



JE KINDLE-NOTITIES VOOR:

Monetary Kaleidics: Reflections on Money Illusion and the War on Cash

door Michael Hoffman, Melissa Ruiz, Daniel Carney

Gratis directe Kindle-preview: <https://a.co/ebIVd4B>

59 Highlights

Highlight (Geel) | Locatie 192

Properly understood, Jean-Baptiste Say claimed not simply that supply creates its own demand, but that consumption is enabled by prior production, and that production must supply goods that meet the market's demand. Otherwise, there can be misallocations of specific goods that were mistakenly assumed to have a market with a given level of demand. In other words, the correct products must be produced and sold in order to transform that producer's notional demand into effective demand. One year after Say died, economist George Poulett Scrope made the contrary claim in his *Principles of Political Economy* (1833, p. 215) that "general gluts" not only followed monetary disturbances, but were inherently linked with them when he stated:

Highlight (Geel) | Locatie 200

Scrope essentially integrated an unsophisticated interpretation of Say's law with that of Walras' law: total demand, including the demand for money, is equal to total supply, including the supply of money. Put succinctly, an excess demand (supply) for money equals an excess supply (demand) of goods. The question has always been if recessions and economic crises originate on the supply side or the monetary side, and whether these occurrences are endogenous to the market.

Highlight (Geel) | Locatie 319

In the relative short-run, individuals tend to look at prices, costs, and income in nominal terms. Evidence has shown that there are psychological reasons market participants are often unwilling or unable to distinguish between real values and nominal values, the difference being the adjustment for changes in the purchasing power of the medium of exchange. Historical costs in business accounting are another factor creating illusory gains by entrepreneurs who only see the prices of their products rising, but not the prices of the inputs they must purchase. This version of the money illusion creates losses and capital consumption during inflation. But what of deflation?

Highlight (Geel) | Locatie 324

When aggregate demand falls and businesses must find ways to maintain market share, they typically attempt to lower costs, particularly labor costs. This is achieved by either 1) reducing wage rates or 2) laying off employees. The former is more difficult to achieve than the latter, and is often resisted by workers. Employers

do not wish to lower their selling prices right away because they do not want to risk losing profits to competitors, so the optimal choice would be to lower the wage rates of their employees in order to keep price margins from shrinking. However, workers often resist lower nominal wage rates. They see this value of their labor as “objective” in the same way they observe other units of measurement like meters or inches, and view wages as a comparison to their real contribution to the economy. This is an especially potent perspective if workers’ expectations are anchored to previously earned nominal wages, even if those wages have not kept up with inflation, hence lowering their real wages. It is debated among economists how potent the money illusion is, and is perhaps more deceiving during a period of deflation. Prices of consumer goods have a greater tendency to fall before the prices of inputs, including wages, and this increases the real wages of workers. Yet workers usually reject any notion of lowering their nominal wage (for reasons made below) even during a period of falling prices, and this keeps wages too high relative to selling prices, thus creating unemployment. The workers are not aware that even though the nominal amount they are paid per unit of time has not shifted, the lower prices of consumer goods now raises the purchasing power of their wages. If they were to accept the lower wages that employers were perhaps willing to offer, the actual market value of their real wages would have not changed from where they were before the deflation. Workers see the nominal wage rates they have as a proxy for real value.

Highlight (Geel) | Locatie 388

The slope or elasticity of these curves can be influenced by other considerations. The reservation wage is usually higher when a worker can rely on government welfare, unemployment benefits, or disability payments during a recession. In a market free of government intervention such as these, reservation wages would tend to be lower. But, in terms of the business cycle these wages will likely be too high. A worker who has sufficient savings to “bridge the gap” between jobs will likely have a higher reservation wage because they can afford to wait a longer time before finding employment based on their assessment of their productivity. The same reasoning applies to assets and net worth. The higher the value of a worker’s assets and income derived from those assets is, the lower their reservation wage is likely to be. If they are released from employment and wish to sell assets in order to maintain their current lifestyle instead of lowering their reservation wages to find a source of income quicker, they may choose to do so. Also, workers not only tend to view their wages as a proxy for their self-worth, but also in comparison to others. If a worker notices that their neighbors and acquaintances have procured job security while maintaining above average wages, that worker may choose to hold out for a better-paying job in order to “keep up with the Joneses.” During recessions, there are often workers with higher marginal productivity that tend to remain employed, while lesser productive workers are laid off. These concepts mentioned can make the reservation wage relatively inelastic with respect to job opportunities and can prolong unemployment during a recession. Employee

Highlight (Geel) | Locatie 425

Bewley has found empirical evidence through numerous interviews and surveys that workers lean towards loss aversion when given a choice between lower nominal wages and being released from employment. The cut in wages lowers their “psychic income” more than being laid off or fired and that “would cost the firm more than the pay cut would save, so that it would be profitable only if workers accepted it.”

Highlight (Geel) | Locatie 440

Prior to the twentieth century, economists generally realized that in times of duress, wages and prices should be allowed to fall in order for labor and capital to be reallocated to more worthwhile production processes. The division of labor would be able to restructure itself promptly with little resistance by exogenous forces. However, in 1914 Henry Ford began publicly supporting what is now known as the high-wage doctrine, which essentially stated that raising wages during a recession increases workers' purchasing power and their higher incomes allow them to increase demand enough for businesses to increase production and employ more workers. He announced that Ford Motor Company would be paying workers five dollars a day for eight hours of work per day. In the 1920s it was raised to six dollars per day, and during the Great Depression it raised the wages of the workers to seven dollars per day. This allowed the concept to gain popularity in the U.S. during those two decades, as Selgin and Taylor (1999, pp. 6-7) state "within a year of instituting the five-dollar day, annual labor turnover at Ford factories fell from 370 percent to sixteen percent, productivity was forty to seventy percent higher, and profits were up about twenty percent."

Highlight (Geel) | Locatie 454

Both Foster and Catchings' *Business Without a Buyer* (1927) and Withers' *Poverty and Waste* (1920) anticipated the policy implications of Herbert Hoover's presidency during the early years of the Great Depression, explaining that higher wages paid to workers actually benefited businesses because workers were also customers, and needed the additional purchasing power to increase demand and economic output. Not only economists, but business leaders and industrialists supported related versions of this doctrine in the 1920s and onward. These included Julius Rosenwald who was part-owner of Sears, Boston retailer Edward Filene, Thomas Edison, and Magnus Alexander. Some of these men as well as others in the business community eventually supported minimum wage policies after the stock market crash of 1929. In fact, it is often asserted that Hoover's economic policies forced market wages higher than they otherwise would have been, creating unemployment during the 1930s that rose above twenty-five percent at one point.

Highlight (Geel) | Locatie 462

What is true is that these laws and policies such as the National Industrial Recovery Act of 1933 (NIRA) were mostly suggestive measures meant to convince businesses to raise wages in order to stimulate a recovery. In essence, it was voluntarily accepted by a vocal part of the business community. In November of 1929, Hoover held a conference with twenty-two major industrialists and business leaders and was given reassurance that "there was no reason why business should not be carried on as usual." Despite the popular canard that Hoover forced wage floors on the economy, the press release from the White House (*Bulletin of the United States Bureau of Labor Statistics* 1931, p.34) shows that these business and organized labor leaders largely agreed with this doctrine:

Highlight (Geel) | Locatie 483

While it seems obvious that government interference in the labor market often causes unemployment and misallocated labor, during the two decades leading up to the Great Depression, it was business leaders and industry in general that contributed to the mindset that higher wages will increase spending and market activity enough to stimulate output and employment.

Highlight (Geel) | Locatie 486

This is an important point for two reasons. First, advocates of the free market often blame the government for unemployment due to minimum wage laws, and point to the depression as an example of when wage rates were kept above their market-clearing levels, which caused an average of seventeen percent of workers to be unemployed during the early to mid-1930s. Now, we can see that this was, at least in part, not the fault of government, but of the market itself. Second, this mindset by businesses and economists not only prevails today, but has grown ever since then with a certain ratchet effect that has also heavily influenced the general population. While it is true that a genuine free market will no longer have minimum wage laws, unemployment benefits, and other government policies that tend to reduce employment opportunities due to making wages less flexible, it seems obvious that market psychology can still promote faulty economic theories that can create de facto price floors in an unhampered labor market. It was the conventional wisdom of the 1920s and 1930s that “would serve as a major force behind one of the most significant labor-policy developments of the century: the minimum wage” (Selgin and Taylor 1999, pp.

Highlight (Geel) | Locatie 498

1938. While it is true that the real value of the minimum wage has fluctuated and has decreased by over thirty percent in the last fifty years, it has steadily increased in nominal terms which is more important in terms of wage rigidity during the business cycle. Without government legislation requiring federal minimum wage enforcement, one could argue that, in a pure free market, nominal wages would be allowed to fall depending on the economic environment and wage flexibility would increase. Yet, there is still significant market support for maintaining wages even during times of positive economic growth. It is arguable that during a recession, there is a lesser probability that workers would accept lower wages, whether the money illusion is present or not.

Highlight (Geel) | Locatie 504

Putting aside general polls and surveys (most show that the majority of U.S. citizens support higher minimum wages), higher pay for workers in the form of a federal minimum wage has shown increasing support in the business world, similar to that of the decade or so before the Great Depression. Amazon has pledged to raise the minimum pay for all full-time and part-time employees, including seasonal employees by late 2018. Target has made a similar promise to raise worker pay to at least fifteen dollars per hour by 2020, while Walt Disney Theme Parks, Ikea, GAP, Ben and Jerry’s, and Walmart have all increased their minimum pay to employees in the last several years. In addition, a 2015 survey by Employment Policies Institute showed that sixty percent of economists who participated favored a rise in the minimum wage from \$7.25 per hour, which was over twenty percent higher than it was a decade prior. What matters is not the implications of a rise in the minimum wage, but the support of maintaining wages above market-clearing levels by today’s companies, intellectuals, and public figures. Even if the minimum wage were abolished in a free market, there will still be significant bias by market participants, the media, and employers towards keeping wages high, whether it is because of the high wage doctrine, efficiency-wage hypothesis, or welfare considerations.

Highlight (Geel) | Locatie 522

During a recession, households cut spending on consumer goods and entertainment and use a larger percentage of their disposable income to pay down private debt. For related reasons mentioned earlier, private debt is

nominally contracted and is thus subject to the money illusion, causing market participants to stubbornly resist lower wages due to their desire to reduce real debt levels in terms of their incomes during times of recession.

Highlight (Geel) | Locatie 1180

In its most popular form it states that during an economic boom stimulated by artificial credit expansion, incomes from wages and entrepreneurial profits enable spending on consumer goods, which raises demand and thus prices. This causes wages to lose purchasing power, thus lowering real wages. When businesses see that real wages are falling, this indicates that their selling prices are rising relative to labor costs, which incentivizes them to use more labor in proportion to capital when creating their products. This definition

Highlight (Geel) | Locatie 1193

In the artificial boom story, the Ricardo effect works in the opposite direction. Rather than an increase in voluntary savings by citizens, the banking system injects artificial credit by lowering market interest rates below the unobservable natural rate. This increases investment during an economic slowdown or recession. Income in the form of rents, profits, and wages rises. The main difference between this story and the former is that consumption has not fallen. While interest rates have fallen, the demand for consumer goods on the part of citizens has not. This creates a mismatch between social time preferences and the natural rate. The owners of the factors of production have increased incomes, and since their chosen demands have not actually changed relative to before the increase in credit, consumer goods industries are stimulated, followed by their prices rising. In the former situation, there was a temporarily reduced supply of consumer goods since the desire to spend on longer term investment rose. This was met by a more than offsetting reduction in the demand for these final goods, allowing their prices to fall and real wages to rise. Currently the demand for consumer goods does not fall, thus their prices rise ahead of wages. This causes a fall in real wages, and the use of more labor-intensive methods of production since the cost of labor has fallen in terms of their percentage of profits. This

Highlight (Geel) | Locatie 1222

The most important thing to note is that businesses do not concern themselves with what economists call real wages. These are calculated by deflating the nominal wage rate with the price level. There are a few shortcomings to this concept that we will cover briefly before Cowen's point can be critiqued. First, there is no such thing as a "price level". There are only individual prices, which are more relevant to estimating profits relative to business costs. This also applies to wages. There are thousands of different jobs and industries that employ a multitude of employees with a different range of skills and pay. In essence, real wages are too much of an aggregation for entrepreneurs to be able to calculate their profits accurately.

Highlight (Geel) | Locatie 1227

Second, real wages in this context are not relevant because businesses look more at their own profits compared to their employees' wages, not the rate of consumer goods price increases, also known as the consumer price index (CPI). This is because the capital structure consists of many businesses that are higher up in the supply chain, or in earlier stages of production before consumer goods industries. In being consistent with Austrian theory, both nominal and real wages (and therefore costs) do rise during the credit expansion and ensuing

economic boom. Unfortunately, Hayek did not seem to recognize that real wages are not the issue, and wrongly insisted that they would always fall. In fact, he saw the case of rising real wages as a 'special' case, and not the general case in his later work.

Highlight (Geel) | Locatie 1241

What truly matters to businesses in terms of whether to hire more workers or increase the use of capital in production is the element of time, which often supersedes their desire for productivity due to the possibility of increased profit. This is because of the concept that Hayek referred to as "turnover". It is a businessman's turnover, and refers to the period of time it takes an entrepreneur to get back his initial investment, in value terms. Thus, the rate of turnover is the number of times an amount of money that is spent on a particular investment is earned back through revenue as a result from that specific input. The profit earned on the turnover of a given amount of labor is the difference between the specific wages and the marginal product that labor. If the price of a product rises the turnover profit does as well regardless of the length of said turnover. However, the time rate of profit increases proportionately more for labor used in shorter periods of turnover than in longer periods. A simple numerical example of this is explained by Tyler Beck Goodspeed (2012, p. 155):

Highlight (Geel) | Locatie 1256

As we can see, the technique that has a higher turnover also obtains a higher profit per unit of time. This applies to labor and is called the time rate of profit. Notice the technique that has the lower rate of turnover has a higher profit margin of six percent at first than the technique with the higher rate of turnover at three percent. When profits increase, the latter yields a ten percent rate of return and the former eight percent. This will cause entrepreneurs to use less capitalistic methods in production. Toward the end of the boom, consumer good demand rises and so do profits in the industries that produce these goods because of the increased employment of workers in the earlier stages of production. The producers of consumer goods want to increase production to meet this growing demand. They can either hire more labor to do it or they can buy more equipment. The important point here is that labor as an input has a considerably shorter turnover than capital. Put differently, it takes more time for capital to get a return on investment in monetary terms than it does labor.

Highlight (Geel) | Locatie 1263

Thus, in the short-run, businesses will choose to use more labor in the form of extra shifts or overtime hours (in addition to hiring more workers). They can get more profit by increasing the labor/capital ratio in favor of labor as demand for their products rises. This addresses Cowen's other point that the Ricardo effect emphasizes capital and labor substitutability, rather than complementarity. Increased use of labor with existing non-durable machinery can and may occur if the turnover of labor is high relative to more capitalistic production methods. This does not pose a problem to the Austrian position as he claims. Calculating real wages is something economists do in order to utilize data for determining appropriate policies to mitigate stagnating wages, lower incomes, unemployment, and declining economic growth. This was a mistake even Hayek made in some of his work on the topic, and explains the misinterpretation critics have for the Ricardo effect.

Highlight (Geel) | Locatie 1270

The business world, on the other hand, looks simply at nominal profits and revenue. They most often do not account for inflation-adjusted prices during the boom, not do they pay attention to aggregate nominal or real wages. This dovetails nicely with other aspects of Austrian business cycle theory which will be discussed later. Furthermore, since the Ricardo effect usually begins at the peak of the boom, the economy is at full capacity or close to it. This could also allow businessmen to use less efficient and older equipment which were previously laying idle or in storage. What will result is lower productivity, particularly in the later stages of production closest to consumption. Since employing more labor with the same amount of capital, or using less productive capital equipment causes diminishing marginal returns, this lowers overall productivity in the economy. But businessmen are willing to sacrifice productivity for the sake of short-term profits.

Highlight (Geel) | Locatie 1277

Procyclical real wages are a sign of increased productivity, but apply mostly to labor in the early stages of production, not in consumer goods industries. This is because artificial credit expansion brings about increased technology and other more 'roundabout' methods of production which increase productivity. The same is not true in consumer goods for the reasons made above. Perhaps the reason why real wages rise only modestly during the upswing of the business cycle is due to inflationary pressure from price stabilization policies. With increasing growth in the economy due to a supposedly proportional increase in productivity, real wages should rise in conjunction with growth. However, this is often not the case. Thus, real wages will remain procyclical, but the rate of their growth may be suppressed considerably due to inflationary policies by the central bank. This explains the phenomenon of co-movement in terms of wages and production that concerns Cowen. It is not real wages that businesses consider in the short-run during the business cycle, but nominal wages and prices. Real wages can rise during the latter part of economic expansion due to increasing productivity, but they will fall relative to revenue.

Highlight (Geel) | Locatie 1285

Another implication of the Ricardo effect is the relevance of uncertainty, a concept emphasized by both Austrians and post Keynesians. Prospective profits are always more attractive in the short-run, particularly in production stages that rely more heavily on higher social time preferences (consumer goods industries). With the risk of losing business, both in the near future with short-run sales and the further future with permanent customers, entrepreneurs have a higher incentive to "make hay while the sun shines". In other words, immediately increasing production to meet short-run demands becomes a greater importance than long-term endeavors. Businesses may do this for different reasons. As the boom continues and prices and profits increase in the consumer good industry, entrepreneurs will not be certain as to how long this trend will continue. Short-term demand may be maintained for a considerable amount of time, but it is less certain the longer the period under consideration. Thus, businesses will have a justified reason to increase short-run production at the expense of capital spending, reinvestment, or other longer terms advancements. Professor Fiona Maclachlan, a post Keynesian, mentions this in her book *Keynes' General Theory of Interest: A Reconsideration* (2013). Since the future is uncertain and production has a significant time element, the Ricardo effect proper, as Maclachlan calls it, leads to an increase in the output of consumer goods since businesses do not know how long the increase in consumer demand will last, so they take advantage of these short-term profit opportunities. While she finds

several faults with Hayek's Ricardo effect, she agrees that an increase in consumption demand will lead to a fall in investment, particularly in capital goods industries.

Highlight (Geel) | Locatie 1313

To the extent that consumer goods businesses use the same machinery, which can be more durable, they will utilize this equipment more intensely. The reason for this is that they expect higher costs in the future due to the bidding for nonspecific factors (labor). The specificity of the durable capital means it cannot be reallocated easily, and must be used in accordance with the complementary nonspecific labor. With the increased cost of this labor in the future, businessmen see profitability being more obtainable now rather than later. This can also be because of our earlier reason of uncertain future demand for consumer goods. Thus, they increase output now using durable machinery, increasing production to the advantage of the lower cost of labor now. This has several implications related to the Ricardo effect. First, it explains the co-movement in both consumer goods and investment goods production during the boom. Despite Cowens' assertion that this should not happen in the Austrian explanation of business fluctuations, we can see that since the increase in investment takes time after interest rates fall, output in consumer goods industries tends to increase due to uncertainty and the expected increase in the cost of labor. Second, it acknowledges that real wages rise later in the boom which, again, shows that Cowen is mistaken in his claim that the increase in real wages disproves the Hayekian notion of a capital and labor switch in techniques during the business cycle. According to professor Bilo, with the increase in demand for complementary nonspecific labor from the early stages of production, real wages will rise in the future due to the previously mentioned lag. And this rise in real wages does not mean that profits cannot be maintained in the later stages due to the relatively high rate of turnover for labor. While this seems to lead to more capital use in both the early stages and later stages of production in the short-run, it will eventually lead to less capitalistic production methods in the future due to capital depreciation which brings us to our third point.

Highlight (Geel) | Locatie 1363

The canonical version of the Ricardo effect can be supplanted by a more robust model that emphasizes relative nominal wages, and their relation to sales and revenue in consumer goods industries. This will determine the turnover rates of less capitalistic methods of production. The uncertainty of future demand coupled with the certainty of future higher labor costs due to competition reduces the durability and market value of capital equipment. These forces bring a growing economy based on inflationary monetary policies to a grinding halt. While the latter increases the likelihood of the bust if it is assumed aggregate savings are not sufficient to compensate for the lack of renewal in the capital base, the former changes the entire composition of capital to restructure due to entrepreneurs' most important endeavor being the profit motive. Hayek deserves credit for bringing this catalyst of recession to the forefront of Austrian business cycle theory. He also deserves criticism for not properly integrating it into a more general explanation of capital theory, forming a comprehensive framework for further research. Perhaps with less focus on real wages, which are a macroeconomic concept, and more emphasis on specific wages in terms of profits, which are based on microfoundations, economists can revisit the Ricardo effect with an open mind as to how an economic boom can self-reverse merely through the price mechanism.

Highlight (Geel) | Locatie 2290

While Garrison's version of the equation of exchange attempts to explain the distinct effects of how derived demand and the time discount principle can guide the intertemporal allocation of output, our intention has been different. Using Austrian microfoundations and monetarism's emphasis on the velocity of money, the meso-stage model explains how disaggregating the demand for money and total output can show that nominal changes have real effects. The divergence of the pre-income and post-income demand for money due to false market signals created by the central bank can cause dysfunction in the Mengerian capital structure between consumption and investment, leaving the intermediate stages to dissolve as resources and capital are consumed without the proper supply of savings to maintain the price system's coordinating effects. And although our model retains the core tenets of Austrian business cycle theory, it does not understate the importance of money's effect on real macroeconomic activity. Thus, we see that it simultaneously satisfies the underpinnings of modern monetarism.

Highlight (Geel) | Locatie 2360

What Hoppe fails to realize is that the value of money, like all economic goods and services, depends not only on one's individual reservation demand and exchange demand for money, but more importantly on the aggregate supply of and demand for money. Even in the kind of gold-based monetary system Hoppe supports, an increase in the purchasing power of gold would induce miners to extract gold naturally from the earth and this would, at least temporarily, affect the supply and price of gold as a currency as it tends to its equilibrium level. Whether in a fractional reserve banking system or a hundred percent full reserve system, the value of money must be determined, at least in part, by short-run increases or decreases in the supply of money. By asserting that increasing the money supply in a free banking system is indefensible because it reduces the value of individuals' money holdings, Hoppe is making the exact same claim of conservative socialism that preserving the recent historical allocation of wealth and value is of the utmost importance with regard to the status quo, regardless of the workings of supply and demand and their effects on the price mechanism. While the latter argues in favor of preserving the value of fixed goods like land and capital, Hoppe views money as such "wealth" that must not lose value regardless of the benefits a fractional reserve free banking system brings. Selgin and White (1996, pp. 92-93) explains Hoppe's obvious confusion,

Highlight (Geel) | Locatie 2377

Notice the use of the word inescapable when referring to the effects of one's market actions on another's monetary wealth. Considering that all economic decisions are made on the margin, even the smallest exchanges can change sellers' perceptions and market prices slightly and thus affect the decision-making process for any number of individuals. Hoppe incorrectly sees this as a negative externality, or what economists commonly call a technological externality. This conforms to his self-described socialistic view that sees a reduction in purchasing power of money stemming from the practice of fractional reserve banking as a more tangible violation of property.

Highlight (Geel) | Locatie 2402

If customers are aware and voluntarily accept the fractional reserve status of their respective banks, and it is agreed that this can theoretically avoid the charge of fraud as Block (1988, p.29) and particularly Hoppe (2006, p. 201) admit, then Hoppe's specific criticism of externalities falls apart.

Highlight (Geel) | Locatie 2497

The vision that Hoppe has for banking is one in which banks are not free regardless of their efficiency, intentions, or transparency even if these things protect these institutions from the charge of fraud. Therefore, this is in yet another way that Hoppe's monetary theory and hundred percent reserve views can be described as socialistic. And while Rothbard never explained how such a banking system would be enforced without a state, Hoppe has never devoted any space in his work for how a society will abolish the existing worldwide system of fractional reserve banking without a state. If the state is abolished but the banking system does not end with it, who will impose force to eliminate an international fractional reserve banking system? He does not say, but his assertions remain. The prohibition of the means of production in money, the enactment of de facto price controls, and the insistence that "freedom of contract does not imply that every mutually advantageous contract should be permitted" can only mean that Hoppe cannot be categorized as an advocate of free markets. By his own admittance he is a socialist of the conservative variety.

Highlight (Geel) | Locatie 2578

It is now apparent that Salerno's insistence that the definition of praxeology be the litmus test for Austrians must necessarily exclude two of its founding members, Carl Menger and Eugen von Böhm-Bawerk, since praxeology views empiricism as being unnecessary and incapable of rejecting the axioms derived from the praxeological method. Clearly, these "masters" cannot be considered members of Salerno's exclusive Austrian tradition. Furthermore, there are other highly regarded Austrians from the third and fourth generations that also did not fully accept Mises' purely deductive method.

Highlight (Geel) | Locatie 2582

Fritz Machlup, for instance, did not "hold that the elements of economic theory are somehow true a priori," according to Richard N. Langlois and Roger Koppl (1991, p. 90). Instead, Machlup finds a position that supports observation verifying theoretical systems but remains skeptical as to their necessity for generalizability. This point is solidified in his work on international trade (1950, p. 68):

Highlight (Geel) | Locatie 2590

Machlup, while clearly skeptical of the predictability of historical and statistical research methods, does not believe that it should be discarded in favor of pure deductive reasoning like that of Mises' praxeology. In fact, he uses such statistical methods in his work on capital consumption to show the disastrous effects of inflation and tax policy. In his paper "The Problem of Verification in Economics" (1955), he states,

Highlight (Geel) | Locatie 2599

Other early Austrians that ultimately rejected the purely deductive method in economic theorizing are Gottfried von Haberler and F.A. Hayek. While Haberler (1933) was more overt in his critique of the praxeological method, Hayek's position was less pronounced, at least to Mises. In his famous 1937 article "Economics and Knowledge," Hayek deviated from Mises' position of apriorism, seeing economics from a macro perspective, as an empirical phenomenon. Hayek makes this very clear in Hayek on Hayek: An Autobiographical Dialogue (1994, p. 72), What

Highlight (Geel) | Locatie 2676

In truth, Salerno incorrectly treats capital and labor as a homogenous blob in the aggregated “black box” framework that neoclassical economists have used. Capital is, in fact, heterogenous. It is made up of millions of factors of production with different purposes, durabilities, users, and constraints. When capital is shown to be inefficiently allocated to a given stage of production, it must be liquidated, bought or rented, refit with other appropriate capital goods and factors of production to produce more specific goods, and maintained to prevent depreciation. Capital utilization and reallocation imposes transaction costs, transportation costs, intertemporal costs, and depreciation costs on the market. Any change in the market data, including the demand for money, necessarily imposes costs on the reallocative nexus of the capital structure. In other words, capital has a multi-specificity dimension, substitutability dimension, and a complementarity dimension which determines the rate at which disequilibrium can, but not necessarily, be corrected for. The market value of capital, and therefore the severity of the disequilibrium, is based on how it can be fit and refit in the structure of production during market adjustments. This is ironically the capital theory of Lachmann which Salerno seems to ignore, while simultaneously claiming he takes disequilibrium seriously. The same analysis applies to the heterogeneous labor that must be re-trained and readjusted to market disequilibrium.

Highlight (Geel) | Locatie 2719

This provides a problem for the Austrian equilibrium-theorizing. If the tendency towards equilibrium requires the proper knowledge and therefore appraisal of future market conditions, how does one distinguish between an economic miscalculation being made by an entrepreneur or consumer, and a lost opportunity for potential profit in a given production process? Does only the first constitute a tendency away from equilibrium? If not, how can Salerno ever identify an opportunity forgone if he cannot even identify that opportunity ex post due to its inherent subjectivity? In other words, how can the equilibrium models and praxeology assert that the market inherently tends toward equilibrium when these methods cannot ever recognize a profit opportunity that was not identified, nor equilibrated? Jonathan M. Finegold Catalán (2012) gives a concrete example,

Highlight (Geel) | Locatie 2732

The very nature of the market process is disequilibrium, and to question the ability of the market to overcome these knowledge problems is not to assert that the kaleidic nature of economics is akin to chaos. It is to contextualize and highlight the inherent subjectivity, and therefore immeasurability, of the human mind. Does this mean Austrian punks should accept indeterminateness or non-finalism in economic theorizing? It seems, despite Salerno’s assertions that austro-punkism views Austrian economics “as a discipline in a state of constant and radical flux,” that the younger Austrians have found a way to attempt to reconcile the differences between themselves and Salerno’s Austrian economics proper.

Highlight (Geel) | Locatie 2778

To reject praxeology is not to reject deductive reasoning entirely, but to supplement it with observation regardless of how limited its effectiveness is. To embrace empiricism is not to embrace the worst of mainstream economics, it is to integrate the aspects of economic theory which Austrians may have missed or ignored.

Highlight (Geel) | Locatie 2794

One suggestion would be to find the nucleus of the real Austrian school. Salerno rejects the notions of subjectivism and methodological individualism on the basis of their lack of specificity, citing orthodox economists who could be connected with them but could not be labeled correctly as Austrians. However, if we remember the inability of pure praxeological reasoning to identify certain paradoxes within the Austrian theory of disequilibrium and money, perhaps there is another concept that fuses the two terms mentioned above which requires deduction, empiricism, and other methods to analyze and understand it; methodological subjectivism. Hayek himself stated that every great advancement in economic theory for the last century has been established consistently with subjectivism. In contrast to Salerno's approach, Hayek finds nothing objective about certain "laws" of economics unless we can understand the intentions of individuals, and with the passage of time these intentions and perspectives may change, thus altering the nature of our understanding (1979a, p. 53),

Highlight (Geel) | Locatie 3505

As before, economic history will be the focus since the author makes several false claims as to the origin of our current economic environment. To start, one should question the dubious claim that manufacturing has decreased in any real sense. The problem with his assessment perhaps stems from his tendency to look at production from a physical standpoint instead of a subjective value standpoint, which is economically more relevant. To be sure, the total real output of manufacturing has been rising significantly in the past few decades. It nearly hit an all-time high in 2015, with the output of durable goods three times higher than it was in 1980.

Highlight (Geel) | Locatie 3510

The value of each worker's output has risen proportionately as well. Recessions, including 2008-2009, typically reduce employment and output in the manufacturing sector, but historically that has not stopped the progression of productivity and thus real incomes for workers. In fact, when this rise in value output is compared to other major countries, it is seen that the U.S. is not in a "seventy-year decline" as Rickards states. Other than China, the growth of American manufacturing has outpaced other major countries in the last several decades.

Highlight (Geel) | Locatie 3515

More importantly, according to economists John W. Kendrick, Robert E. Gallman, and Thomas J. Weiss, both the output and labor force associated with manufacturing and industry have actually been lower than service sector output since at least 1840.

Highlight (Geel) | Locatie 3518

Instead of taking Rickards' unsubstantiated claim that the fall of manufacturing and industry was caused mainly by currency manipulation and protectionism from countries like China, we find that manufacturing as a percentage of the total U.S. economy was never really the dominant force relative to the service sector as is widely believed. However, further inquiry is needed to determine the cause of the fall in the amount of jobs in manufacturing and industry, especially since it is obvious that output in both physical and value terms has risen in recent decades. We can see clearly that private-sector employment for the production of goods, with

manufacturing included, in the private sector as well as a percentage of total private-sector employment has fallen steadily since World War II. This fact will be applied to our discussion below after wages and income for both manufacturing and the economy in general are dealt with.

Highlight (Geel) | Locatie 3525

It is often claimed by political commentators that wages in the U.S. have been stagnant for the last few decades, but this is a mistake in methodology. Economist Donald Boudreaux (2014) has recently found that wages have not “decoupled” from productivity which has risen exponentially, despite Rickards’ claims:

Highlight (Geel) | Locatie 3550

This shows that Rickards does not take into account these factors which is surprising considering his in-depth focus in each of his books on the effects of inflation on wealth distribution and accumulation. To be clear, his motivations are not being questioned here, just his methods for analyzing data and the inconsistencies that his newest book shows. In addition to this wage productivity analysis, Boudreaux and other economists have found a similar trend in U.S. income distribution. Since the early 1970s, the percentage of middle class and lower-class households dropped considerably, while wealthier income households more than doubled between 1975 and 2009. Thus, more people have been moving to higher income brackets. This can only mean wage and income mobility is 1) due to higher value productivity and 2) becoming more flexible making upward movements less difficult for former lower-income families to obtain higher standards of living. Thus, the claim by Rickards that the middle class is stagnating due to job losses and wages not rising is clearly not true. The question remains, however, of why employment in the production of manufactured goods and exports have fallen while the total value of output and incomes of those workers still in those markets has risen exponentially. The answer is, in fact, quite simple. Productivity gains from improvements in information technology and automation have allowed workers to create more output with an increase in the amount of capital accumulated. In essence, fewer workers are needed to create the output necessary for businesses to compete. According to a study done by Michael J. Hicks and Srikant Devaraj (2017) of the Center for Business and Economic Research at Ball State University:

Highlight (Geel) | Locatie 3568

Putting these facts into context, there is no denying that U.S. wages, when fringe benefits and proper inflation adjustments are accounted for, reflect manufacturing and productivity gains since Rickards’ aforementioned period of higher growth and incomes ending in 1971. This flies in the face of his assertions that free trade is an obsolete concept which no longer applies to international economics. Protectionism did not play the huge role he claims that turned the U.S. into a dominant economic power because manufacturing has composed a relatively small part of the U.S. economy since at least the middle of the 1800s. And while currency manipulation may have a negative effect on trade flows and export markets, it is obvious that the areas of the market most affected by this can not only breathe, but flourish regardless of foreign protectionist barriers and currency wars. However, there are still some flaws in his economic analysis that need to be rectified.

Highlight (Geel) | Locatie 3580

The claim by Rickards of lower productivity and stagnant wages has already been refuted. However, labor participation is often cited as a problem of our shifting economy and supposedly indicates that many capable people are dropping out of the workforce. Fortunately, this has more to do with demographics than free trade. The trends we are seeing are that older citizens are retiring in larger numbers and women in general are choosing not to work as much as they did in the past. In addition, our youth are extending their educations and going to college, sometimes for longer periods. This follows the basic premise that markets tend to adjust. Rickards connects this lower rate to the manipulation of free trade. But there is a problem with this. There is no shortage of jobs. We live in a tremendously intricate division of labor, and that system is constantly changing. Jobs are being added or changed, or sometimes even becoming obsolete. But to think that the number of jobs in the U.S. are somehow fixed is a fallacy. Economist Richard Ebeling (2010) writes:

Highlight (Geel) | Locatie 3591

Since labor is part of a heterogeneous structure of inputs, there are costs involved with refitting and reorganizing proportions of labor with capital in order to create new products or improve old ones, thus creating new ways to improve this structure of production. Rickards pays lip service earlier in his book on the “varied and diverse” forms of capital and labor especially, but fails to apply this statement when looking at jobs as an aggregate concept. The main point is that there is always work to do since diverse desires and demands are never truly satisfied in an economic sense. The lump of labor fallacy, as well as comparative advantage, is a topic that many economists typically agree on, and many of them can certainly not be described as “neoliberal” or “elite globalists” as Rickards states. He then proceeds to mention that the kind of labor that doesn’t provide positive externalities are what the U.S. is left with due to other countries manipulating free trade:

Highlight (Geel) | Locatie 3600

There are several faults one can find in just these few sentences alone. The first is the concept of externalities. It is true that businesses in foreign countries often create negative outcomes with questionable production techniques (Rickards’ example of China dumping cyanide into rivers is a legitimate concern), and that is inexcusable. But to deny the existence of positive externalities with service sector jobs ignores a concept called derived demand. When someone becomes a barista or a retail clerk, they instantly provide new effective demand in the market. For example, if they demand a new pair of tennis shoes, that means, on the margin, the demand for all of its inputs or factors of production increase as well. So, with demand for leather, rubber, and other synthetic materials increasing, the need for more labor and capital, not to mention research and development, to extract and utilize these materials to make these shoes means that wages and jobs will increase in those industries, as will profits. Rickards fails to understand this important positive externality.

Highlight (Geel) | Locatie 3607

Another point he makes in regard to high-valued manufacturing jobs that enable supply chain improvements in labor and capital processes is more nuanced than he realizes. The fact is there are no nations on earth with totally local manufacturing supply chains located strictly within their boundaries. Quite often intermediate products and unfinished goods are transported to other countries where they are completed or worked on further. Rickards is

not completely accurate in his assumption that an improvement in the supply chain from domestic manufacturing jobs will automatically create more jobs here in the U.S. In fact, this trend has actually been reversing for the past few decades, but it will not be discussed at length in this essay. Suffice it to say that economies of scale are becoming less relevant over time and manufacturing as a “cultural icon” or a nationalistic concept is a fading ideal.

Highlight (Geel) | Locatie 3626

As a writer on monetary economics, Rickards should be more focused on the effects of monetary factors on prices of final goods and costs of inputs, instead of looking at growth as an objective indicator of value. Recently The Economist has questioned the usefulness of GDP as a measure of wellbeing, among a diverse array of economists. The usual reasons that GDP is not as useful as is thought by the mainstream is that it counts “goods” as well as “bads” which falls for the broken window fallacy, it omits black and gray markets which make up a considerable part of the production structure (especially with barter), and does not consider leisure as an economic good and thus overemphasizes the importance of work instead of relaxation which is a real measure of wealth. In fact, people work less today than they did before World War II. So it seems Rickards’ obsession with growth as a measure of economic well-being is misleading at best, and only gives a rough estimation of the wealth of a nation over a period of time. But perhaps the most egregious error of GDP is its inability to account for advancements in technology.

Highlight (Geel) | Locatie 3634

Fifty years ago, the U.S. had much higher growth on average than today, yet the technology we possess has changed our lives and wealth in multiple ways. Obviously, the prices of phones, computers, and other similar technological innovations have generally decreased substantially, despite an otherwise inflationary environment. Not only does this improve the wealth of all individuals, it also reduces the prices of inputs and the time it takes to organize them to create the products which is beneficial to businesses as well. These technologies provide things that are not always tangible such as information, data, education, services, and networks. These are often free as well, like free banking apps or stock trading on an iPhone, which is not accounted for in GDP. This does not give an accurate picture of how American lives have improved to such a large degree in the last several decades, due to shorter working hours, increased value productivity, lower prices for life-enhancing information technology, and an increasing network of information and communication. None of these things are tangible and thus are largely ignored by conventional GDP accounting standards.

Highlight (Geel) | Locatie 3666

His other error is in looking at China specifically. He first states that China has cheap labor costs, but then goes on to say that it is due to this labor being more efficient than U.S. labor. This flies in the face of common economic theory. With higher labor productivity, labor costs like wages and benefits tend to rise proportionately. The reason for this higher productivity can be attributed to more and better capital, better education, better training, and a more stable legal system protecting property rights. U.S. workers are more productive; thus, they can demand higher wages than Chinese workers, and they have better options. And it is true that this can make it more difficult for U.S. manufacturers and exporters, but the source of the discrepancy is not what Rickards believes.

Highlight (Geel) | Locatie 3674

But even the assertion that China has a large effect on our economy in terms of employment and prices is false. According to economists Jay H. Bryson and Erik Nelson, the U.S. is not very dependent on China's economy, especially its export markets. Only seven percent of U.S. exports are sold to China, and that is less than one percent of GDP. This means that even under the commonly held belief that the devaluation of the Chinese currency, the yuan, will reduce prices of their exports as well as make U.S. exports less competitive, this will not result in major job losses or significantly lower growth that Rickards so passionately asserts. On the contrary, the depreciation of the yuan improves the purchasing power of U.S. citizens in terms of Chinese imports and has little correlation with U.S. consumer prices. As Bryson and Nelson (2015) state:

Highlight (Geel) | Locatie 3989

As a corollary to the lack of faith in empiricism on business cycles by the Austrians, their perspective on how to solve these cycles (other than by "ending the Fed") is to sit back and let the market correct the disequilibrium caused by government intervention. This has several implications. First, advising that the government and central bank sit on their hands to let markets clear is a second-best solution, even in terms of Austrian theory. It is usually embraced in libertarian circles because it is the politically equivalent philosophy. This is not to say those two entities should counteract a downfall in the economy's performance. On the contrary, the market should proactively solve these issues rather than let either the Federal Reserve or the price mechanism do all of the work. Two examples of this stand out. To start, the Federal Deposit Insurance Corporation (FDIC) is a bank deposit insurance corporation run by the government which insures depositors in U.S. banks and savings institutions. It was created with the Banking Act of 1933 during the Great Depression to prevent bank runs on institutions that overextended credit and saw too many redemptions for currency. After the infamous bank holidays that occurred, bank failures ceased. This was due to the FDIC. In stark contrast, 465 American banks failed which the FDIC seized between 2008 and 2012, including Washington Mutual Bank and Indymac, which were two of the biggest bank failures in U.S. history.

Highlight (Geel) | Locatie 3999

While most people believe the FDIC protects their deposits and bank in the case of a financial catastrophe, it has proven to operate imperfectly. An alternative to deposit insurance that exists is known as an option clause. This is a temporary suspension of payments to depositors (written into an agreed-upon contract) for a specified amount of time, after which the depositor will be compensated with interest for foregoing the ability to withdrawal currency on demand. This option would only be exercised during times of an abnormally high amount of redemptions where interest rates would rise and raise the risk of bank failures and defaults, as well as recession. The strength behind the option clause is that there would be an upper "threshold" for short-term market rates of interest to rise due to a scramble for liquidity. The moment these rates rise above this amount for the option clauses to take an effect, the banks themselves have an incentive to retain their reserves and lend them out to marginal banks at a higher rate than what they would have to pay to depositors after they exercise this option. This will lower markets rates to at least the penalty level the banks will have to pay depositors. It is in this case that there would be no need for deposit insurance and that liquidity and solvency would remain relatively unharmed.

Highlight (Geel) | Locatie 4008

Work by Kevin Dowd (1993) shows that Scottish banking in the mid-eighteenth century saw option clauses being invoked on occasion when liquidity was sparse. Depositors seemed to dislike the threat of not being able to redeem specie for periods of time, but that did not prevent banks' notes from being redeemed without devaluation. This mechanism of free banking is compatible with Austrians' market principles, and thus should and could have been suggested through more popular channels than by simply proposing that the FDIC be abolished without any reassurance given to the populace that their deposits would not be harmed in the future.

Highlight (Geel) | Locatie 4020

In sum, by fixating on expectations of the future path of NGDP, the Fed is better able to impact current aggregate demand, even during a supply shock such as an embargo on oil, whereas an inflation target would allow room for disequilibrium in other markets as the rising imported oil prices would have to be deflated as well as all other prices. Members of the George Mason University group of Austrian free bankers mostly sympathize with this proposal, with some slight alterations in Selgin (1997) in which the productivity norm stabilizes the prices of the factors of production, but unfortunately many individuals at the Mises Institute reject both versions on theoretical and ethical grounds. They incorrectly assert NGDP targeting goes against free markets in that it tends to not allow the price mechanism to work fluidly when in reality prices and wages are not perfectly flexible and responsive to changes in supply and demand for numerous empirical reasons that have almost nothing to do with price controls or other government intrusions. The former group have identified with monetary disequilibrium theory which finds common ground with market monetarism and NGDP targeting, while integrating concepts such as Mengerian microfoundations, capital theory, and Austrian business cycle theory. The latter group has dogmatically remained dedicated to the gold standard tradition instead of following Hayek (1979) who abandoned his earlier anti-stabilization position and instead supported offsetting what he called the "secondary deflation." It seems Hayek realized that allowing prices to fall during deflation was not the best path to take, if only for political reasons. This support for nominal income stabilization is something that the more popular Austrians failed to recommend when the financial crisis hit hardest, which did little to progress their public image beyond their predictions of recession. It seems that in any economy, the public prefers a proactive arrangement of institutions that can correct the anguish of unemployment, stagnant incomes, falling home prices, and devaluing investment portfolios. Claiming "markets always clear" does nothing to comfort those that have lost their only means of income, even if it is true in the long-run.