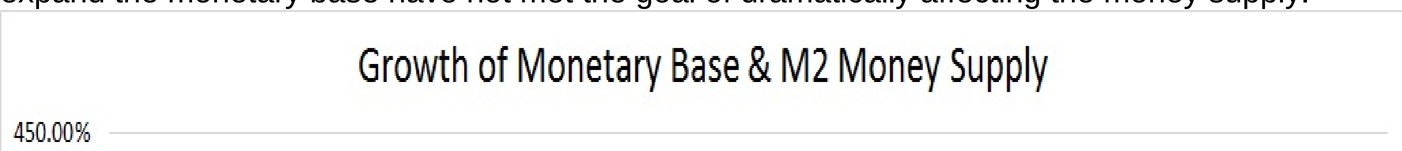
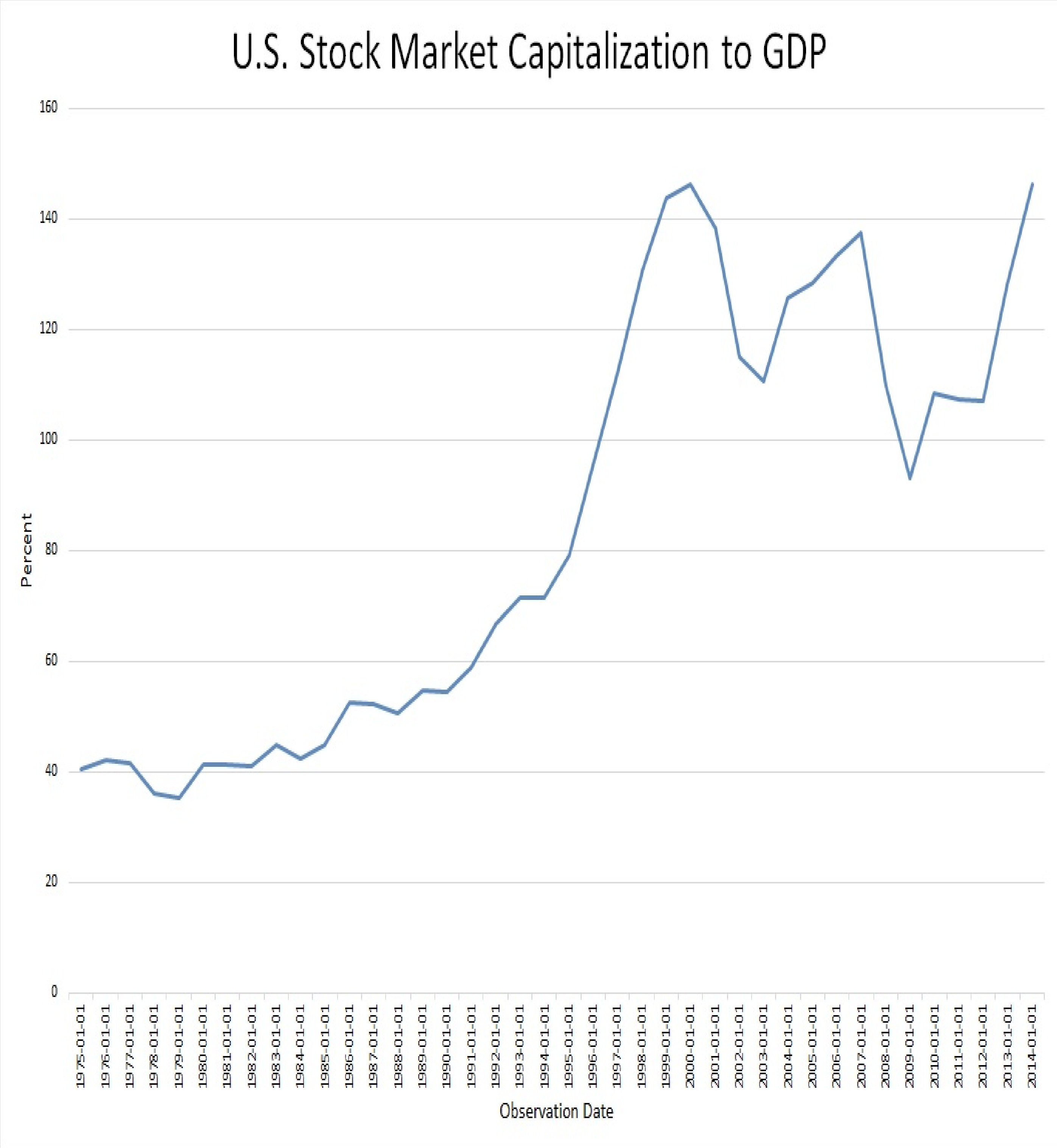
The Questionable State & Abusive Use Of Economics - Part 1

[Real Investment Advice](#) welcomes Ben Masters to our growing list of contributors.?Benjamin Masters is the creator, designer, and writer for[Third Wave Finance](#), With over ten years of experience working as a lead Portfolio Analyst, Ben brings additional insights into the discussion of economics, markets and portfolio management.

As lackluster results from rather experimental central bank policies continue to emerge, it?s time to readdress the seemingly endless nature of the perpetual-motion machine known as central bank stimulus ? to stop and be still for moment and question whether the endlessly spinning wheels should be spinning at all, to question whether the maze is leading us back to the beginning. It?s often difficult to do ? to question a lifetime?s worth of custom ? but it?s so very important, as even the most advanced civilizations have drifted off course at some point in history. A brief look at the charts below can give us a sense of the misalignment that is occurring: 1. The experimental monetary policies (Large Scale Asset Purchases / Quantitative Easing) that have been used to expand the monetary base have not met the goal of dramatically affecting the money supply.



2. A misallocation of capital has occurred shifting assets away from the broader economy, and toward a portion of the economy ? tradable securities. Since the 1980s, the prices of many tradable securities, including stocks, have seen a significant rise, yet the economy as a whole has been unable to reach previously-attainable levels of growth.



Citation: World Bank, Stock Market Capitalization to GDP for United States [DDDM01USA156NWDB], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DDDM01USA156NWDB, March 6, 2017.

And although the results can be damaging *(to be addressed in this multi-part series)*, the outcome should not be surprising: When faced with near-zero interest rates, it?s not surprising if banks decide against pursing their low-return commercial banking side, and instead favor leveraged asset speculation via their proprietary trading desks. **If the trade-off from low-risk/guaranteed-low-return to high-risk/potential-for-return takes place,** it may actually deprive the economy of funds while banks temporarily improve earnings through risk-taking ? a point that would be consistent with Robert Hall?s comment at the Jackson Hole Monetary Conference in 2013: ?An expansion of reserves contracts the economy?. And in a similar fashion, when savings rates are near-zero, there may be an irresistible temptation for companies and investors to take on unsustainable, speculative, investment risk (in an attempt to try to meet performance and savings goals). Questions then arise: Why is this form of economics being pursued? Are there other options available? Is economics and central bank policy worthless?

A Starting Point

Although economics is typically addressed without a qualifier to distinguish one version from another, it may be worthwhile to begin the custom as there are many schools of economics ? each with strongly opposing views of the world. And if there are many schools of economics (see the video Economics is for Everyone), why should we assume that the choice made by many of the world?s economies ? which is to eschew all but one version ? is the proper decision? Given that the world is constantly changing, and that each version of economics has its own built in assumptions, it may be na?ve to assume that economics in its existing state has reached peak perfection; and based on the charts above, the current form of economics may not even be desirable.

The Questionable State ? and Abusive Use ? of Economics

A necessary and constant desire to explore alternative viewpoints ? as a way to broaden the scope of understanding ? has brought me to Henry Hazlitt?s Economics in One Lesson. It aligns with the important recognition that an idea, profession, concept, axiom, or story, should not be seen as a static topic to be memorized and repeated, but as one to be challenged in a constantly evolving process of reeducation, to merge established ideas with novel ones; it should constantly be influenced, adjusted, and questioned. Only then, is the fallibility of any one particular idea realized ? its transitory nature recognized. And this brings us to our current economic environment, where one predominant ethos has been perpetuated, saturating the economic landscape ? arguably because its benefits are lucid and ramifications clandestine. That idea is a bizarre version of keynesian economics ? not even in its originally intended form ? a version that pursues debt-based spending to temporarily boost growth, a version that disregards the quality of debt being taken on and the long-term affects on all other parties; this is the version of economics used by central banks and governments throughout the world. It?s a stagnant policy that has favored the short term over the long term, while creating an illusory environment based on inflation, the results of which are a misallocation of wealth, and social disruptions. In moving away from the study of classical economics ? which also suffers its own drawbacks, showing a certain callousness toward the groups immediately hurt by its attempt to focus on the long term ? modern economic policies have reversed course so drastically that they have merely unbalanced the ship to the other side.

> *?There are men regarded today as brilliant economists, who deprecate saving and recommend squandering on a national scale as the way of economic salvation; and when anyone points to what the consequences of these policies will be in the long run, they reply flippantly, as might the prodigal son of a warning father: ?In the long run we are all dead.? And such shallow wisecracks pass as devastating epigrams and the*

ripest wisdom.But the tragedy is that, on the contrary, we are already suffering the long-run consequences of the policies of the remote or recent past. Today is already the tomorrow which the bad economist yesterday urged us to ignore. The long-run consequences of some economic policies may become evident in a few months. Others may not become evident for several years. Still others may not become evident for decades. But in every case those long-run consequences are contained in the policy as surely as the hen was in the egg, the flower in the seed.From this aspect, therefore, the whole of economics can be reduced to a single lesson, and that lesson can be reduced to a single sentence. The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.?? Henry Hazlitt (H.H.)

And the oversight suggested in the last line is the reason that economics and central bank policy are becoming questionable endeavors ? not because they are worthless but because they have been abused. The immediate effects of a policy are visible, the affects on one (or a few) particular groups are seen, yet the implications for all remaining groups are overlooked; the chain of events that is set into motion ? each causing its own further effects ? is forgotten.

?Economics is haunted by more fallacies than any other study known to man. This is no accident. The inherent difficulties of the subject would be great enough in any case, but they are multiplied a thousandfold by a factor that is insignificant in, say, physics, mathematics or medicine ? the special pleading of selfish interests. While every group has certain economic interests identical with those of all groups, every group has also, as we shall see, interests antagonistic to those of all other groups. While certain public policies would in the long run benefit everybody, other policies would benefit one group only at the expense of all other groups. The group that would benefit by such policies, having such a direct interest in them, will argue for them plausibly and persistently. It will hire the best buyable minds to devote their whole time to presenting its case. And it will finally either convince the general public that its case is sound, or so befuddle it that clear thinking on the subject becomes next to impossible.? ? H.H.

One may stop to ponder on why the immediate is preferred to the future (An innate survival instinct? Merely due to a lack-of-awareness of consequence?), but one point is clear and immovable in our current environment: it is easier to choose the *?here and now?.*

The Fallacy of Deficit Spending

The fallacy in the concept that a country can borrow money to boost growth *(i.e. deficit spending)* in an economic downturn is that it assumes that politicians will counter the process in the recovery period to actually slow growth down. When an individual takes a loan they are able to boost their current spending, yet at the same time they?re also reducing their future spending (future payments toward the loan are reducing their income and ability to spend at that time). Just as an individual can only spend from income, a country can only spend from taxes, so a country that uses deficit spending to boost the economy during a downturn will be forced to slow the economy while the loan is being paid back through increased taxes. **Deficit spending is easy to agree to, but its other side is so very difficult to complete ? especially when it?s likely that a different politician will be the one that will need to complete the process. Although it?s possible, what politician would campaign to slow the growth of the country? ? yet that?s what is necessitated by deficit spending.** Although deficit spending can be used to boost growth in a deflationary / recessionary / depression-type environment, by doing so the country is pulling growth forward ? borrowing from future taxes ? and if it occurs over a long enough period of time, the taxes will be placed on a different generation; this is the concept of ?generational warfare? ? the consequences of a spendthrift generation are passed to another. **Click Here For Part II**