



Views From the Stream

September 30, 2024

Inflation, Price Controls, Shortages, Depreciating Currencies, and The Loss of Freedom: Looking Like A Banana Republic

"...whatever the reasons, every American family is confronted with a real and pressing problem of higher prices. And I have decided that the time has come to take strong and effective action to deal with that problem.

Effective immediately, therefore, I am ordering a freeze on prices. This freeze will hold prices at levels no higher than those charged during the first 8 days of June. It will cover all prices paid by consumers. The only prices not covered will be those of unprocessed agricultural products at the farm levels, and rents."

Address to the Nation Announcing Price Control Measures
President Richard Nixon
June 13, 1973

"It wasn't raining when Noah built the Ark."
Howard Ruff, 1975

When I was growing up, I remember my Dad talking about Banana Republics. So, my young self asked him if they exported the bananas I liked to devour on a regular basis, a bunch at a time. (My parents had wisely decided that this was an economic solution to my hollow leg appetite.) My Dad quickly explained that the term referred not to a country that produced lots of bananas but to a country where a ruling plutocracy exploited the majority of workers for their benefit. In effect, it meant state capitalism that benefited those in power, typically an alliance of key companies, government leaders, and the military. (Of course, my Dad had to explain the word plutocracy to my young self as well.) Typically, he went on to explain, these countries possessed paper currencies that devalued consistently and became worthless. Thus, the ruling class typically exported goods for hard currencies that were kept outside the country and

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enriched themselves but not the populace. I would later learn that the term was coined by the American author O'Henry in 1904 in his book *Cabbages and Kings*, which was based on his time in Honduras. And his fictional characters were based on the real life actions of the United Fruit Company, backed by the US Government, which helped to overthrow a democratic government in Honduras to establish one that would serve its interests there. And in doing so, it would export the country's bananas, paying low prices in Honduras, and sell them for much higher prices in the United States. This would ensure that the company kept its large profits outside the country where they could not be touched. Unfortunately, this led to impoverished peasants, who received subsistence wages and faced merciless persecution if they objected to the state of affairs.

Let us fast forward to the 1970s. On August 15, 1971, President Nixon officially ended the international convertibility by foreign governments of their US Dollar holdings for Gold. Prior to then, under the Bretton Woods currency regime, which began in 1944, the US Dollar was convertible into one ounce of Gold at \$35.00 fixed. The US Government attempted two small devaluations. In December, 1971, the US Dollar was devalued to \$38.00 per ounce. In October, 1973, the dollar devalued to \$42.22 per ounce. This devaluation failed as well and the US Dollar started to float just two weeks later. This marked the official beginning of fiat currencies. By the end of the decade, the US Dollar price of Gold was over \$800 per ounce.

For those of us who lived through President Nixon's years, Wage and Price Controls, which were imposed in 1971, proved less than ideal. While they were trumpeted as a solution to the rising cost of goods, they merely served to treat the symptom, not the disease. They made selling a variety of items uneconomic. And, as a consequence, they produced large disruptions in the US economy. Farmers stopped shipping cattle to market. Chicken farmers drowned their birds. And a variety of supermarket shelves went bare as consumers grabbed up items before they disappeared. This just recreated the problems that occurred during World War II when the government did something similar. And just as in that era, when the controls were lifted in 1973, goods made up for lost time, soaring in price. Of course, the underlying cause of the massive inflation stood the quadrupling in energy prices. Something over which the government possessed little control, as OPEC exerted its true economic clout for the first time.

Let us fast forward to today. Over the past five years, prices soared, with the government's official measure of inflation vastly understating the true inflation borne by the public. Items at the supermarket stand 30%, 50%, 100%, or more of their price in 2019 prior to the Pandemic. In addition, Insurance costs soared, with auto insurance rates doubling and home insurance rates up 50% to 200% depending on the state. The price of homes soared as well with the S&P Core Logic Case Shiller Index up ~50% from December 2019 to June 2024. And rents rose at similar rates, providing no shelter for the average American. In contrast, Median Household Income only rose 17.3% through December 2023. Thus, Households Real Income fell significantly. This stands in sharp contrast to the official CPI, which shows a change of just 21.54% from December 2019 to August 2024, allowing the Federal Government to claim

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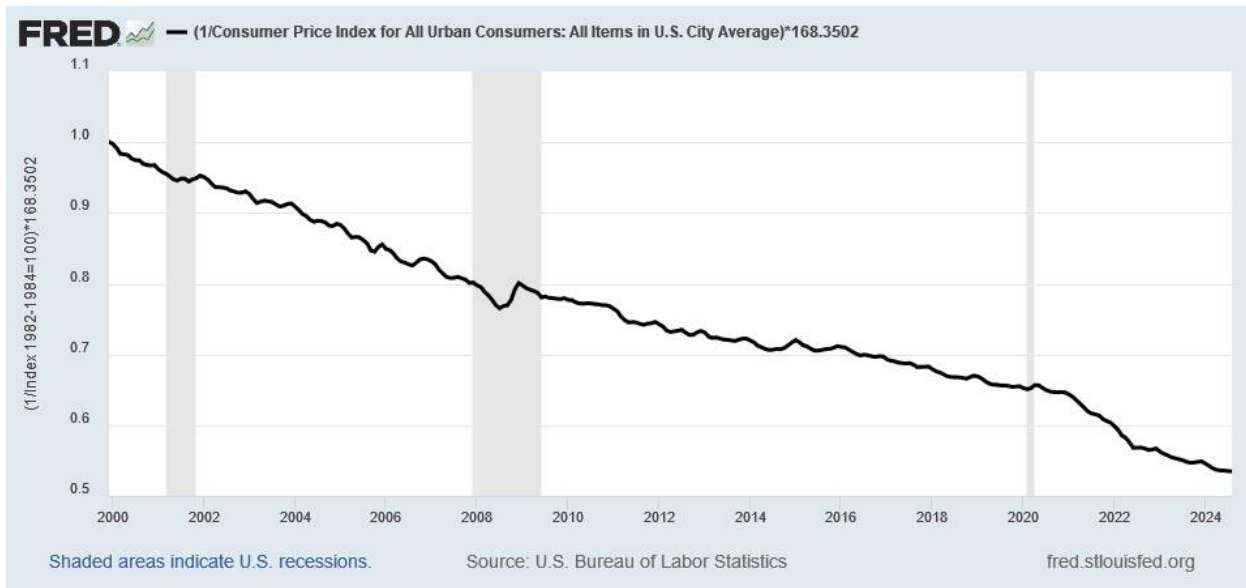
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that incomes kept up with prices, something the average American would vociferously dispute. (Please see <https://fred.stlouisfed.org/series/CPIAUCNS> for the official government data.)

The easiest way to understand this loss of purchasing power for the average American stands the real value of the US Dollar deflated by the CPI. Based on the official statistics, this looks as follows from January 2000 to today:

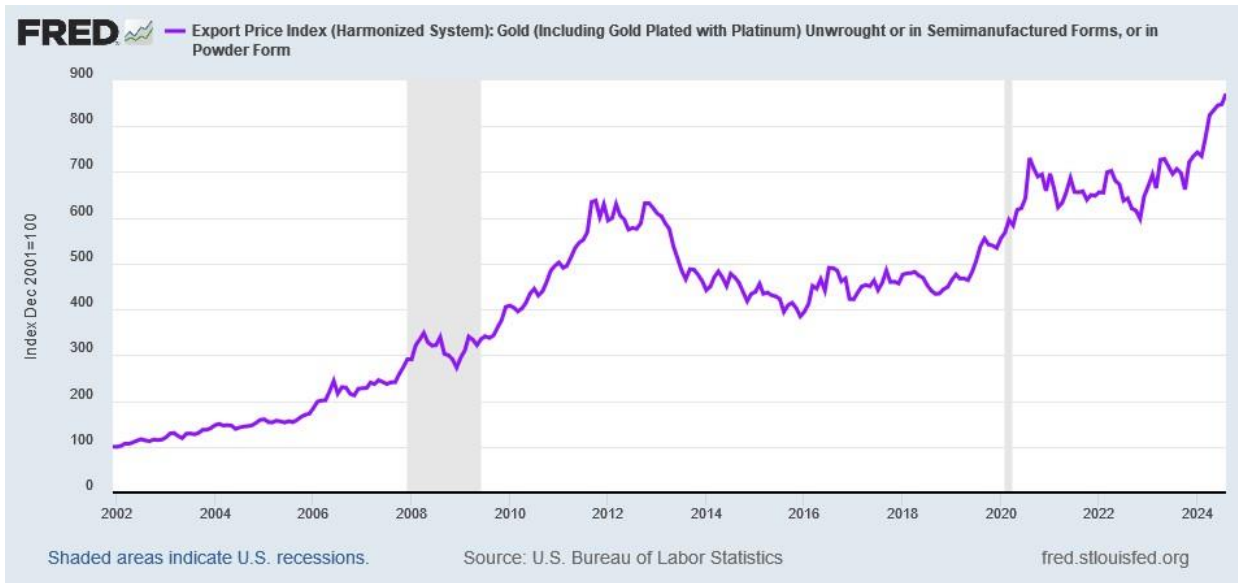


As the official data demonstrate, over the past 24 years, the value of the U.S. Dollar depreciated over 45%. If real world data replace the official statistics, the value of the U.S. Dollar fell over 80% in purchasing power. The easy way to demonstrate this stands the price of Gold, which stands a monetary unit that measures the real value of a currency for thousands of years. If the price of Gold is normalized to 100 in January 2001, then the value of Gold rose over 8x since then, as the following chart demonstrates:

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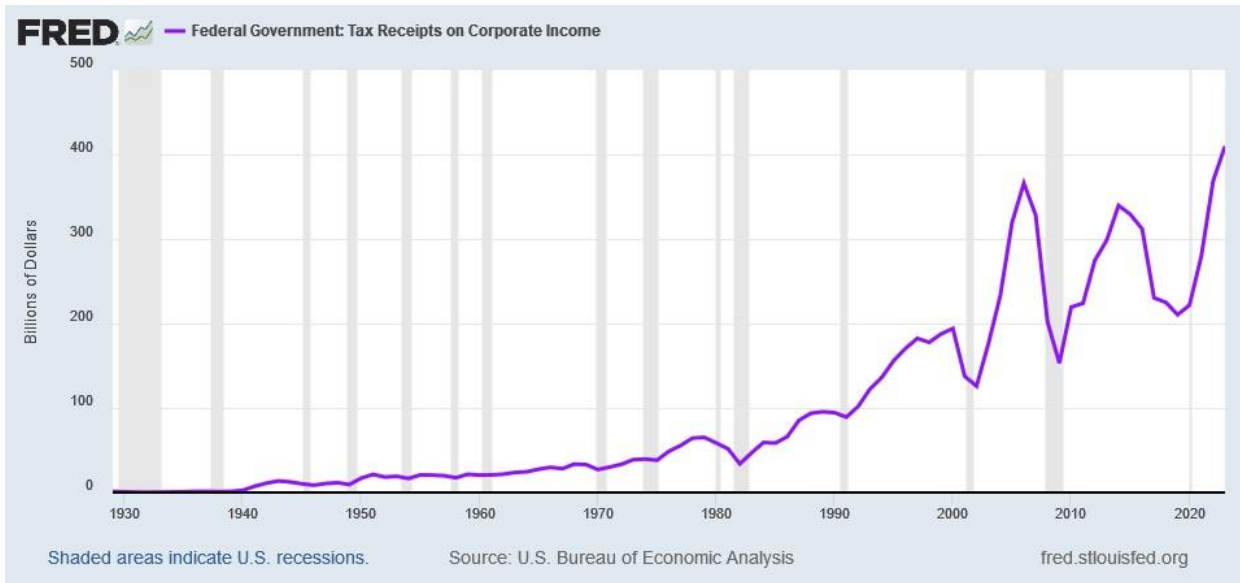
That value stood 871,2 as of August 31. Utilizing the closing price of Gold on September 27, 2023, the Index Value would rise to 919.6. This means, as measured in Gold, the value of the U.S. Dollar fell over 90% over the past 24 years. For Consumers told that the way to retirement stands savings, this promised land sounds like a fable when viewed in Depreciating Currencies.

In contrast to the pressure on Consumers, Corporations benefitted tremendously over this time frame, especially since 2019. Despite soaring Corporate Profits, as prices rose at a rate well above costs, Government tax receipts barely grew.

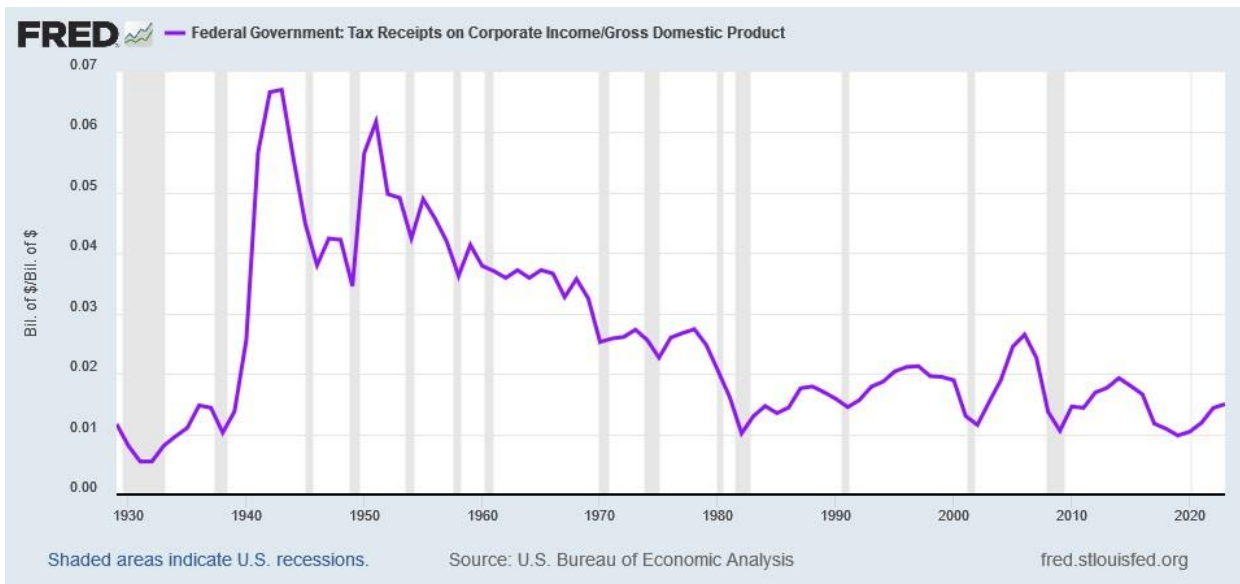
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And stand at record lows relative to GDP for a recovery:



Corporation used the numerous lines of the tax code coupled with overseas jurisdiction shifting to move corporate profits around to minimize taxes. Much of this occurs by creating profits in low or no tax jurisdictions and avoiding U.S. tax rates. In addition, with numerous tax credits littering the tax system,

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companies became very good at finding ways to not pay taxes legally. This sounds much like what the United Fruit Company did in the late 1800s to shield its profits from the Honduran government by creating the profits offshore.

This year's Presidential Campaign provides some interesting fodder. One party proposed Price Controls, mirroring those of 50 years ago but including rental properties. The inevitable result of such a policy, if enacted, stand Shortages and Black Markets. One need only look at The Netherlands to see how National Rent Control impacts the markets. Or to see how interventions by the state government in California to require Green Energy and ban fossil fuels, created electricity shortages and rolling blackouts. Neither have produced a positive outcome as originally expected. Both ignored the fundamental tenets of economics and how unintended consequences typically ensue with these types of legislation.

In addition, fundamental freedoms that Americans enjoy, such as Freedom of Speech, have come under attack. For those unfamiliar with American history, periodic attempts to squash Freedom of Speech reach back to the Alien and Sedition Acts of 1798. There were used by the Federalists to suppress the opposition party, the Democratic Republican Party, and any press associated with it. Over the past four years, viewpoints, that oppose official Government views, come under heavy attack as did the people espousing them from both the Government and the Media. Confirming this Government move to control the narrative across numerous aspects of the economy, data publicly revealed by Facebook demonstrate the Government actively moving to censor viewpoints. One Party proposed altering the judicial system, much as Mexico just did, in order to ensure that its proposals would withstand any legal challenge based on the Constitution of the United States of America. In addition, the Government moved to put one of the Presidential candidates in jail, which stands no different than Brazil or India where both parties in power moved to jail the opposition Presidential candidate.

For the United States, these actions eerily resemble those that occurred so long ago in Honduras. Stepping back, they include moves to promote corporate profits, lower citizens' earnings, remove freedoms, and punish political opponents. If one were to remove the name United States from the list of items, one would think they were experiencing Central America in the late 1800s, standing alongside O'Henry watching the actions of the United Fruit Company. With Inflation, Price Controls, Shortages, Depreciating Currencies, and the Loss of Freedoms, it appears America is Looking Like a Banana Republic.

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