The "Skyscraper Index"

AND OTHER SIGNS OF A BUBBLE

Interview with Mark Thornton

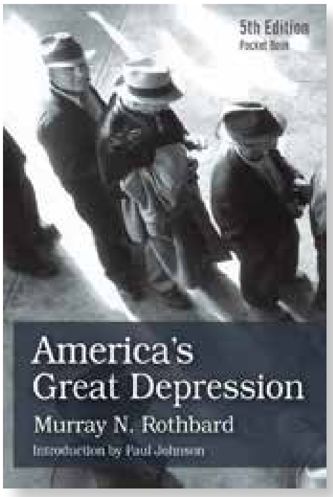
Mark Thornton is Senior Fellow at the Mises Institute. He serves as the Book Review Editor of the *Quarterly Journal of Austrian Economics.* His publications include *The Economics of Prohibition* (1991), *Tariffs, Blockades, and Inflation: The Economics of the Civil War* (2004), *The Quotable Mises*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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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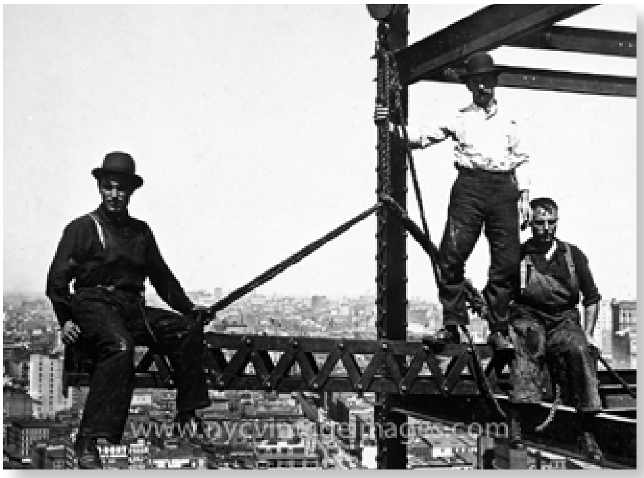
I used basic "technical" tools to identify the start of the Housing Bubble in my February 2004 article, the "top" in the housing stock index in August of 2005 (https://www.lewrockwell.com/2005/08/mark-thornton/is-the-housing-bubble-popping/), and the skyscraper index to identify the top in US stock markets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

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

MT: The Skyscraper Index was first constructed by real estate analyst Andrew Lawrence in the late 1990s as a chronicle of the relationship between new record-breaking skyscrapers and major economic crises dating back to the Panic of 1907. It was discussed in all the major financial media but was largely dismissed. I immediately saw the ABCT as the connection between the skyscrapers and business cycles. My academic article was finally published in 2005 after several rejections from mainstream economic journals. (https://mises.org/library/skyscrapers-and-business-cycles-4) This was at the height of the Housing Bubble. The paper explains that artificially low interest rates do several things to an economy with several important effects that can be easily described in skyscraper construction.

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



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

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

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

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

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in stock market and other investments before we get a "skyscraper signal." We have not yet seen this signal. That would occur when that project reaches a new record height and sets a new record for inhabitable height, in contrast to spires or antennas. However, given that this project—the Jeddah Tower in Saudi Arabia—has suffered several significant delays and has been on hold since late 2017, I would urge readers to be cautious because most fundamental and contrarian measure indicate that markets are already at a top.

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

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

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

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

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

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