Trade Policies of the Cavemen

By The Mogambo Guru

09/22/03 Mogambo on Monday! This week, our hero descends on government statistical quants and the politicians who love them.

US GDP is supposed to be still rising, even though the number of people with jobs is going down.

One question: who are these people with jobs that can maintain their spending lifestyles, and actually increase their spending to make up for the fact that less people even HAVE jobs with which they are to get the money to do the spending?

Well, the fact is, none of it's really true…

Just as Michael Boskin showed the government how to lie with statistics about inflation – as if the government ever needed any help with lying, since they seem to cleave to it so naturally – our sainted leaders make ludicrous assumptions about adjusting prices for quality and the substitution effect and all the rest of that lying crapola that any second-grade kid can easily see through. But to get with the program and show that I am a team player, I want to prove to you that the Mogambo can be just as clever, and has just as many tricks up his economic sleeve.

The lights dim, and I reach out and slowly raise my seemingly empty hand, turning it slowly around, presenting to the audience every square inch of my empty hand for their inspection, so that later they can verify that there is no freaking way that anyone could have had anything concealed. And yet, they all agree that an instant later, a white-tipped black magic wand, which eye-witnesses estimate was about a foot long, maybe more, appeared at my fingertips out of nowhere! The audience, of course, is delighted, and claps their hands in glee, shouting "Mogambo! Mogambo!"

Lying with Statistics: Lessening traffic Congestion

For my first trick, I note that there are fewer people with jobs. To demonstrate, I remove some billiard balls out of one bowl filled with billiard balls, and deposit them into another, but empty, glass bowl. I continue to move the balls one by one, as I explain that the filled bowl represents the traffic situation, as all of the billiard balls filling up the bowl were likewise filling up the roads. As I remove the balls one by one, I explain how there are fewer people on the road in the morning, and so there are fewer people clogging up the roads getting TO their jobs.

When I get to the last ball in the bowl, I say, "Therefore, the traffic congestion is lessened, and therefore you don't spend as much time tied up in traffic, and in fact you have the whole road to yourself. And therefore you are spending less time commuting, which means that you are more productive, and therefore GDP must," (I strike the bowl with the magic wand, producing a puff of smoke and a loud bang. The bowl is instantly, magically, filled with money), "go up!"

Again, the audience is delighted beyond words, and they instinctively rise to their feet and clap their hands, again in childish glee, shouting "Mogambo! Mogambo!"

Encouraged, I go on to my next trick. I note that there are television shows that have an "and" in the title. For example, "Law and Order." You are not just getting law. You are not just getting order. So you are getting, at once, both law AND order. You are getting twice the entertainment value for your buck! Therefore, for the same expenditure of time watching the TV, you are more productive! Therefore GDP again (I strike out with my magic wand, and another bowl of money appears out of thin air) goes up!

This time, the audience has sunk into their chairs in stupefied amazement, struck dumb by the fabulous magician, namely me, Marvelous Magical Mogambo, performing what seem to be impossible feats. They clap wildly, shouting "Mogambo! Mogambo!"

Lying wiyth Statistics: For My Next Trick

Not giving the audience a chance to catch its breath, I launch into my third trick, which shows how the Patriot Act allows the government to go snooping around, even breaking into your house for a ‘sneak and peek,’ and all the rest of that Big Brother-ish police-state stuff that is so popular these days. In theory, they will round up all the nasty people, and then you will feel so much safer, and since you feel so much safer, then you don’t have to spend as much time on self-defense and home-protection, and therefore you will experience an adjusted quality of life! Therefore, GDP (and again we do the magic wand thing and again another bowl full of money appears) goes up!

The audience collapses in a swoon, literally falling to the floor unconscious, paralyzed with amazement, trying to mouth the words "Mogambo! Mogambo!" but it comes out sounding like "Moahgo! Moahgo!"

Man, this is all so cool! I could do this all day long! I can prove to you, just like Greenspan and that group of lying hustlers he hangs out with do it, that GDP has risen by any number you want!

So you would think that this demonstration of my talent, my Big Mojo, would have Alan Greenspan calling me on the phone, offering me a big, fat contract to create economic guidelines based upon my genius. The bad news is that, in grim reality, I have to sit here in this locked closet, with burly caretakers sitting outside the door to make sure I don’t get out again, angrily banging away on my little computer, while Michael Boskin and Alan Greenspan get to eat high-cholesterol foods in a classy restaurant and rake in the big bucks for doing the exact same thing! So they next time somebody says "Life isn’t fair," you tell them that the Mogambo says "Amen, brother!"

Congress, for their part, who seem to delight not only in being stupid but also in doing one stupid thing after another, are now threatening China with a 27.5% punitive tariff on Chinese imports if they don’t trash the U.S. dollar. Oops, I mean, if they don’t let their currency float.

Lying with Statistics: The Government Gets the Money

Who gets the money raised by these tariffs? The government. But that is, of course, not news. I mean, that's all governments EVER do, so it WOULD be news if the government DIDN'T act like greedy vampires and suck the damn money out of you.

But, on the other side of the coin, right off the bat you and me and the rest of us doofus consumers out here will immediately notice a big increase in the price of things for sale in WalMart, almost all of which come from China, as far as I can tell. So the government GETS the money that tariffs bring in, and that makes the prices go up, and we final consumers PAY all the money. Which will also be reflected, then lauded mercilessly by the great unwashed financial media hoards, in a rising GDP number.

In the old days, in those halcyon days before Michael Boskin and Alan Greenspan, when prices went up, it was called 'inflation,' and it was considered a bad thing. Nowadays, of course, is called 'preventing deflation,' and for some reason it is NOT considered a bad thing.

But, just as a rose by any other name smells as sweet, the end result is the same. Namely, prices go up. You can call getting hit on the head with a baseball bat a 'goodnight kiss' if you want, but it still feels exactly the same as a whack on the head, because it IS a whack on the head.

The idea behind the tariff is simplicity itself, and you might want to write this down because in later years you are going to think about this time in your life and wonder to yourself, "Were we ever so stupid as a nation that we believed such a thing could possibly work?" The answer, of course, is 'yes,' but the theory is that these higher prices, see, will induce American producers to salivate over making that big moolah, and vow to produce some of that now-expensive stuff we are importing from China, which is, as you know, damn near everything anymore.

And when we industrious Americans gear up the factories, pack our lunchboxes and head off to work to produce this stuff again, see, it will be putting Americans back to work. And, for all I know, it might work. Stranger things have happened.

Lying with Statistics: Tariffs Always Have a Downside

But, and when I say 'but' you know that there is something wrong here, I mean, was there ever a time in all of history when tariffs didn't have a huge downside? Huh? I mean, how many times do I have to read about our pre-Neanderthal ancestors levying tariffs on cheap imported dinosaur meat on the theory that local hunters could then compete and stimulate their economy? We've all read the damn articles, and there was that whole History Channel series about "Trade Policies of the Cavemen," so it is obviously NOT a new idea.

And since tariffs are NOT a new idea, the results are probably not going to be new, either. At the end of the day, and at the end of the year, and at the end of many years after that, prices are higher. And you will not like that. Nobody likes that. And that is why, in subsequent years, everybody agrees that tariffs are a bad idea, and they stop, and then they start yammering about free trade again.

I'm surprised nobody is bringing up Smoot-Hawley. Which was, if memory serves, a tariff! And Smoot-Hawley is commonly regarded as one of the worst ideas to come out of a Congress, and is considered by some, me for one, to be strongly implicated in the causes of the Great Depression!

For crying out loud, people! And yet here we are in 2003, and we pick up the morning newspaper and are astonished to read that Congress is passing another tariff! The same Congress, but populated by a different set of ignorant bozos sitting on their fat worthless butts, who are obviously even dumber than the clods who passed the original Smoot-Hawley tariff, because these current weenies have the disaster of the Smoot-Hawley to look back on and learn, and can say to each other, "Hey, dude! We better not pass this tariff, because – wow! – look at what happened with the Smoot-Hawley thingie! What a gnarly bummer, dude!"

Whereas the guys who actually DID pass the Smoot-Hawley back in those old days at least had an excuse for their stupidity, because maybe they did not have a specific, horrific example to learn from.

And, I note for the record, that all the guys who voted to pass Smoot-Hawley are now dead, so maybe there is a curse thing attached to tariffs. Spooky, huh?

Sincerely,

The Mogambo Guru,
for The Daily Reckoning

September 22, 2003

P.S. Fortunately, I am not as alone as I feared. Stephen Roach of Morgan Stanley weighed in and wrote, "In my opinion, this is a classic example of opportunistic politics leading to bad economics. Such an approach would have negative impacts on the U.S., China and the broader global economy. It is right out of the script of the nightmares of the 1930s."

So, now that's TWO of us talking about this Smoot-Hawley thingie, dude.

If you had to sum up as much financial outlook, investment advice and economic theory as possible in just a few words, what would you say?

"The dollar will fall," is our choice. We thought of it Saturday night at a dinner party for a group of Lebanese and American friends.

The dollar will fall because the dollar-based international monetary system is doomed, we explained.

It will fall because too many dollars and dollar-based credits have been issued…and because Americans are too deeply in debt to the rest of the world.

It will fall, too, because the current recovery is a fraud. And because U.S. assets are overpriced. And because Asian assets are a better deal.

"I don't know anything about international finance," said Ibrahim, "but I know that stocks and real estate are rising in America now. That's where the economy is improving. That's where to invest.

"In America, they know how to manage these things," Ibrahim continued, speaking of economic downturns. "They don't do anything in Europe. But in America, they cut interest rates and so forth…and get the economy moving again."

"Good luck," said your editor.

The dollar fell on Friday, whether measured in euros or gold; against gold it dropped $5. We don't know whether gold buyers anticipate the frothy seas of inflation or a whirlpool of deflation…but what they don't expect is smooth sailing ahead.

And why should they?

"Local employment still stagnant," says a headline from Houston. How can you have a recovery without an increase in employment, enquiring minds want to know? We have already given you the answer, dear reader. We repeated it for our Lebanese friends:

"The recovery is a fraud," we replied.

The second-quarter GDP numbers were largely mythical or misinterpreted. Half of the increase came from military spending, which makes people poorer, not richer. Another $38.4 billion was listed as spending on computers.

Too bad it didn't exist: "The vast majority of computer investment never occurred," explains U.S. News & World Report article (thanks to Richard Russell for mentioning it). "Given the bizarre way government statistics are compiled, nobody actually paid anything and nobody received anything. That's because Washington measures computer investment by calculating how much it would have cost in 1996 to buy a computer of equivalent power to today's machines. On the $38.4 billion in increased computer investment, therefore only about $6 billion was real spending. The other $32 billion was a statistical construct, which is just a fancy way of saying that it wasn't real. Without that false comfort, we would have been looking at a second-quarter growth not of 3.1 percent, but of roughly 1.7 percent – and most of that attributable to defense spending. Profits tell the same story, down $31 billion from the first quarter."

(More on the statistical mirage, from the great Mogambo…who has a few of his own economic magic tricks up his sleeve…below…)

"I don't think the recovery is a fraud," said Ibrahim, standing his ground. "Lower interest rates put more money in people's pockets. We refinanced our house in Virginia twice in the last year. And the house keeps going up in value. This is great…"

USA Today reports that the refinancing boom has gotten a second wind. Mortgage rates had their "steepest plunge in 8 years," last week, falling to 6%.

Meanwhile, an advertisement on the USA Today website shows a house sitting atop a pile of moneybags. "Are you sitting on an equity gold mine?" asks the headline. "Access it today." Daily Reckoning readers who want to go deeper into debt are invited to call 1-800-71-FIXED. And who knows? Maybe a 20-year fixed-rate mortgage at today's low rates will turn out to be a great bargain. In a few years, you could see it wiped away by inflation…if you're not bankrupted by deflation and foreclosed first.

Well…at least the dinner party ended on friendly terms. Long after midnight, your editor said good night to his guests with this solemn prediction: "The dollar will fall."

Here's Addison with the weekend news:

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Addison Wiggin, writing in Paris…

- "Well," reports our London correspondent, Sean Corrigan "it looks at first glance as though the Americans have gotten what they wanted out of the weekend's Group of Seven meeting in Dubai – no, not an upwardly valued Chinese Yuan, but a downwardly valued U.S. Dollar!"

- In early trading in Asia, after the weekend meeting, the dollar fell to its lowest level against the yen since Christmas 2000. What does that say for the imperial currency, dear reader? The greenback is falling against another specie backed by unpayable public debts, a rapidly aging population, near insolvent banks and insurers and zero percent interest rates! Wait…that kind of sounds like the dollar itself…hmmmnnn…

- Markets across the board fared well last week (inexplicably, my internal editor desperately wants to add). Eric Fry gave us the run down in the Daily Reckoning Weekend Edition: the Dow gained a total of 173 points for the week to close at 9,471…the Nasdaq jumped nearly 3% to 1,855. Even the bond market "enjoyed steady buying interest"…the yield on the 10-year Treasury issue dipped to 4.16% from 4.27% the week before.

- The meeting in Dubai seems to have been 'the place' to create 'buzz' over the weekend – if you can ever imagine the collective heartbeat of a room full of economists, bureaucrats and politicians rising above 60 beats per minute.

- Russian central bankers, for example, used the meeting to announce they're ready to buck the trend set by their European and U.S. counterparts. Rather than unload their gold supplies, as the European banks just announced they would continue to do, the Russians want to add bulk: "Our gold reserves," the Deputy Governor of the Russian Central Bank, Oleg Vyugin, told Reuters on the sidelines of the conference, "are around seven to eight percent of our total international reserves and actually we think that we have to get at least 10 percent of international reserves."

- Friday, partially in response to such announcements, one suspects, and partially reacting to dollar weakness against the yen, gold closed near its highest level since 1996. "This could be a very interesting week for the devotees of hard money," notes Corrigan, "versus the paper crowd!"

- On the other hand, if the dollar doesn't continue to fall, it won't be John Snow's fault. Another Reuters report: "While the G7 meeting in Dubai over the weekend may not have contained the explicit language of the Plaza Accord, the desire to weaken the USD and spread the burden of USD weakness from Europe into Asia could not have been clearer," said National Australia Bank strategist Greg McKenna.

- "The wording of the communiqué seems stronger language than we anticipated. It could be viewed as a victory for the U.S. side of the argument and for (U.S. Treasury Secretary) John Snow," McKenna said.

- The Plaza Accord of 1985 brought the dollar down against yen…and triggered, perversely, a bubble in Japan. This time, it could stimulate a boom in the whole Asian region and a bubble in China. Japan's trade surplus, for example, is rising at a 23% annual rate.

- "Hot money surging back to Asia," says a headline in the Business Times. The IMF named Asia, minus Japan, as the world's largest economic region. China bought $41.4 billion in U.S. securities in the first half of the year, twice as much as the year before. China now owns more U.S. Treasuries than any other nation except Japan.

- Kenneth Rogoff, the IMF's top number-cruncher, also took the opportunity at Dubai to elaborate on warnings we recapped in these pages last week about soaring government spending and a trade deficits. "Right now," said Rogoff, "the U.S. is just charging ahead. The United States has the best recovery that money can buy. [Unfortunately,] it's borrowing a great deal in order to sustain this very high recovery…this comes at the cost of mortgaging growth further down the road."

- "The real thrust of the IMF's message on the world economy is pretty obvious," writes Morgan Stanley's Stephen Roach, summing up the Dubai conference. "While near-term vigor is not to be denied, there are some increasingly worrisome signs on the not-so-distant horizon with respect to the sustainability of yet another burst of U.S.-centric global growth. I couldn't agree more."

- We've had our eye on the 'other twin towers' – government spending and private debt – for some time here at the Daily Reckoning HQ. "Americans are in debt for $31 trillion," says a report released by the Strategic Group, "three times what we produce in a year. The last time our debts were so totally out of control was the 1930s. In 1980 – just 23 years ago – we owed only $4 trillion. This is just one indicator out of many that point to a coming [soft, slow] depression."

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Meanwhile, Bill Bonner, back in Paris…

*** NY Times columnist Thomas L. Friedman has been in such a hot sweat of war fever for so long he's begun to hallucinate. He was one of the biggest backers of plunging into war against Iraq; every week he urges the Bush administration to get itself in deeper.

But his latest delusion is to treat any alternative suggestion as an act of war. "The U.S. and France Are Now at War," says his latest column. What stirs Friedman's bellicose blood is French president Chirac's plan for straightening out the Iraq situation. It is an absurd plan, of course, but compared to Friedman's preposterous neo-con nostrums, it seems almost brilliant.

Here in Paris, the French are taking the news rather calmly. We look out our window and see people enjoying the warm Indian summer weather. Women walk down the street in light, filmy dresses, admiring the new fall fashions in the shop windows…children go off to school, as usual, with heavy backpacks…businessmen and saloonkeepers go about their daily chores…Should we warn them that Friedman is preparing an attack?

*** Today, we received our first copy of our new book, Financial Reckoning Day. We also learned that the book was a best-seller on the BN.com list over the weekend, that it had completely sold out, and that Amazon hasn't even received its first shipment yet. And, as we shared with you on Friday, our publisher, John Wiley & Sons, has already gone back for a second printing.

So once again, dear reader, we make financial publishing history; we have a best-seller that no one has yet read. We only hope that we don't make publishing history twice; we hope the book gets to bookstores before it is remaindered.

*** Our old friend Martin Spring sends this update on gold: "Expect the gold price to fall back a bit over the next few weeks, but then to resume its uptrend and possibly breach the $400/oz level before the end of the year, says the research house Gold Fields Mineral Services.

"At a seminar I attended in London this week, GFMS's MD Philip Klapwijk said he is bearish short-term because of the overhang of speculative long positions which have driven up the gold price 'too far, too fast.'

"But further ahead – before year-end – the uptrend should resume.

"[Klapwijk] bases his optimism primarily on the growth of investment demand, forecast to increase 23 percent this year to 468 tons, which is underpinned by these factors:

* The 'powerful political backdrop' – tensions in the Mideast, terrorism, potential crises over North Korea/Iran going nuclear.

* Economic uncertainties such as fiscal deficits, inflation fears, interest rates and currencies. 'The dollar will probably drop, maybe sharply,' and there is a fairly strong inverse correlation between gold and the greenback (they trend in opposite directions).

* Non-performance of, or fears about, major investment asset classes such as shares, bonds and property.

"You couldn’t ask for a better mixture for investment demand and higher gold prices – and the positive dynamics are likely to remain in place next year," Klapwijk says.

"Although much of the strength of the gold price in recent months has come from speculative buying, there are some signs of improvement in the quality of investment demand. Over the past two years HNWIs (high net worth individuals) have begun to buy. And private banks have started to recommend a gold content in portfolios to lower their overall risk."

*** And this from a dear reader: "USS Dollar Standard, riding low in the water and laden with trillions of dollars of interest-bearing debt, plunges ahead towards monetary maelstrom. Film at eleven…"

Mogambo Sez: I remind you, every day, to take the time to stop and smell the flowers, as one day very soon the world that we know will be swept away in the coming economic cataclysm, as all other worlds in all other times were swept away when their economic stupidities got to the point where we are now.

As a coda to that, I will quote Doug Noland, "This is an extraordinary, fascinating, historic period for Credit Bubble analysis. And if there were doubts that the Credit Bubble had entered the precarious ‘blow-off’ stage, the Federal Reserve’s second quarter Z1 ‘flow of funds’ report certainly provides ample evidence. It’s One for the Time Capsule.

"In the 21 quarters prior to the second quarter (since the beginning of 1998), total Credit Market Borrowings (Non- financial and Financial) surged 51% – or $10.9 Trillion – to $32.1 Trillion. After such an extended period of historic excess, Credit growth has now gone ‘parabolic.’"

And if you don’t know the horrific ramifications of debt growth going parabolic, don’t worry. You will.