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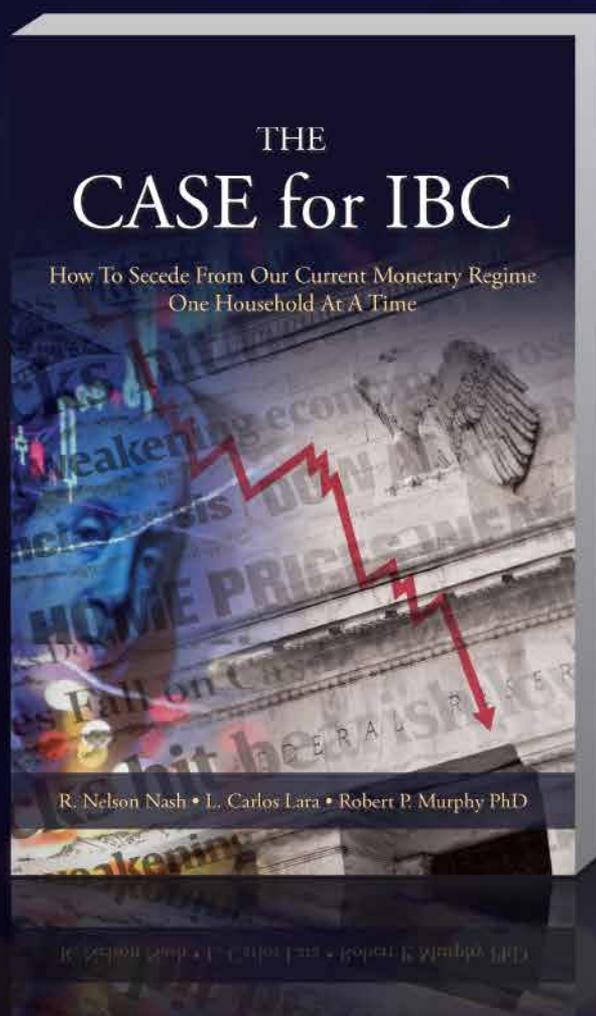
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THE POWER OF

BAD IDEAS

Interview With Carmen Dorobăț



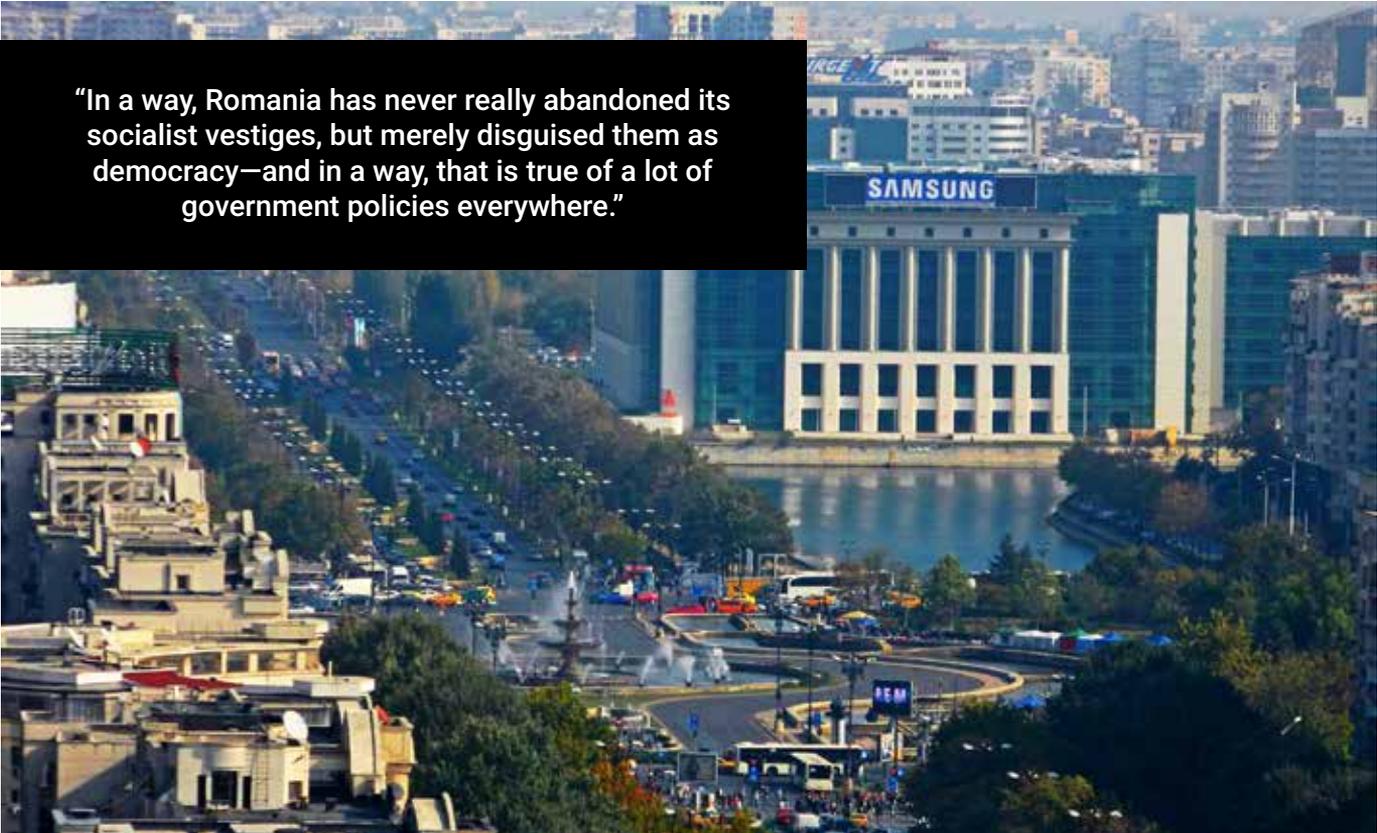
Carmen Elena Dorobăț is assistant professor of business and economics at Leeds Trinity University in the United Kingdom and a Fellow of the Ludwig von Mises Institute. She has a BA and MA in International Business and Economics from the Bucharest Academy of Economic Studies, and a PhD in Economics from the University of Angers. She is the recipient of the 2015 O.P. Alford III Prize in Political Economy and the 2017 Gary G. Schlarbaum Prize for Excellence in Research and Teaching. Her research interests include international trade, monetary theory and policy, and the history of economic thought.

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

Carmen Dorobăț: By accident, to be perfectly honest! I believe that has happened to most Austrian economists I know. I was planning on changing my major from Economics in my second year, as I didn't find the material stimulating or interesting. On my way out, as it were, I attended an elective class taught by Vlad Topan, the president of the Ludwig von Mises Institute Romania. Vlad introduced me to Mises and Rothbard and I found that economics not only made sense, but that I enjoyed it tremendously. And it has slowly grown from there, first through the mentorship of Vlad during my masters studies, then of Professors Joseph Salerno and Guido Hülsmann during my PhD, and of course through the great privilege of being a research fellow of the Mises Institute, which has become my intellectual alma matter. I put it all down to serendipity, really.

LMR: You grew up in Romania. Given your age, it was admittedly after the Cold War had officially ended, but were there vestiges of communism that you can remember?

CD: I was only one and a half years old when Ceausescu's regime col-



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lapsed, but my parents, particularly my father, have always made me aware, growing up, of the harsh times and privations they went through when they were young. My father remains an outspoken critic of communism and socialism, and of its present vestiges, as you say. I think the latter can be divided into two categories, from what I can tell looking back at the 50 years of communism Romania had experienced through the lens of Mises's political economy.

On the one hand, the rather violent revolution of 1989 in Bucharest that toppled Ceausescu's reign only removed the head of a state that was by no means a "personal" state, but rather a very deeply entrenched state apparatus. This apparatus, made up of corrupt politicians and socialist ideologues, was barely shaken in 1989, and it has continued to survive over the last 30 years in Romania. I find it is now even thriving in a democratic context. In a way, Romania has never really abandoned its socialist vestiges, but merely disguised them as democracy—and in a way, that is true of a lot of government policies everywhere.

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On the other hand, speaking of deeply entrenched ideas, the Romanian market environment is still plagued by a strong anti-capitalist mentality, where words like "profiteers," "speculators,"

and "tycoons" are too often used to vilify ordinary businesses and business-people. I would attribute it mainly to the decades of communism where you are taught, as a people, to distrust anyone claiming to do you any good—so of course the natural conclusion is that capitalists are out to exploit you rather than collaborate with you or help you. The social, integrative nature of the market is more lost on Romanians than anywhere else I've been—though again, it is hardly thriving as an ideal elsewhere in the world.

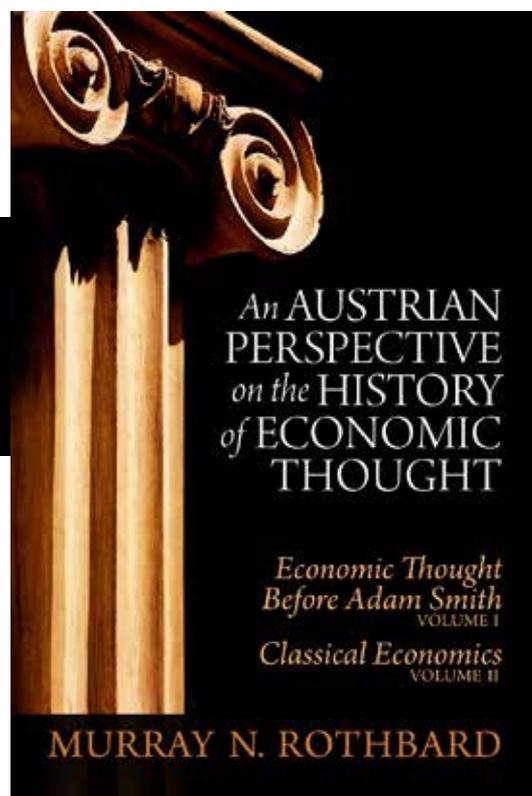
I don't know if Romania will ever shake off these remnants of communism. I like to hope it will. But all this underscores to me just how right Mises is when he talks about the power of ideas, and particularly of bad ideas. The only way to get rid of bad economic policies and the anti-free market mentality is to root these bad ideas out. But that's easier said than done!

LMR: One of your research specialties is the history of economic thought. Many economists nowadays dismiss this as a hobby, akin to stamp collecting. After all—so the “modern” thinking goes—people who go to MIT to learn physics don’t waste their time studying the actual writings of Isaac Newton. So why should today’s economists waste time reading the work of Carl Menger, let alone David Hume or Richard Cantillon?

CD: Because it is not a waste of time at all. What attracted me in the first place to the history of economic thought was the fact that it greatly helped me better understand modern theories, their development, and of course their shortcomings. Sometimes, reading recently published papers from the mainstream can make you feel as if you are reading about someone re-inventing the wheel.

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I recently came across an NBER paper claiming to discover a great, previously unknown effect of monetary policy: an unequal impact on firms’ wealth and capital structure depending on their sources of finance. And it is all a rather clumsy approximation of an insight otherwise easily deduced from Cantillon’s description of the uneven effects on prices of an increase in the money supply, only applied to modern financial markets. A well-researched, data-rich paper, but that otherwise explains nothing new; in other words, not a new contribution to economic theory at all. In this case, this is what I see as the true waste of time—while reading Cantillon and Hume would have actually been beneficial.



The other aspect of this is that all the drawbacks of the current hyper-specialization of economic science—where each sub-field carries out its work in its own little theoretical box, as it were—can be overcome by being at least conversant with the history of economic thought. Looking at economic science in its historical development, seeing the filiations of ideas (good and bad) can make you better understand the connections between these sub-fields and between the models and policies they endorse, and often provides a new perspective that is like a breath of fresh air on the

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stale, overused models modern economics relies on. Otherwise, economists are bound to just let high-level math drive their economic conclusions, and that makes their work, and maybe even the science as a whole, irrelevant to the real world.

LMR: When you teach international trade, you actually incorporate monetary calculation—a quintessentially Misesian insight—in the discussion of comparative advantage. This departs from the textbook approach. Can you explain for our readers?

CD: Mises’s approach to comparative advantage—or rather, what he calls the law of association—is different from the modern mainstream understanding precisely because Mises developed his system of economic theorizing as a unified whole. One of his key insights here—which, speaking of the history of economic of thought, was overlooked by the British classical economists like Smith and Ricardo, but understood by the French liberal economists of the school of Say and Bastiat—was that there is no difference in nature between domestic trade and international trade. There is only a difference in the data, but not in kind.

Mises then showed that monetary calculation makes economic planning possible by making alternative production processes commensurable and comparable with each other. In using monetary calculation, entrepreneurs can use the profit and loss test to figure out which of the alternative production processes available will be most efficiently satisfying future consumer needs at the anticipated future prices in future exchanges. This is true of any market, whether it is contained or stretches across national borders.

All this then has two key implications. First, comparative advantage explains why people trade within and across national borders, in other words why people form economic bonds through exchange: because specialization in production and trade greatly increase output and productivity. Second, specialization in production, in any economy, requires economic planning, thus entrepreneurial judgment and monetary calculation. Thus, comparative advantage and monetary calculation must be intrinsically linked. In the market, the ones driving specialization and trade, allocating resources

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in such a way as to increase output and productivity, are the capitalists and the entrepreneurs, aided by the tool of monetary calculation. Thus, they calculate and judge what a firm's comparative advantage may be, what line of specialization it ought to pursue. The two, monetary calculation and the discovery of comparative advantage, are in fact sides of the same coin, accomplished at the same time in real-world markets.

This sort of insight is really rather simple and straightforward when you read Mises and are, as I was saying previously, conversant with elements of the history of economic thought, like the contributions of the French Liberal School or the socialist calculation debate. But when, on the contrary, you work on international trade in a separate box, where for the sake of mathematical efficiency models remain barter models instead of incorporating a monetary unit, the same insight becomes almost impossible to grasp.

LMR: Finally, you spent time studying in the United States (at the Mises Institute) but are now stationed in the UK, and of course you grew up in Romania. For our American-bound readers, what are some of the things they might be missing in their economic outlook due to their focus on the Federal Reserve and U.S. politics?

CD: The things one can miss are similar to those overlooked by not taking into account the history of ideas that we discussed before, so not being aware of policies that have been tried and failed not only in the same country in the past, but in other countries, some time ago or at present.

For instance, in the current debate between the private and public health-care camps you can often hear praise of the alleged 'enlightened' Western economies and their greatly performing systems of socialized medicine. If you look a little closer, however, you can very easily discover that what these latter systems actually do is consume capital. It has happened in China, Russia, North Korea, Romania, Ukraine, and so on, and it is now happening in Canada and in the UK. The British health-care system used to operate much better 10 years ago than it does today, and we wonder what has gone wrong. The answer is simple: since it has been created, socialized health-care has consumed and wasted capital, and not replaced it effectively because, as a socialized system, it cannot calculate and efficiently allocate its resources. So it should come as no surprise that things have gotten worse, and will

continue to get worse. It unfolded the exact same way on all the countries we mentioned before, and countless others that have tried it.

This turn of events should be even less surprising when you compare how socialism failed everywhere it has been tried. It is not a mere coincidence that in all former USSR countries, socialist experiments have ended with enormous queues and shortages of basic amenities, as it is now happening in Venezuela, and it is not unrelated that socialized healthcare systems come with increasing waiting times and lack of adequate medical equipment and

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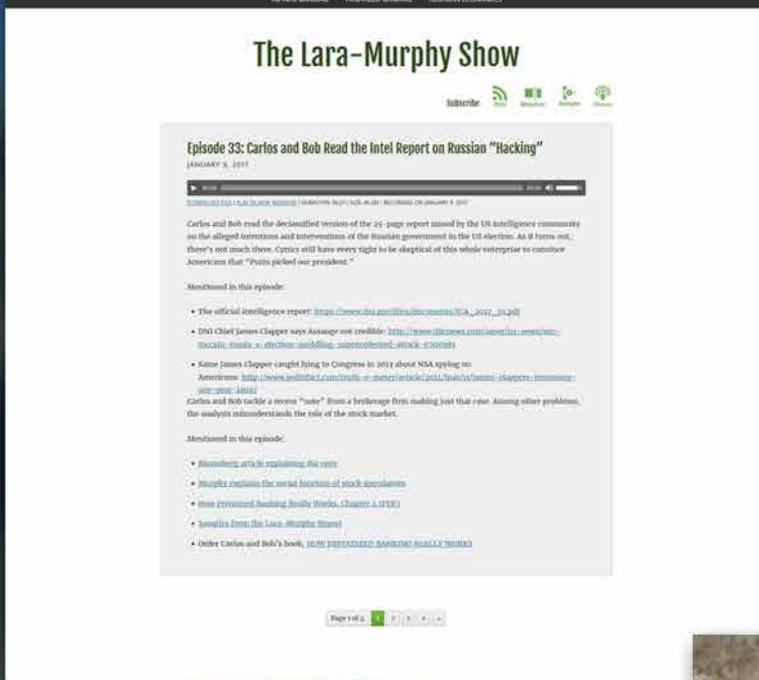
professionals. These are not just independently badly managed economic systems, the problem lies with the system itself and the way it cannot rationally allocate resources as markets can.

If you focus on only one system and only one country, you may think the problem lies with one administration or other, with a particular level of corruption or incompetence. Or you may falsely believe things are going well because in your country you have not yet experienced these same symptoms. But the U.S. Federal Reserve policies have not been disastrous because the past Fed chairmen have been incompetent—albeit that has had a role too!—but because of what the Federal Reserve, and any other central bank in the world do through their policies, i.e. create malinvestments and financial crises. Equally, the “bad” don’t rise to the top only in U.S. politics, they do so everywhere, because that is in the nature of the political system.

I think then that while the history of ideas can greatly deepen and detail one’s understanding of economic theory and economic policy, a good grasp of world economic history can likewise expand our understanding of how policies and economic systems have been applied in the past and of why they have failed or succeeded. One works to expand your understanding of the world in depth, the other in breadth.



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.



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