is that enforcing prohibition makes alcohol and drugs more potent and dangerous. During Prohibition American drinkers switched from mostly beer and wine to rotgut double-strength whiskey and bathtub gin. In the modern War on Drugs the black


**"The current problem of asylum seekers entering the US where immigrants are separated from their parents is directly rooted in the violent drug traffic in Central American countries."**

market has switched from marijuana, i.e. cannabis, to cocaine, heroin, and crystal meth, and now more recently to extremely dangerous chemical opiates. As the risk to drug smugglers rises they want their product to be as small as possible on a per-dose basis. No one has directly died from consuming cannabis, but now more than 50,000 are dying annually from Opioid drugs, including many social conservatives. The current Opiate Crisis is the inevitable result of what you would expect from the Iron Law of Prohibition combined with the Pharma-medical complex endorsing the prescribing of dangerous and addictive opiates like Oxycontin and Vicodin for ordinary cases of pain when non-opiate painkillers would suffice.

5. It has caused enormous difficulties in Central and South America, including increased crime, corruption, and violence. The current problem of asylum

seekers entering the US where immigrants are separated from their parents is directly rooted in the violent drug traffic in Central American countries that have been taken over and ruthlessly ruled by drug cartels in an attempt to get their drugs from South America into the US.

6. **Why would social conservatives accept this state of affairs?** The powerful trend of cannabis legalization, and its many successes, means that more and more American now realize that their politicians and bureaucrats have not been truthful with them. Given that I started my career with this line of research at the peak of the War on Drugs, means that the success of the legalization movement has been highly satisfying for me.

**LMR:** For years, we've been giving presentations to the general public, using Austrian business cycle theory to explain the housing bubble and the financial crisis of 2008. One of us (Murphy) tries to convince the audience to pay attention by devoting a PowerPoint slide to a quote from your 2004 article "Housing: Too Good to Be True." (https://mises.org/library/housing-too-good-be-true) In that article you *eerily* predict some of the features of the coming crash, and of course this was years before most other economists even knew there was a problem. Can you give us the background here? At what point in your career did you feel confident in leaving the abstract supply-and-demand diagrams to talk to people about the "real world" and what might be coming?

**MT:** In contrast to the unrealistic models of mainstream economics, I love to study and talk about the real world. However, I am still not very comfortable explaining what might be coming in terms of the business cycle and all that goes with it. Austrian Business Cycle Theory (ABCT) does not give you the tools to measure magnitudes or to predict the timing of events. It only tells you that the conditions might be ripe for a boom and bust cycle. I first mentioned the housing bubble in an LRC article in early 2004 (https://www.lewrockwell.com/2004/02/mark-thornton/bull-market/), but only timidly. I do not recall many others talking about the bubble at the time. As I discussed in my June 2004 article(https://mises.org/library/housing-too-good-be-true), what I saw earlier in the year was much more obvious to me in the statistics by summer. The psychological factor was much more evident, the euphoria of the Tech Bubble had returned. More visibly, "For Rent" signs began popping up all over my town of Auburn, Alabama. The city is home to both the Mises Institute and Auburn University. There had always been a tight market from apartments in town ever since I had arrived in 1982. The appearance of the signs was a brand-new phenomenon and was a warning of oversupply of housing and that people were switching from being renters to being homeowners in large numbers.

I did several interviews on the bubble and gave speeches to students, academics, builders, and bankers. I got the sense that the majority of my audiences did not understand or believe what I was saying. People would say "how could we have a crash when everything looks so great?" I would respond by saying that "when *everything* is *great* that is the number one sign of a bubble—it's not normal for everything to be great."


**"I did several interviews on the bubble and gave speeches to students, academics, builders, and bankers. I got the sense that the majority of my audiences did not understand or believe what I was saying. People would say 'how could we have a crash when everything looks so great?' I would respond by saying that 'when everything is great that is the number one sign of a bubble—it's not normal for everything to be great.'"**

I used basic "technical" tools to identify the start of the Housing Bubble in my February 2004 article, the "top" in the housing stock index in August of 2005 (https://www.lewrockwell.com/2005/08/mark-thornton/is-the-housing-bubble-popping/), and the skyscraper index to identify the top in US stock markets in August 7th, 2007. (http://www.cnn.com/2010/WORLD/asiapcf/01/08/skyscrapers.rise.markets.fall/index.html)

**LMR:** Can you explain your "skyscraper index," and what it's currently telling us?

**MT:** The Skyscraper Index was first constructed by real estate analyst Andrew Lawrence in the late 1990s as a chronicle of the relationship between new record-breaking skyscrapers and major economic crises dating back to the Panic

of 1907. It was discussed in all the major financial media but was largely dismissed. I immediately saw the ABCT as the connection between the skyscrapers and business cycles. My academic article was finally published in 2005 after several rejections from mainstream economic journals. (https://mises.org/library/skyscrapers-and-business-cycles-4) This was at the height of the Housing Bubble. The paper explains that artificially low interest rates do several things to an economy with several important effects that can be easily described in skyscraper construction.

Two obvious things that low interest rates cause are increased investment and increases in the value of capital assets, such as stocks and real estate. In terms of skyscrapers, artificially low rates increase the value of land and this induces build-

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ers to build taller building in order to make a profit. Low rates also cause firms to become bigger, so that "mom and pop" industries evolve into larger franchise businesses that require human relations, product development, marketing, and accounting departments. This requires more office space in commercial hub cities. You can also see this during mergers and acquisition booms, which coincide with artificially low interest rates. The third thing we see is that taller structures require new technologies across the board in terms of "building systems," such as elevators, air conditioning, and plumbing. We see a similar phenomenon in construction technologies, equipment, and materials. Companies have to adopt "advanced" technologies in order to build record-breaking skyscrapers and this is symptomatic of what is going on throughout the economy during an artificial boom. Most of these changes are the malinvestments that will be revealed during the bust.

Similar things happen during the process of natural economic growth so it all depends on whether the low interest rates are driven from a natural accumulation of savings or artificially low rate caused by the Federal Reserve's monetary policy.

Remember, skyscraper construction does not cause an economic crisis. Artificially low interest rates cause *both* record-breaking skyscrapers and economic crises or curses. That may seem obvious, but I have been criticized in the academic journal, *Applied Economics,* and in the *Economist* magazine on that basis!

Currently we are on a "skyscraper alert" as of January 1, 2016. That is when it became clear that a new record-breaking skyscraper had begun construction and was likely to be completed. The alert is a sign of caution, but it is also a sign that there is an investment boom underway and that large gains were possible


**"Remember, skyscraper construction does not cause an economic crisis. Artificially low interest rates cause *both* record-breaking skyscrapers and economic crises or curses."**

in stock market and other investments before we get a "skyscraper signal." We have not yet seen this signal. That would occur when that project reaches a new record height and sets a new record for inhabitable height, in contrast to spires or antennas. However, given that this project—the Jeddah Tower in Saudi Arabia—has suffered several significant delays, I would urge readers to be cautious because most fundamental and contrarian measure indicate that markets are already at a top.

**LMR:** Finally, can you explain your latest project and what is needed?

**MT:** I am finishing up a book called the *Skyscraper Curse: and How Austrian Economists Have Predicted Every Economic Crisis for over a Century.* It is really two small books. The first one is about the Skyscraper Curse: where did it come from,

**"Austrian economists have correctly predicted every major crisis going back to the Great Depression. Their success is based on ABCT (Austrian Business Cycle Theory), not the Skyscraper Index!"**

what is it, how accurate has it been, and what are the implications in terms of understanding the economy and its impacts on investments. The second part is a history of how Austrian economists have correctly predicted every major crisis going back to the Great Depression. Their success is based on ABCT (Austrian Business Cycle Theory), not the Skyscraper Index! It contains amusing anecdotes of how badly mainstream economists have been in terms of predictions, from Irving Fisher to Milton Friedman.

It provides further insights into ABCT and why most other theories of the business cycles are really not economic theories at all. It is all written to be read by anyone interested in these subjects. There are several short chapters and an introduction that provides a revealing history of my experience with this topic over the last two decades. Naturally, the book is highly critical of the Federal Reserve and explains how and why Fed officials help their politically connected friends at the expense of the general population. We at the Mises Institute would like to get this book into as many hands as possible, especially young people, so that we can learn from the next bust and prevent economic crises in the future. Your readers are naturally welcome to help us achieve that goal.

*Editors' Note: Readers can donate to support the publication of Mark's book on the Skyscraper Index / Austrian business cycle theory at the following link (mention "Thornton skyscraper book" in the comment box):* https://mises.org/snippets/publications-support-page

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*Note: The economists and financial professionals interviewed in the LMR are given the freedom to express their views, without necessarily implying endorsement from the editors.*

# EVENTS & ENGAGEMENTS

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

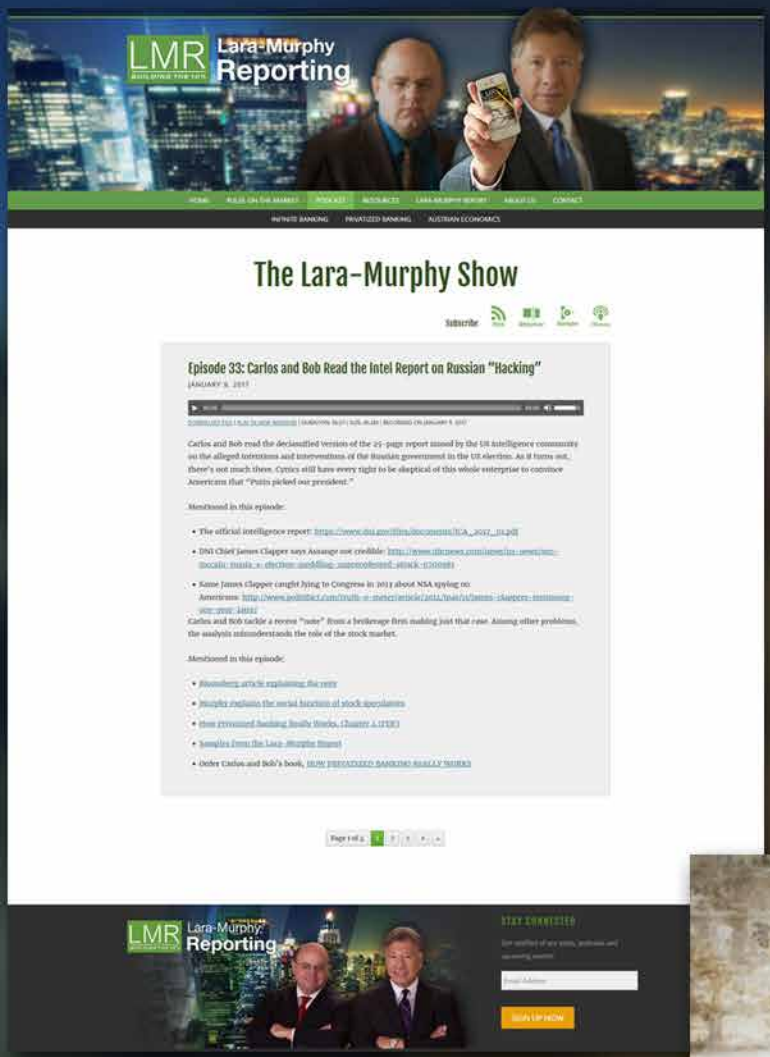
**JUNE 30, 2018**
**NEW ORLEANS, LA**

Murphy talks about political strategy for the LP Mises Causes. Details at:
http://lpmisescaucus.com/take-human-action-bash/

**JULY 15-21, 2018**
**AUBURN, AL**

Murphy presents at Mises University

**SOME EVENTS MAY BE CLOSED TO GENERAL PUBLIC.**
**FOR MORE INFORMATION ON EVENTS CONTACT: RPM@CONSULTINGBYRPM.COM**

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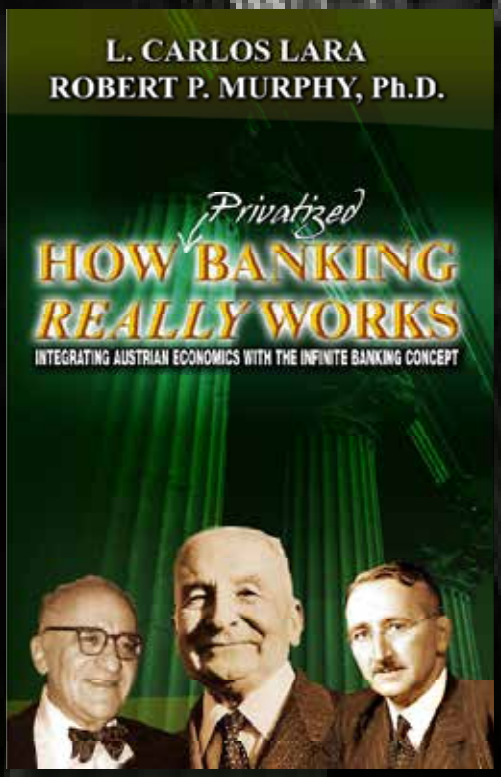


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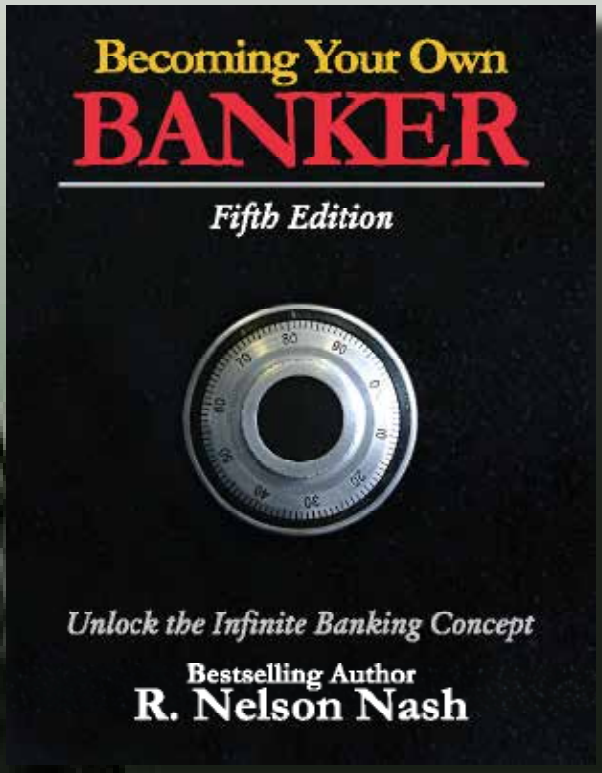


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