

LESSONS IN LIBERTY

Notes on Economics

With Robert Gray

Current Economic Issues for 2022

- Minimum wage
- Tariffs on international trade
- National debt and Modern Monetary Theory (MMT)
- Inflation
- Taxes
- Capitalism versus socialism
- Involuntary transfer of resources between social groups

Basic Definition of Economics

- Economics: ***the study of the use of scarce (limited) resources that have alternative uses.***
- The definition of “scarce” is that the total of available resources is less than the total desired. Without scarcity, there is no need for economics.
- “What everybody wants always adds up to more than there is”. -- Thomas Sowell, *Intellectuals and Society*

Basic Definition of Economics

- Therefore, the distribution of resources involves trade-offs. In general, “solutions” do not exist. There are always “trade-offs” and “unmet needs”.
- This is always true, regardless of the prevailing economic system (capitalism, socialism, feudalism, etc.)

Economics is not about Money

- It is the volume of goods and services that determine the wealth or poverty of a country.
- Most economics is about maximizing the wealth of the people as a whole, rather than a subset of the people. Political and social decisions can affect this.
- Battlefield triage is an economic process, although no money changes hands.

What Is Money?

- Money is anything that serves as a medium of exchange
 - Coins and paper currency
 - Cigarettes
 - Fish
 - Tobacco
 - Horses
 - Bank deposits
 - Etc, etc.

What Is Money Used For?

- A medium of exchange
 - Bartering occurs when there is no acceptable medium of exchange.
- A unit of account
 - A consistent way of measuring the value of a thing
- A store of value
 - Holds value over time.

Types of Money

- **Commodity Money**
 - The money has an intrinsic value apart from its use as money.
 - Examples: Commodities or precious metal coins.
- **Fiat Money**
 - Money that the government or other authority declares acceptable as a medium of exchange, or “legal tender”.
 - Examples: Paper money, bank deposits, checks.

Some Other Economic Principles

- It is human nature to desire to maximize the return of the efforts or resources of an individual.
- TINSTAAFL (There Is No Such Thing As A Free Lunch)
- It is human nature to desire things whose immediate cost is zero or low, and whose eventual cost(s) is/are not easily recognized.
- Decisions are usually better if they are made by those who will incur negative results of a bad decision.

Homo Economicus

- “Economic man”
- Human nature is both rational and self-interested. It attempts to maximize gain and minimize pain (loss). Our decisions are based on the relative importance of these two incentives. Every person is different.
- Regardless of the political system, almost everyone will attempt to put his self-interest first. “Gain” and “loss” may or may not be monetary. It may also be power, prestige, influence, control, etc.
- Altruistic people such as Jesus, Mother Theresa, and Gandhi are a vanishing small percentage of society.

Homo Economicus and Capitalism

- Adam Smith in “*The Wealth of Nations*” shows how the pursuit of self-interest creates an economic structure where prices signal the most effective distribution of resources.
- This is the essence of capitalism, and does not require government to make it work.
- In fact, government intervention has negative impacts:
 - Government introduces overhead costs.
 - Government decisions are made by people with limited knowledge (compared to the entire population).
 - Governments do not incur costs for bad decisions.
 - The negative impacts of government policies are often known only years after the original decision.
 - Government decisions are often made to support political allies or special interests.
 - Politicians are often motivated to “do something”, even if the resulting policy makes the situation worse. See the impacts of the Smoot-Hawley tariff in 1930. An attempt to mitigate the October, 1929 stock market crash made the situation worse, and extended the Great Depression.

Homo Economicus in Government

- Elected officials wish to be re-elected
 - Focus and publicity is on the short-term
 - Long-term consequences are downplayed
- Unelected bureaucrats wish to expand their control, and avoid criticism and negative results
 - If actions do not obtain the intended results, personal consequences are usually minimal, often zero.
 - Focus is on avoiding actions that might result in negative outcomes.
 - Doing nothing is usually safer.
- *“It is hard to imagine a more stupid or more dangerous way of making decisions than by putting those decisions in the hands of people who pay no price for being wrong.”* -- Thomas Sowell

Homo Economicus in Government

- The inevitable expansion of unelected government does not mean that the officials are necessarily evil or corrupt. They are usually following the same economic incentives as the rest of us.
- Control of the size and power of the unelected government requires Congress to control the budget.
- Permanent weight loss requires a permanent diet.

The Problem With Government

- Government injects a third party into the decision-making process. This party does not suffer the consequences of bad decisions.
- There are usually “hidden agendas”.
- The consequences are often not known until years after the original decisions are made.
- Programs often result in a narrow concentration of benefits and a broad distribution of costs. “Special interests” benefit, paid by the general population. The proposed college loan forgiveness is one example.

The Importance of History

- ***"Those who cannot remember the past are doomed to repeat it" --- George Santayana***
- Intentions and results may be very different.
 - Intentions are usually known immediately.
 - Results may occur far in the future.
- ***"The definition of insanity is doing the same thing over and over and expecting different results" --- Albert Einstein***

Production

- The production of desired resources (outputs) requires the use of other resources as inputs.
- Input resources may be:
 - Land
 - Labor
 - Capital
 - Energy
 - and others.....

Decisions Create Incentives

- *“Be careful what you wish for, you might get it”.*
- Decisions can create incentives for personal behaviors that oppose the purpose and intentions of the original decision. Examples of this are well-known in command economies.

Why Doesn't Socialism Work?

- Basically, it can't work
 - No one person, or group of persons, can have the aggregate knowledge to manage a modern economy.
 - Capitalism provides that knowledge via prices, reflecting millions of decisions made every day by the entire population.
 - Those in charge pay no penalty for bad decisions.
 - Socialism and other command economies also suffer from the inescapable human tendency to make decisions for personal benefit (money, power, votes, etc.), or to comply with an ideology, regardless of actual benefit to the population at large.
 - History keeps proving that it doesn't work, going back at least to the French Revolution of 1793. But, Left-Progressive leaders keep pushing it, in large part because it brings personal power.
 - **"Power tends to corrupt, and absolute power corrupts absolutely."** -- Lord Acton (1834-1902)

The Role of Prices

- In an economy, prices are signals as to the relative value of a resource, affected by the availability of that resource.
 - A seller wishes to maximize the price.
 - A buyer wishes to minimize the price.
 - Both are attempting to maximize their own benefit.
- A transaction occurs when both sides believe they have realized a net benefit.
- Price and wage controls distort this process, and inject a third decision-maker into the process.

Do High Prices Equal “Greed”?

- Greed assumes that the seller can set prices at will, regardless of demand. This would be a monopoly (only one seller).
- Example: The U.S. Post Office is a monopoly provider for certain mail services.
- The opposite of monopoly is monopsony (only one buyer).
- Unrealistic prices (high or low) probably represent an incorrect calculation of demand and/or costs.
- Prices convey availability but do not create availability.

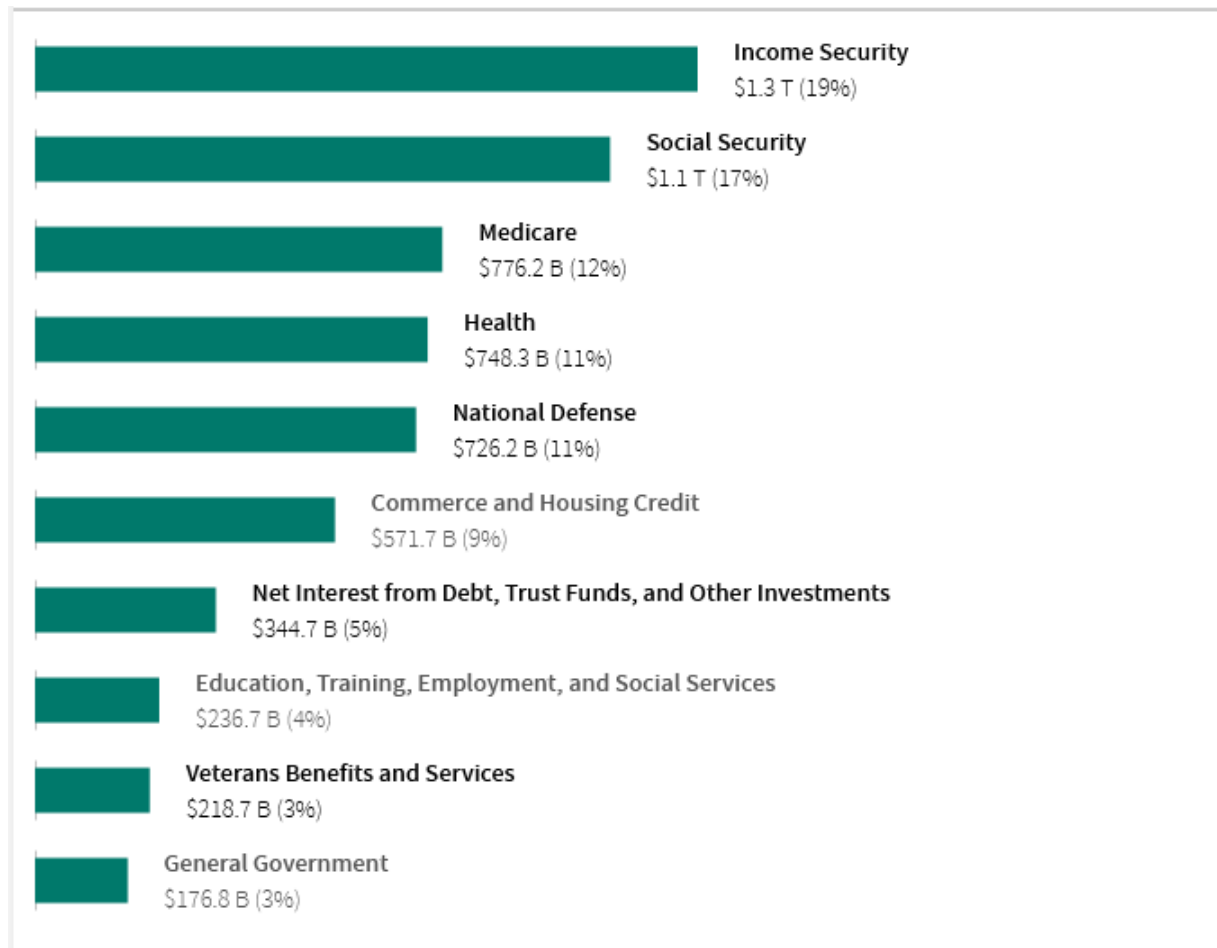
US Federal Government Budget

- Government income
 - Taxes
 - Borrowing via bonds. Sale of bonds increases the national debt.
 - Printing “fiat money”. A prime cause of inflation.
 - Service fees
 - Sale of land and equipment
- Government spending
 - Interest on bonds
 - Bond retirement (reduces national debt)
 - Current-year expenses
 - Capital expenditures (multi-year)
- US Constitution, Article 1, Section 7: “All bills for raising Revenue shall originate in the House of Representatives;...”

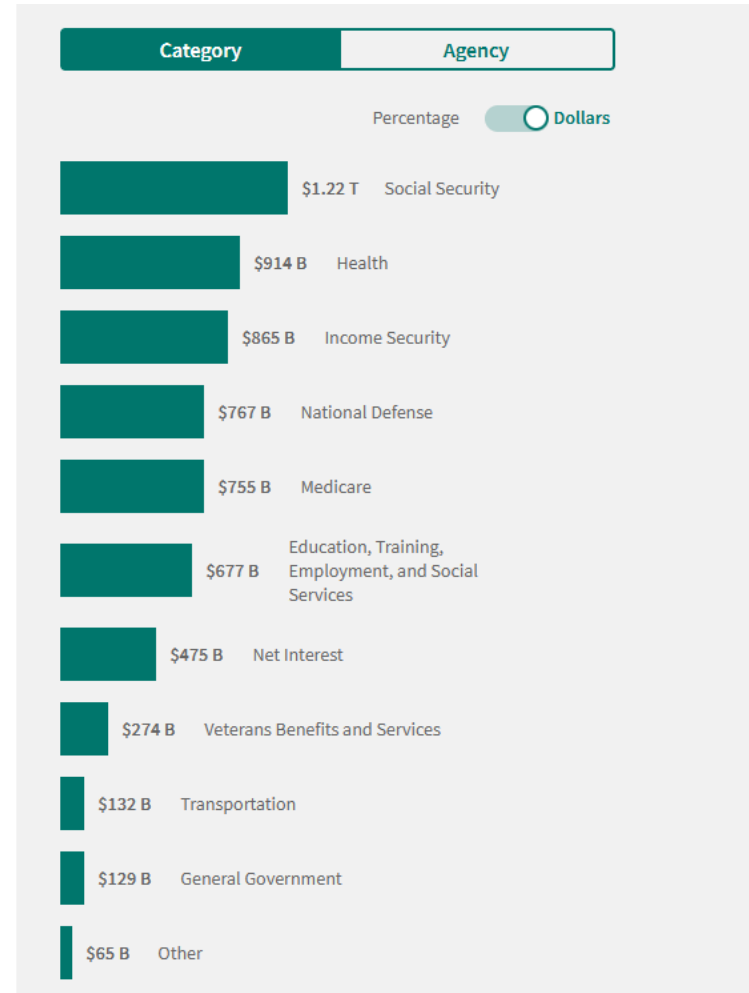
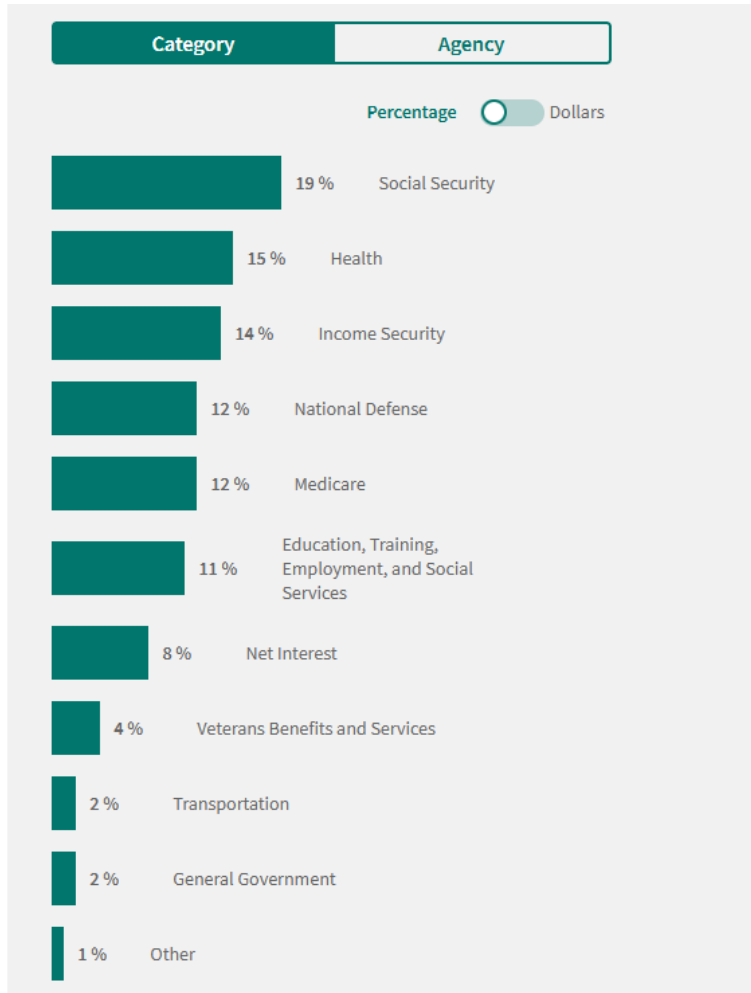
Classes of Government Expenditures

- **Mandatory**: Based on previously established laws (Social Security, Medicare, etc.). Also called *entitlements*. Includes interest on national debt. Cannot be precisely budgeted, as whoever meets the eligibility requirements will receive payments.
- **Discretionary**: Approved by Congress and the President each fiscal year. Defense is the majority of discretionary spending.
- **Supplemental**: Approved by Congress and the President outside the normal budget process. COVID-19 spending in 2020-2021 is an example.

2020 Federal Budget

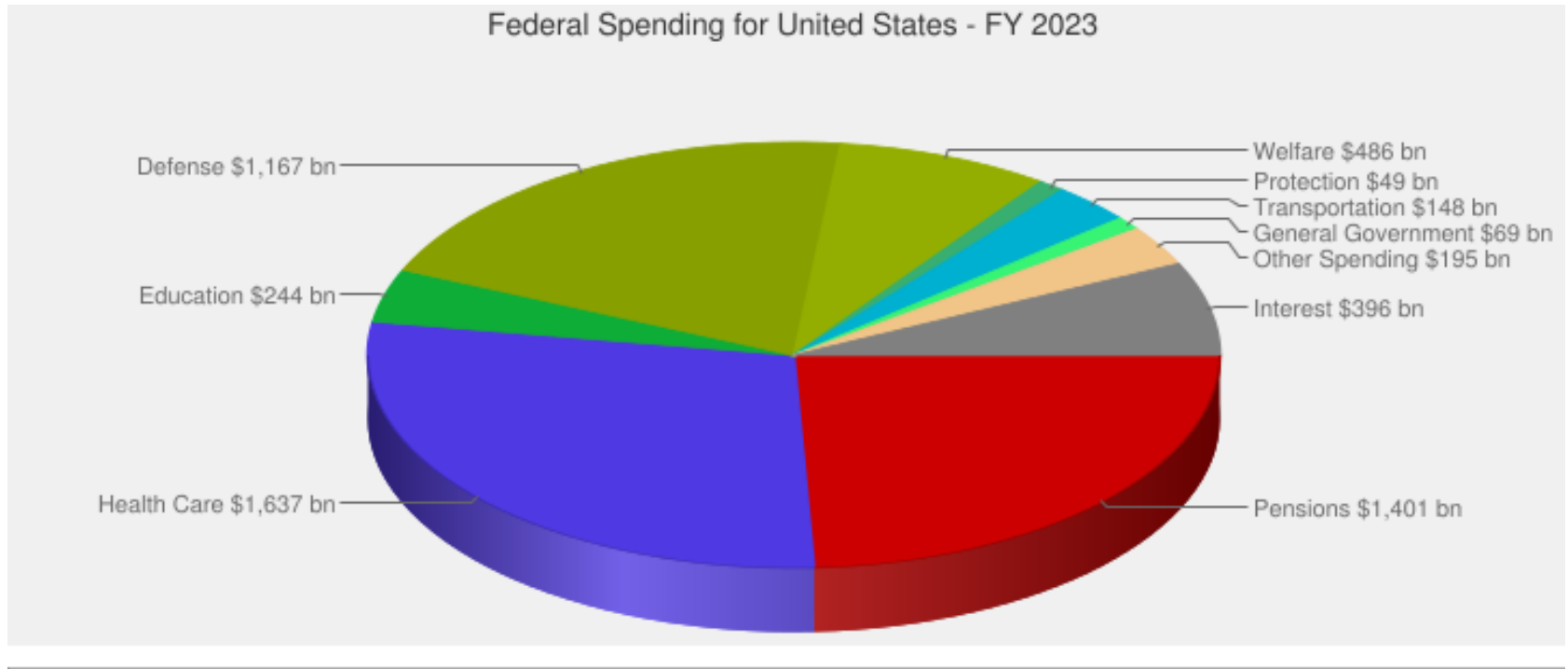


2022 Federal Budget



<https://fiscaldata.treasury.gov/americas-finance-guide/federal-spending/>

2023 Federal Budget



https://www.usgovernmentspending.com/us_fed_spending_pie_chart

2023 Federal Budget

GDP: \$25,566.5 bln
 GO: \$45,777.5 bln

state, local United States Federal Pie
 US CA > Pop: 334.5 million

United States Federal
 State and Local Government Spending
 -5yr -1yr Fiscal Year 2023 in \$ billion +1yr +4yr

View: people old function radical census programs altprog oldprog COFOG

	Fed	Gov. Xfer	State	Local	Total	chart
[+] Pensions	1,401.5	0.0	316.7	71.5	1,789.7	
[+] Health Care	1,636.9	-579.1	938.0	218.1	2,213.8	
[+] Education	244.2	-79.7	394.1	879.5	1,438.1	
[+] Defense	1,167.4	0.0	1.0	0.0	1,168.4	
[+] Welfare	486.0	-183.2	68.1	122.4	493.3	
[+] Protection	49.1	-17.2	95.6	236.8	364.4	
[+] Transportation	147.9	-104.9	151.8	214.7	409.5	
[+] General Government	68.9	-10.5	68.1	99.8	226.3	
[+] Other Spending	194.5	-52.4	115.1	478.8	736.1	
[+] Interest	395.5	0.0	41.4	76.2	513.1	
[+] Balance	0.0	0.0	0.0	0.0	0.0	
[+] Total Spending: <i>Start chart</i>	5,792.1	-1,027.0	2,189.9	2,397.8	9,352.7	
[+] Federal Deficit	1,153.9	0.0	0.0	0.0	1,153.9	
[+] Gross Public Debt	32,593.2	0.0	1,235.2	2,348.3	36,176.7	
[+] Other Borrowing	510.4	0.0	0.0	0.0	510.4	
[+] Agency GSE Debt	11,915.8	0.0	0.0	0.0	11,915.8	

https://www.usgovernmentspending.com/us_fed_spending_pie_chart

The National Debt

- The National Debt Clock
(<https://www.pgpf.org/national-debt-clock>)
- As of 1145 p.m., October 11, 2021:



The National Debt

- The National Debt Clock
(<https://www.pgpf.org/national-debt-clock>)
- As of 9:22 p.m. CST, February 25, 2022



The debt increased 1.73 trillion dollars in 132 days, or \$13.1 billion per day.

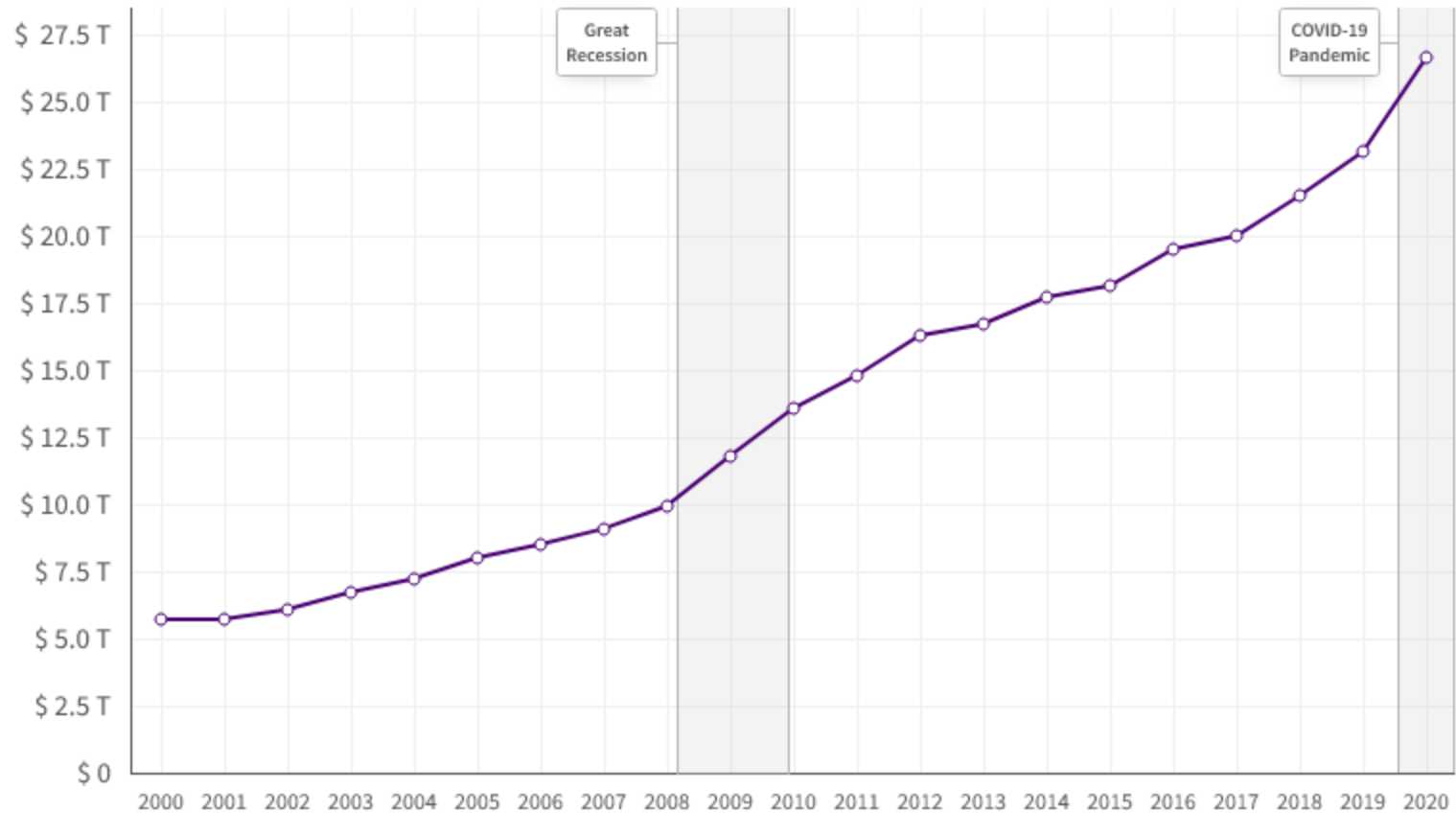
The National Debt

- The National Debt Clock
(<https://www.pgpf.org/national-debt-clock>)
- As of 9:46 p.m. CST, February 16, 2023



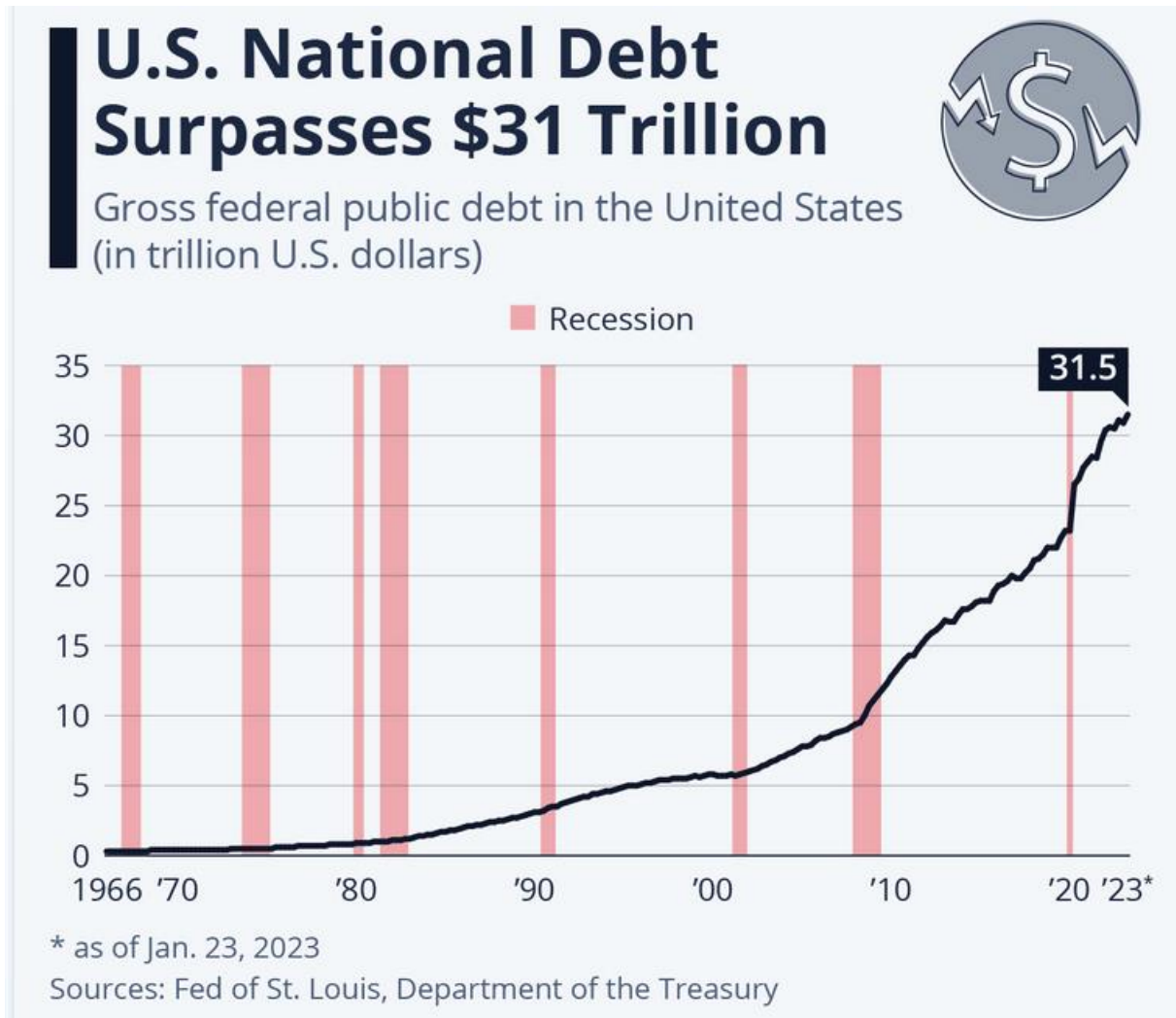
The debt increased 1.29 trillion dollars in 355 days, or \$3.6 billion per day.

Federal Debt Trend Over Time



According to the most recent Financial Report of the United States Government (FR), the current fiscal (2020) policy is NOT sustainable. (<https://www.fiscal.treasury.gov/reports-statements/financial-report/>)

Federal Debt Trend Over Time

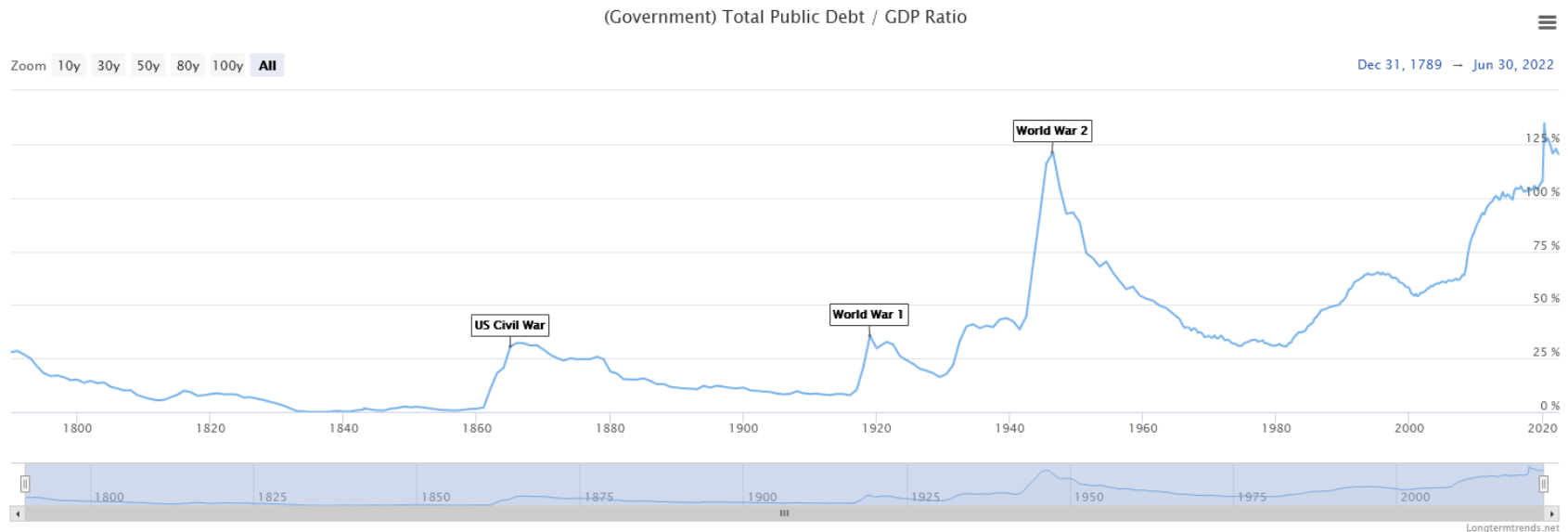


When Does The Debt Become a Problem?

- GDP = Gross Domestic Product
- “A 2013 study by the World Bank found that if the debt-to-GDP ratio exceeds **77%** for an extended period, it slows economic growth.”
- “In the third quarter of 2022, the U.S. debt-to-GDP ratio was **122%**.”
 - According to the Bureau of Economic Analysis second-quarter estimate, that's \$28.4 trillion U.S. debt divided by the \$22.7 trillion nominal GDP.
- Source: <https://www.thebalance.com/debt-to-gdp-ratio-how-to-calculate-and-use-it-3305832>

History of Debt-To-GDP Ratio

Federal Debt to GDP



Source: <https://www.longtermtrends.net/us-debt-to-gdp/>

- Rapid rise in March, 2008, starting at 62.72%.
- By the end of the Obama administration, the ratio was 103.65% (Dec, 2016).
- On December 31, 2020, the ratio was 126%.
- The ratio has basically doubled in 14 years. It is currently about the same as the peak of World War II.

Inflation

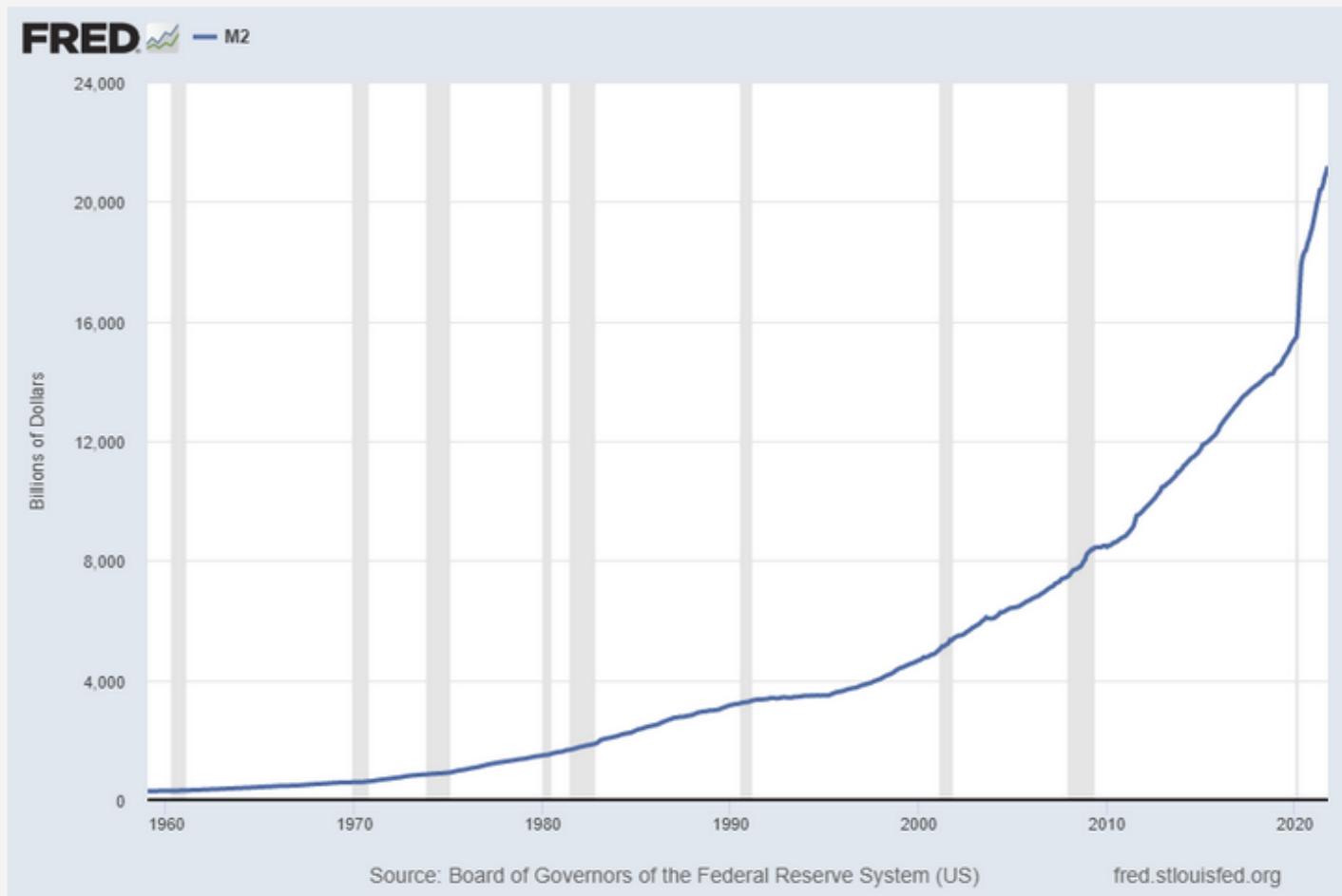
- *“Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output”.* -- Economist Milton Friedman
- Money is a commodity, like any other. The difference is that it is accepted in exchange for any other commodity. Inflation is when the “price” of money falls, in relationship to other commodities.
- A common cause of inflation is for a government to “print money” (fiat money) not backed by increased goods or services, in order to pay for government spending. It is money only because the government says so.
- Inflation often results.
- *“The advocates of public control cannot do without inflation. They need it in order to finance their policy of reckless spending and of lavishly subsidizing and bribing the voters.”* – Ludwig von Mises

M2 Money Supply

- **Before May 2020**, M2 consists of M1 plus (1) savings deposits (including money market deposit accounts); (2) small-denomination time deposits (time deposits in amounts of less than \$100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (3) balances in retail money market funds (MMFs) less IRA and Keogh balances at MMFs.
- **Beginning May 2020**, M2 consists of M1 plus (1) small-denomination time deposits (time deposits in amounts of less than \$100,000) less IRA and Keogh balances at depository institutions; and (2) balances in retail MMFs less IRA and Keogh balances at MMFs. Seasonally adjusted M2 is constructed by summing savings deposits (before May 2020), small-denomination time deposits, and retail MMFs, each seasonally adjusted separately, and adding this result to seasonally adjusted M1.

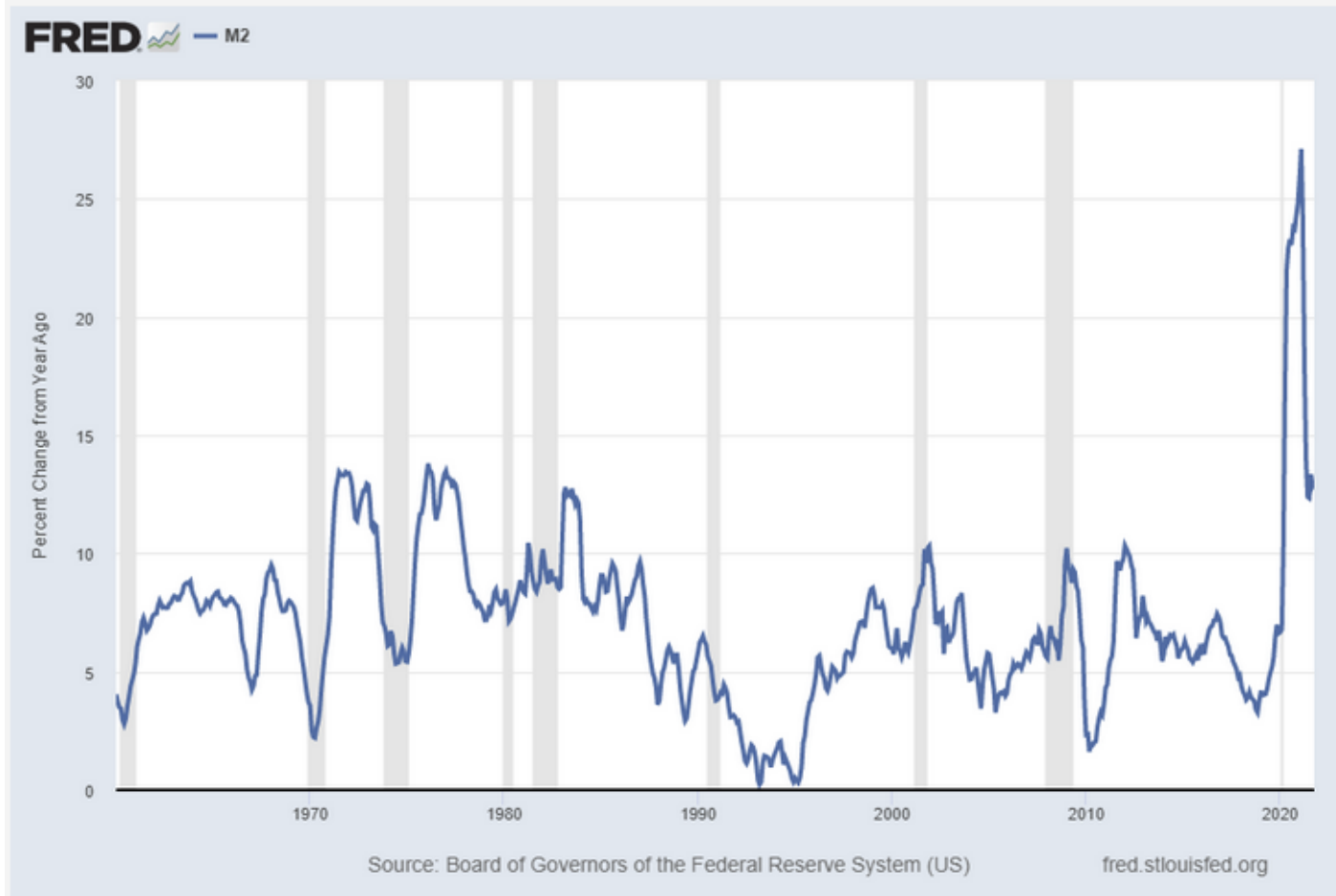
M2 Money Stock

Here is the "M2 Money Stock" (seasonally adjusted) chart, updated on November 23, 2021, depicting data through October 2021, with a value of \$21,187.1 Billion:



M2 Money Stock (% change)

Here is the "M2 Money Stock" chart on a "Percent Change From Year Ago" basis, with a current value of 13.0%:



Discussion Topics

- What are the meanings of “price”, “cost” and “value”?
 - “Price” is the amount paid to acquire any good or service.
 - “Cost” is the amount incurred in producing and/or maintaining the good or service.
 - “Value” is the utility or benefit of a good or service as perceived by the customer at a particular time.
 - “Price is what you pay, value is what you get”. -- Warren Buffet

Discussion Topics

- Are tariffs against foreign imports a benefit?
 - Sowell, *Basic Economics*, pages 490-491
 - Many tariffs benefit a single industry, while penalizing other industries and consumers in general. Examples include steel and sugar.
 - Tariffs often cause retaliatory tariffs. The Smoot-Hawley tariff of 1930 is an example of the government “doing something” and making things worse.
 - After the market crash in October 1929, unemployment peaked at 9 percent in December.
 - Over 1000 economists opposed the tariff, predicting it would make things worse.
 - US unemployment was down to 6% in June, 1930, when the tariff was passed.
 - One year later, unemployment was at 15 percent.
 - After another year, unemployment was at 26 percent.
 - 5 years after the New Deal was passed, unemployment was at 19 percent.
 - Even as late as December, 1940, unemployment was at 10 percent
 - Vedder and Galloway, *Out of Work*, 1993 edition, page 77.

Discussion Topics

- Should the government set minimum wages?
 - Why do proponents assume that the government has enough knowledge to make such a decision?
 - This destroys the ability of an individual to make his own decision.
 - Historically, minimum wage laws have a negative impact on employment opportunities for lower income groups.
 - If the government is wrong, who suffers?

Discussion Topics

- Do higher prices in inner-city stores represent either greed or racism?
 - Probably not.
 - Inner-city environments impose higher costs, due to crime (e.g shoplifting), and security costs.
 - Smaller businesses cannot achieve economies of scale.
 - Insurance costs are higher.
 - If inner-city profits are higher, why aren't more businesses moving there?