

DICE HAVE NO MEMORY

BIG BETS & Bad Economics from Paris to the Pampas



BILL BONNER

bestselling coauthor of *Empire of Debt* and *Financial Reckoning Day*



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—John

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—Robert O.

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*Big Bets and Bad Economics
from Paris to the Pampas*

WILLIAM BONNER



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*To my mother,
Anne Bonner,
with much appreciation*

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■ Introduction ■

It was 10 years ago, or a bit more, that I began writing the Internet series called the *Daily Reckoning*. The collection of essays and short notes you have in your hands developed over the course of the years that followed.

When I began, I was ahead of the innovation curve. I was blogging before blogs had been invented. Day after day, I watched what happened in the world of finance, economics, and politics. And day after day, I found myself entertained. I merely described what I saw happening.

This was something fairly new in the press. Journalists believe their job is to report the facts, not to laugh at them. Even the commentariat and editorialists believe they need to take the news seriously; who will buy their papers and magazines if they make a joke of it? The lectors, too, had become convinced that the world of finance, investments, and economics was serious business. Many believed that the latest developments—both in technology as well as in financial theory—would make them rich. They had heard that the Internet made wealth secrets available to everyone. You could now go onto the Internet to find out how to make a nuclear bomb, or a fortune. “Stocks for the long run” seemed like an almost risk-free road to riches. Readers weren’t going to pay someone to mock their ambitions and undermine their hopes.

But the *Daily Reckoning* was free. Readers could not complain that they were not getting their money’s worth.

The period began with a bubble in the dot.com stocks. Back then, investors believed they could make money by buying companies listed

on the Nasdaq, even those that had no plausible way of making money. Often, these new-technology dot.com companies were managed by people with no business experience. Indeed, the lack of a track record was seen as a benefit. Ideally, what investors looked for was a callow CEO with his baseball cap on backward, who spoke the gibberish of the era. Incoherence and pimples were all the evidence they needed that the company was run by an Internet genius, untarnished by the rules and lessons of the old economy.

The Nasdaq bubble blew up in January 2000. The Internet impresarios moved on—often to the mortgage industry. What followed was the strangest recession in U.S. history. Consumers and businesses are supposed to correct their mistakes in a recession, cutting back on spending and debt; that's what recessions are for. But in the micro recession of 2001, consumers borrowed and spent more than ever. Something very odd was taking place.

On September 11, 2001, came the assault on the Twin Towers in New York. This too was freakish. At least you expect freaky people to do freaky things. But if the attack surpassed our expectations, so did the Bush administration's reaction to it. Rather than put the cops on the case, run the miscreants to ground, and punish them, the United States launched a vast and implausible "war on terror." As far as we know it was the first fighting war against nobody in particular ever proposed. "September 11 changed everything," said the neoconservatives. And so it seemed, as I recall in "The Dark Years" in Chapter 4.

The public should have been appalled; the war on terror looked from the get-go like an expensive military misadventure. Instead, the voters closed ranks. Americans imagined that they were under general attack. In Dubuque, they bought tape to seal their doors and windows against chemical attack. In Dallas, they stopped opening their mail, afraid that the towelheads were aiming to poison them. Even to this day, electronic billboards along I-95 north of Washington, D.C., tell travelers to "Report Suspicious Activity." Another says "Terror Tips. Call 1 800 4XX-XXXX." I was tempted to call to ask for a tip, but this would surely get us on a list of suspects.

The war on terror soon proved a letdown. As far as we know, not once in 10 years was a truck spotted headed south on I-95, with Arab fanatics at the wheel and drums of fertilizers and gasoline in the back. The terrorists went limp. The terror hotlines were silent.

Apparently, the terror pros were dead or under deep cover. But the amateurs soon took over. In the years following the original terrorist strike,

the media reported only three additional incidents worthy of comment. In one, a man tried to get his shoes to explode. In another, a man actually did scorch his own genitals before an alert passenger overpowered him and put out the blaze. In another, terrorists allegedly drove a vanload of explosives into Manhattan, but then were unable to get it to blow up.

There were real wars too, even more expensive and even more absurd. The nation with the largest nuclear arsenal in the world accused poor, desolate Iraq of having “weapons of mass destruction (WMDs).” An invasion was launched. The *Daily Reckoning*, always on the side of the underdog, the lost cause, and the diehard, doubted that the war was a good idea. Not that we had any opinion on who would win the war, or whether the world would be a better place as a result; we just thought it was mildly indecent for such a big country to pick on such a small one. Readers were incensed. Many wrote to accuse us of a lack of patriotism (we pled *nolo contendere*); some wrote to suggest that the U.S. Air Force should drop bombs on us, too. We were in Paris at the time. Had the French not refused flyover rights to U.S. bombers, one of them might have done it.

Those were heady times. Imaginations ran wild. Besides Iraq there was Afghanistan. And more bombast, bickering, and bunkum. No WMDs were ever found. These wars made little sense in terms of U.S. strategic interests, said critics. But perhaps they missed the point. Men have desires. History has destinations. Maybe the point was not to win, but to lose. The United States faced no real enemies or probable threats. Nature abhors a vacuum and detests a monopoly. After the Berlin Wall fell, the United States had a near monopoly on military power. She could not find a worthy opponent. So, she had to create one. She sought to destroy herself by spending money she didn't have on wars she couldn't win. More on this in Chapter 4.

Most of our attention in the *Daily Reckoning* was focused on what was going on in the world of money. Both politics and money are often absurd and funny. But the world of money is not lethal; you can laugh without risking a firing squad. There too, in the 2000 to 2010 period, the United States was so far out in front of other economies, she had to be her own enemy. In economics as in warfare, Americans fought to lose.

So it was that the micro recession of 2001 was met with a dramatic and practically suicidal response. Alan Greenspan's Federal Reserve took its key interest rate down below the rate of inflation—essentially giving away money for free—and kept it there. The Bush administration also used fiscal

stimulus to disastrous effect. It quickly replaced the surplus of the Clinton years with a large and growing deficit. All together, this was the strongest official intervention ever undertaken.

It had results. But not ones any sensible person would want. You can see for yourself in Chapter 5. The new stimulus spending went into speculative assets—stocks, commodities, and (most important) real estate. With mortgage money so readily available, the U.S. housing market took off, rising at roughly twice the rate of gross domestic product (GDP) over the five years to 2007. Soon, ordinary householders began to treat their bedrooms as a kind of automatic cash machine. They believed they could simply take out the equity they had “earned” in their houses and spend it. Why not? There would just be more next year. At the housing market’s peak, house trailers sold for \$1 million and more, house flippers bought and sold houses two or three times before they were built, and homeowners “earned” more from their house price increases than from full-time employment.

Of course, that couldn’t go on for long. It came to an abrupt end when the bottom fell out of the subprime mortgage industry in 2007. Over the next few months, homeowner equity disappeared. The mortgage debt, however, remained. Even today, three years later, a quarter of U.S. homeowners have mortgages larger than their remaining equity. And house prices are still going down.

This was probably the funniest episode of the whole period. The authorities were lost at sea. U.S. Treasury secretaries, Fed chairmen, and leading economists told the world that everything was all right one day . . . and then the next day some new disaster happened. Illusions of competence collapsed along with Wall Street.

The talking heads should have shut up. Instead, they kept talking. And it became more and more obvious that they had no idea what they were talking about. You’ll find that glorious period recalled in various memoirs such as “Said the Joker to the Thief” in Chapter 6.

The financial authorities were not the only ones whose reputations were bruised. Economists, finance professors, investors, and business leaders all were black and blue. Nobel Prizes had been won. CEOs had become celebrities. Hedge funds had made fortunes. All based on theories and formulas that were demonstrably flawed, if not preposterous.

But now, that era is years behind us. Since then, the world’s focus has shifted to rescue and recovery efforts. These efforts were designed and controlled—like traffic at a busy airport—by the same people who had

just proven that they were fogged in. That alone should have told us what to expect. But what the central planners lacked in sagacity they more than made up for in stupidity. Once again, they flew in the rescue teams and heavy equipment willy-nilly. And once again, the accidents multiplied.

It was breathtaking to watch. Trillions of dollars of the public's money was wagered on the basis of ideas that made little coherent sense in theory and had never been effective when put to the test. Yet, the brightest minds in the country asked few questions; everybody's bread was buttered on the same side—toward more spending, more stimulus, more cash and credit.

The scale of the previous major contracyclical relief effort—in 2001 and 2002—was monstrous; this time it beat everything ever before seen. This time the Fed took its key rate down as close to zero as it could get it. And as for fiscal stimulus, the U.S. government ran a deficit of nearly \$3 trillion over the following two years. Including financial guarantees, backups, subsidies, and contingent financing plans, the total put behind the rescue and recovery effort surpassed \$10 trillion.

What was amazing about this effort was that so little real thinking went into it. You'd expect the wisest men on the planet to think twice before putting in play an amount equal to almost the whole private sector output of the entire United States over a complete year. But they seemed not to think about it even once.

Instead, they bumbled and stumbled forward, with that same can-do activism they had just shown in the wars on terror, Iraq, and Afghanistan. Did any of them bother to ask how likely it was that the people who so poorly understood the problem would be able to find the remedy for it? Did they take the time to consider the matter practically: How would the economy be able to put \$3 trillion of new spending to use sensibly and efficiently? Where exactly would the resources come from? How would anyone be better off if those resources were redirected into the government's "shovel-ready" projects—the very same projects they judged not worth doing a year earlier, when they still had the money to do them? You'll see some of these questions raised in the first and second chapters. I was always dumbfounded by how little serious reflection went into these trillion-dollar decisions.

Did the authorities trouble themselves with the philosophical implications? The government had no extra money. It could borrow, but that would only take money away from other projects. And what if it created new money—as, in fact, it did—out of nothing? How could you

expect to get something out of nothing? How can wealth created at the stroke of a key turn into the kind of wealth you can spend, eat, live on, or use to floss your teeth? If you could do it so easily, why not do it more often? Why not do what Gideon Gono had done for Zimbabwe? If you could make a nation richer simply by adding more zeros to the national currency, surely Mr. Gono had proven out the trick. See page 30 for “Gonoism!”

Instead of thinking, the authorities pushed ahead. Then, in 2010, came the “recovery” sightings—like mirages in the desert. The economy was improving! And then the improvements receded into the distance. Unemployment wouldn’t go down. Housing wouldn’t go up. Alas, there was more desert to cross. And then there were disappointments, alarms . . . and more calls for more stimulus.

The simplest explanation for what was happening could be put into four sentences: People had spent too much. They had borrowed too much. Now, they had to spend less so they could pay down their debt. Until the debts were paid down, the economy would suck.

Making more cash and credit available was clearly the wrong course of action. It was like offering another piece of custard cake to a fat man on a diet. If the temptation works, it makes the man need to diet even more.

And yet the economy improvers chose not to notice. The neo-Keynesians believe the solution is for the government to spend more money it doesn’t have. The realists think they can engineer a recovery by more central planning, forcing whole economies to run surpluses or deficits as their theories suggest. The idealists want a whole new, global monetary system over which they would have more control.

And only a marginalized kook would dare suggest that the lot of them—Nobel Prize winners et al.—are quacks and scalawags. You will find my own kooky thoughts on the subject in “Plumbers Crack” in Chapter 2, “100 Years of Mismanagement” in Chapter 1, and various other essays throughout the book.

Probably the most remarkable proposition of the whole decade came into sharp focus in the past six months. It was the idea that the Fed could spur a recovery by creating money out of thin air. In the desperate atmosphere following the Lehman bankruptcy of 2008, the Fed had already used its “quantitative easing (QE)” tool. But it had done so as a way of loosening rusty nuts in the banking system. In August 2010, it proposed to do more, no longer using the tool to provide emergency liquidity; this time it was

using QE as a stimulus measure. And this time it was not just putting money into the banking system; now it was funding U.S. government spending. There was no substantive difference between the Fed's QE II program than Gideon Gono's money-printing in Zimbabwe or Rudolf Havenstein's money-printing in the Weimar Republic. Here was the world's leading central bank printing up paper money to pay for federal salaries, missiles, Social Security, Medicare, and other expenses. In broad daylight. And yet, professional economists looked on coolly. Many even approved. It was as if all the lessons of financial history had been unlearned. Forgotten. Ignored.

At the *Daily Reckoning* our mouths dropped open when we heard the news. And then we all started laughing.

"Buy gold," we said to each other, chuckling. Gold goes up when people lose faith in central bankers. Paul Volcker had restored investors' faith in the Fed in the early 1980s. The price of gold had gone down for 20 years as a result. Now, Ben Bernanke was giving goldbugs a huge gift.

"Ha-ha . . . when he's finished, the price of gold ought to be \$3,000 an ounce," said one of the *Daily Reckoning's* merry staff.

"Are you kidding? It will be \$5,000, at least." See Chapter 7.

Ha. Ha. Ha.

WILLIAM BONNER
Baltimore, Maryland
February 2011

P.S. Man does not live on finance and economics alone. In Chapters 8, 9, and 10 you will find reflections on a variety of subjects. I traveled widely during the decade and lived most of the time outside of the United States. I wrote about what I saw—particularly in France and Argentina.

Over the course of the 10 years I also lost a few friends. You will find them recalled in the final chapter.

■ *Chapter 1*

The Incompetence of Economists

