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(guest lecturer)

Protectionism



UNIVERSITÀ DEGLI STUDI DI MILANO

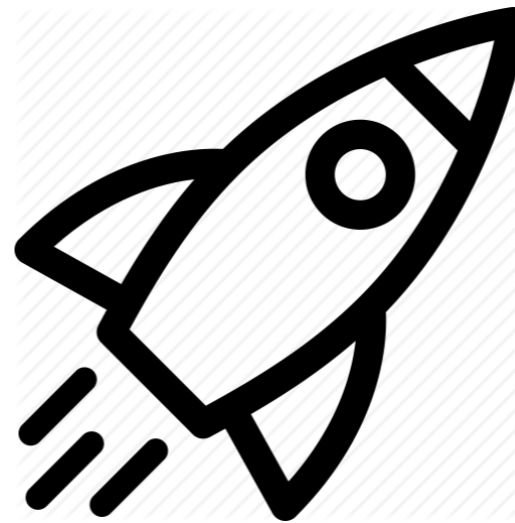
Course in Economic Geography (Prof. A. Vitale)
LLM in Sustainable Development, Faculty of Law, University of Milan

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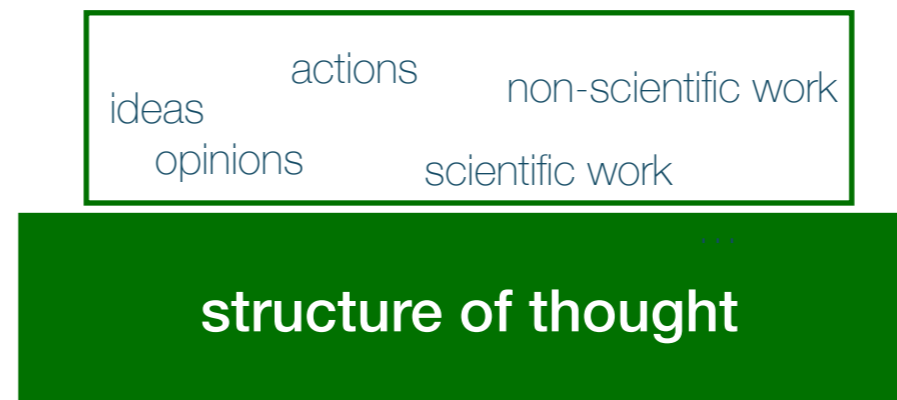
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- today and tomorrow we'll do some **structural thinking** about **protectionism**
- a **structure of thought** is **not** an idea, it is **not** an opinion: it is something much more **basic, elementary** and **preliminary** than that; it is the **ground** on which our ideas and our opinions rest



- the structure of thought is the **way we think**: it is the **'fabric'** of our thought, not its colour
- it is usually acquired **very early in life** and the longer the age, the more **difficult** it can become **to change it**

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- there can be **only two** structures of thought:
 - one which is **scientific**:
 - ◉ **incompatible** with **arbitrariness** and with **logical inconsistency**
 - the other one which is **unscientific**:
 - ◉ **compatible** with arbitrariness and with logical inconsistency
- a scientific structure of thought is **not** science, but it is the **necessary condition** to produce, understand or even only recognize science (and fake science)

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- the scientific and unscientific structures of thought are **not** mutually exclusive **in general**, but **only** in science (by definition)
- i.e. a person can have a **scientific** structure of thought when he talks about subjects which are related to economics or to liberty and (hopefully) an **unscientific** structure of thought when he talks about love, for instance: but he **cannot** have at the same time **both** structures of thought when he talks about economics or liberty
- an unscientific structure of thought is not a 'bad' thing **in general** (emotions, arts, human relations often require an unscientific structure of thought in order to flourish) but only when applied to subjects which are related to **science**, and in particular to social science
- in these lectures, unless differently stated, I will refer to the structure of thought **only** in relation to the field of **social sciences**, and more specifically to **the science of liberty** and to **economic science**

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- a structure of thought (**wether scientific or unscientific**) is something very **simple** which **every** thinking person has, **usually without realizing it**
- it is **quite common** to find individuals who are **not** social scientists and have a **scientific** structure of thought, as well as individuals who **are** acclaimed social scientists and have a **non-scientific** structure of thought
- while ideas, opinions, theories etc. are very often debated, structures of thought **very rarely** are: often they are not even acknowledged or they are taken for granted
- we often evaluate an idea, an opinion or a theory **without** evaluating the structure of thought on which it rests. However, no matter how massive the theoretical work is or how attractive the idea sounds, if the structure of thought on which they rest is invalid (unscientific), that work and that idea are invalid

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- the objective of these lectures is to discuss **protectionism** on the grounds of a **scientific** structure of thought
- actually, we'll go a step further: in discussing protectionism I will touch the **very beginning** of the science of liberty and of economic science
- I'll make sure that there is as much time for **debate** as possible
- feel **totally** free to challenge **anything** I'll say in **any way** you want: **I'm not an academic**, I'm **not neutral** and I **do not** believe in **political correctness**
- I think I have **at least as much** to learn from each and every one of you as you from me

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- **protectionism = use of *legal* coercion in order to limit or prevent *legitimate* free exchange**
- usually protectionism is defined in terms of international trade only
- however, the **structure** of a protectionist act (as defined above) is **exactly the same** quite **independently** from the fact that coercion is used to limit or prevent international trade, domestic trade or to ruin the life of one or more individuals, wherever they live. In other words, science requires definitions as general as possible

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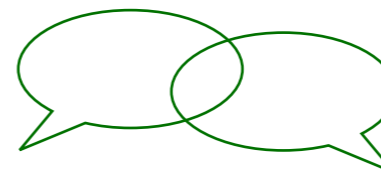
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TOMORROW

- basic economics of protectionism in the **particular case** of international trade
- **not** the most damaging form of protectionism

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- basic economics of protectionism in the particular case of **money** and **banking**
- **the** most damaging form of protectionism

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- we'll discuss possible practical ways out of protectionism, in particular **bitcoin** and bitcoin strategy

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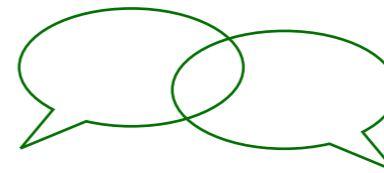
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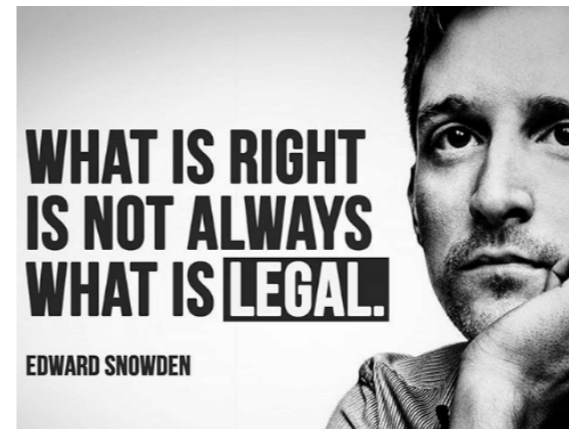
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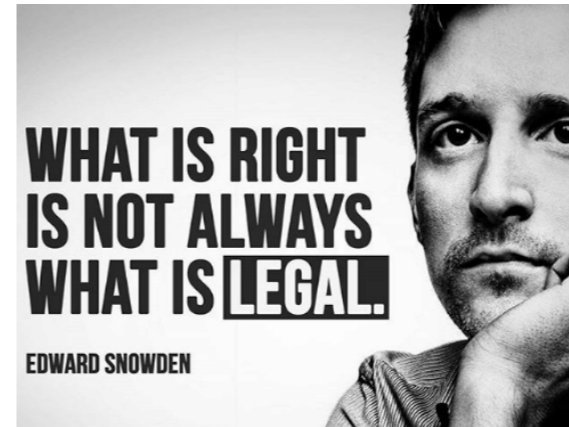
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- some of the worst crimes in history were **legal** (e.g. slavery, racial persecution, ...),

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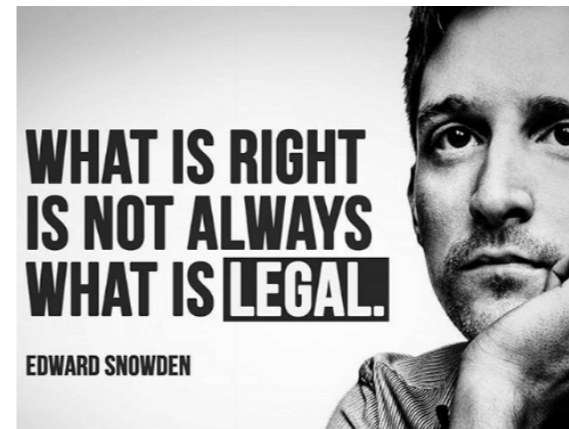
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- some of the worst crimes in history were **legal** (e.g. slavery, racial persecution, ...),
- they were **themselves a form of protectionism**

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- we have defined protectionism in terms of **legality** and of **legitimacy** (protectionism = use of **legal** coercion in order to limit or prevent **legitimate** free exchange)
- in order to understand **what protectionism is**, we have to preliminary understand:
 - a. **what is the law**
 - b. what is the **difference between legitimacy and legality**
- these are **scientific** questions: i.e. questions which **can** (and here **will**) be answered **scientifically**, that is **without** recurring to **arbitrariness** nor incurring into **logical inconsistency**
- **however** they can also be answered in **non-scientific way**: which is **extremely usual** but **objectively false**

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- objectively false (unscientific) idea of law: **positive** (or **fiat**) law
(**fiat**: arbitrarily created out of thin air)

- law as **instrument** of **arbitrary, coercive** power
- i.e. as **particular measure** which exists **only** as authority's **arbitrary decision**:
 - it makes authority's power **unlimited** and thus **ever expanding**
(before you ask, no: **constitutions** are no non-arbitrary limits to governments power, they are the **chastity belts** whose key is always within the bearer's reach**; in other words, they are also positive laws)

"That legislators, at least in the West, still refrain from interfering in such fields of individual activity as speaking or choosing one's marriage partner or wearing a particular style of clothing or traveling usually conceals the raw fact that [because of legal positivism, ed.] they actually do have the power to interfere in every one of these fields" (Leoni)*

- positive law can (usually does) have a **specific purpose** (end state), which is almost inevitably **protectionist**
- this purpose, of course, is considered to be a "**superior good**" by the 'legislative' authority

(*) Leoni B. 1991 [1961], p.9. (**) de Jasay A., 1985, p. 193 and 1997, p. 3.

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- legal positivism is an **objectively false (unscientific)** idea of law because it **necessarily** implies a **violation** of the principle of **equality before the law**
- often in the form of **legal inequality***: e.g. **authority's privileges**, progressive taxation, etc.
- the violation of the principle of equality before the law is **proof of structural scientific error** because it implies a **violation** of at least the first one of the two criteria for scientific meaning (but in fact of **both**):
 - **no arbitrariness**
 - **no logical inconsistency**

(*) legal inequality:

- the authority establishes an **arbitrary criterion** (e.g. race, wealth, authority itself...)
- it creates **categories** of individuals on the grounds of this criterion (arians and non arians; poor and rich; authority and non-authority)
- it treats **equally** individuals **within each category** and **differently** individuals who belong to **different categories** (e.g. racial 'laws', progressive taxation, taxation itself, etc.)

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- objectively true (scientific) idea of law: **non aggression principle, NAP** (or **negative** law)
 - the law is the **non-arbitrary limit** to **any** coercive power
 - it is a **general** principle (i.e. a general rule of **individual conduct**) which exists **independently** from any authority or majority
 - not being 'made', it **cannot** have a **specific purpose**
 - **scientific**: it is **the only** abstract idea of law which satisfies **both** criteria for scientific relevance
 - and of course the principle of **equality before the law** with **no exception** (e.g.: incompatible **authority's privilege**)

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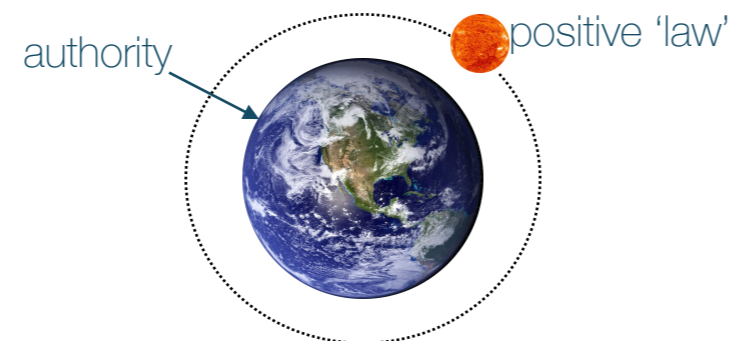
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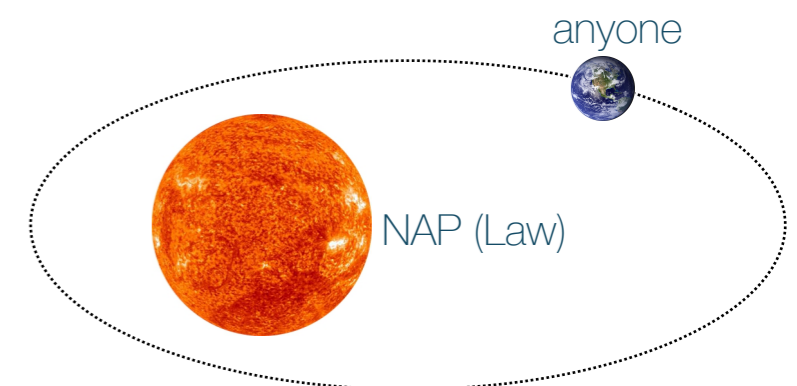
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- these two general ideas of law are “structural” because they form the **structure** of the legal system:

- logically, there can be **no “third way”**



the rule of authority (or of men)



*the rule of Law (**liberty**)*

- sticking to one structural idea of law in some cases (e.g. in the case of “**civil rights**”) and to the opposite one in other cases (e.g. the case of **taxation** or more in general of **state privileges**) is like believing that it is the Earth orbiting the Sun in some cases and the opposite in other cases

- the two structural ideas of law are **mutually exclusive**

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- now that we have scientifically defined **Law** and we have seen the difference between:

- **legality** (respect of authority's command: i.e. of positive law) and
- **legitimacy** respect of the **Law**: i.e. of the **NAP**

we can better understand the previous definition of **protectionism**

use of legal coercion in order to limit or prevent legitimate free exchange

- and actually see that there's is an **identity** between protectionism and government interventionism:

protectionism is government

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- the **structure** of the legal system (**rule of Law** vs. **rule of men**) determines:

a. the **structure** of **society**: **free** vs. **totalitarian**

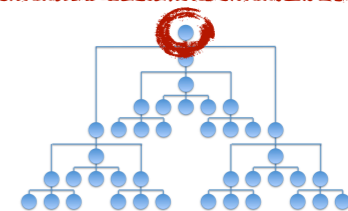
b. the **structure** of the **economic system**:

free market



Vs.

protectionism



- these different structures when applied to society and the economic system produce very **different outcomes**
- free market **cannot exist without liberty**, that is in violation of the NAP (e.g. **within a positive legal structure**): blaming today the free market (or **capitalism**) for a structural economic/social/environmental problem is like blaming a **benched player** for the outcome of the match*

(*) Mises L., 2005 [1927], p. xxiv

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- by making political power unlimited, in the long run legal positivism produces a **continuous expansion of protectionism** (i.e. of government intervention)
- such expansion is in the particular interests of **the parasitic bureaucracy** which controls the state machine
- in time, such an expansion produces an increasing **destruction of wealth** (see later) **and of liberty**

"This is the gravest danger that to-day threatens civilization: State intervention [i.e. protectionism, ed.]; the absorption of all spontaneous social effort by the State ... The result of this tendency will be fatal [...] Society will have to live for the State, man for the governmental machine ..." (Ortega y Gasset*)

(*) Ortega y Gasset J., 1993 [1930] pp. 120-122

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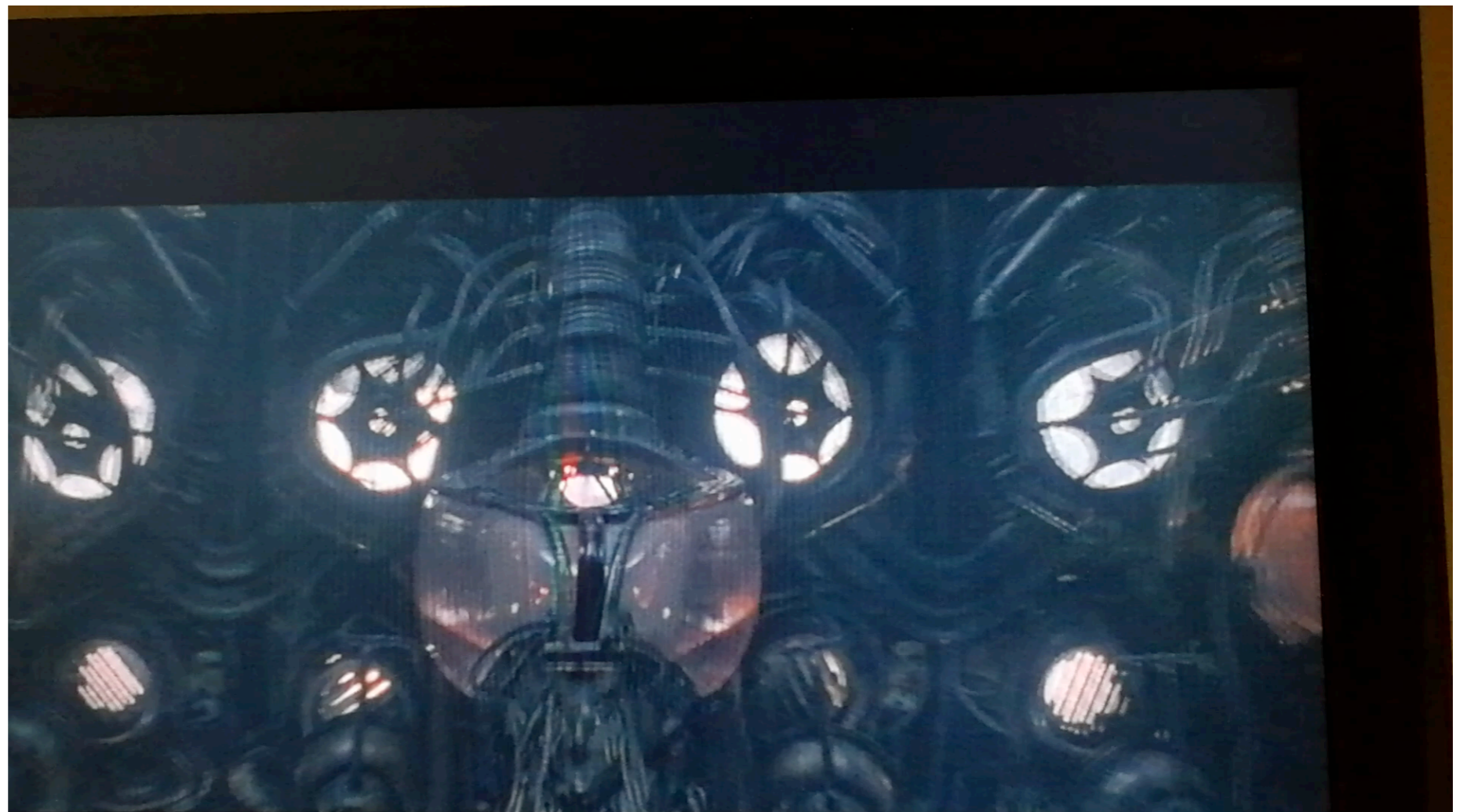
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"... this is what State intervention [i.e. protectionism, ed.] leads to: the people are converted into fuel to feed the mere machine which is the State" (Ortega y Gasset)*



from the movie *The Matrix*, 1999 by L & L.
Wachowski

(*) Ortega y Gasset J., 1993 [1930] pp. 120-122

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- Neo can understand **which one of the two** worlds is real **only when** he can see also the **alternative one**
- In the same way, today one person can understand **which one of the two** structural ideas of law is “real” (scientific) only when she can see (and logically evaluate) **also the alternative one**
- if an individual cannot critically see **both** structural ideas of law (as it happens in most cases) then he is in the **mental cage of positive law** imposed on him by the government
- he cannot imagine social **order**, **nor** sustainable **prosperity**, without the dominance of the very organization which is their greatest **obstacle**: the government itself
- he is the “**fuel to feed the mere machine which is the State**” Ortega y Gasset and the movie *The Matrix* describe
- in other words, he is an **intellectual slave**

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● to **recap**:

- the **Law**, in the **scientific** sense of the word, is only the **NAP**
- in fact, this is the **only possible** rule of conduct which is **compatible** with the principle of **equality before the law**
- like gravity, this principle exists **independently** from the will and ideas of anyone (and from whether it is acknowledged or not)
- to the extent that it is defended, it constitutes a **non-arbitrary limit** to anyone's coercive power
- **positive 'law'** is authority's **command**: it is the **instrument** of arbitrary coercive power
- **legality** is the respect of positive 'law'; **legitimacy** is the respect of the Law
- **protectionism** and **government itself** are **logically incompatible** with the **rule of Law** (i.e. **liberty**)

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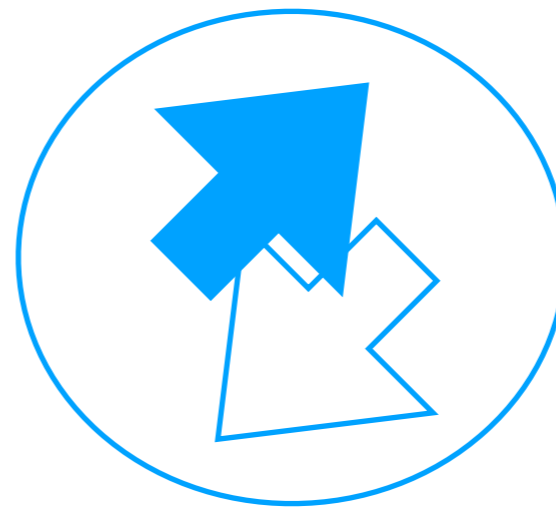
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“The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design” (Hayek)*

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protectionism = use of *legal* coercion in order to limit or prevent *legitimate* **free exchange**

- in order to understand protectionism we must understand what free exchange is and **its implications** (as well as the implications of the **lack of it**)
- to do this, we must do some **economic thinking**
- and we cannot do that if we do not have a **scientific** answer to the question: **what is economics?**

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- how many in this room would buy **more** dinners at their favourite restaurant if, **other conditions being equal**, its prices were **higher**?

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- how many in this room would buy **more** dinners at their favourite restaurant if, **other conditions being equal**, its prices were **higher**?
- example of economic law: **law of demand**:
 - **other conditions being equal**, the quantity demanded of a product/service **cannot** increase if its price increases
- economics is a (social) **science**: its laws are **objectively true**, **eternal** and **without exception** as the law of gravity*
- these laws are discovered by **a priori, logical deduction**

“An [economic, ed.] theory is subject to the tribunal of reason only. [...] it can never be valid for a bourgeois or an American if it is invalid for a proletarian or a Chinese” (Mises)*

*“You will never need to worry that newly published economic research will render [economic laws] false” (Murphy**)*

(*) the ‘theories’ of “conspicuous consumption” and “Giffen goods” describe cases in which the law of demand is supposed to be invalid. The theory of “**Giffen goods**” is invalid because it violates the “other conditions being equal” proviso. And so is the theory of “**conspicuous consumption**” (imagine inviting your partner to a restaurant and her man being without prices).

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- a great part of economics which today is taught in academia is based on **statistics**

- however, **empirical data cannot** proof or disproof an economic theory (e.g. law of demand). Only *a priori* logical reasoning (i.e. **abstract consistency**) can:

“The experience of a complex phenomenon - and there is no other experience in the realm of human action - can always be interpreted on the ground of various antithetic theories. Whether the interpretation is considered satisfactory or unsatisfactory depends on the appreciation of the theories in question established beforehand on the ground of aprioristic reasoning” (Mises)*

(*) Mises L., 1998 [1949], p. 41.

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- what are the laws of economics about? what is the **subject matter** of economics?

- **human action** (i.e. purposeful behaviour)

“Economics deals with the real actions of real men. Its laws refer neither to the perfect man, neither to the phantom of a fabulous economic man nor to the statistical notion of an average man [...] Man with all his weakness and limitations, every man as he lives and acts, is the subject matter [of economics]” (Mises)*

- economic laws do **not** have anything to say about the **content** of any individual's action; however, they **do** have something very precise to say about its **structure**
- all men act (persons are not engines): every person **is** an economist in one way or another and **can be** a better one

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- **by far the largest part** of so-called ‘economists’ don’t understand that economics is about **human action**: they have an unscientific (objectively wrong) idea about what economics is

“Economics is the study of how societies use scarce resources to produce valuable goods and services and distribute them among different individuals” (Samuelson)*

1. **“societies use ... distribute”**: *“Only the individual thinks. Only the individual reasons. Only the individual acts (Mises***) : ‘societies’ cannot act*: e.g. “use” or “distribute” resources
2. **“valuable goods”**: use of the **fundamental** term “value” **without defining it** and suggesting that something can be valuable **in general**, e.g. **for ‘society’**

(*) Samuelson P., Nordhaus W., 2010, p. 4.

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- fortunately, some academic economists have a correct idea about what economics is

“Economics is a Science that studies human behavior as a relationship between ends and scarce means which have alternative uses” (Robbins)*

1. **“human behaviour”**: economics as the study of human (i.e. individual) **action: not** of “society’s” action
2. implicit reference to the fact that **economic value is subjective** (“ends and scarce means” + “human behaviour”)

(*) Robbins L., 1932, p. 15.

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- subjectivity of economic value is the **starting point** of economic science (i.e. of the science of individual, **human action**)
- you can tell whether an economic theory, or an institution, or a policy, or a newspaper article, or a lecture by a professor, or a speech by a friend makes economic sense by checking if it is **consistent** with the subjectivity of value (not always easy to do)
- subjectivity of value means that economic value is **always in persons, never in things**: the **economic value** of smth for **John** is how much of **his own property** John is willing to **voluntarily exchange** for it in that moment
- **in this specific sense** it is the '**importance**' that something has for an individual at a certain moment (**economic value ≠ merit**: value depends on responsible action, merit on irresponsible **opinion** - protectionism often 'justified' on the ground of merit)
- **only John can know** what has value for him and why: no central authority can

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- some important **logical (scientific) consequences** of subjectivity of value which are immediately relevant for **protectionism**:
 - a. “**greater goods**” (e.g. “**social good**”, “**public interest**”, even “**national security**”) = **logical nonsense**
 - b. economic value can be created **only** by free exchange: if a free exchange takes place it means that at the moment of the exchange **both** parties thought they could **improve** their situation: they exchanged something they had for something they preferred
 - c. protectionism (i.e. interventionism) is **always** economically destructive because it limits or prevents the only possible way to create value (free exchange)
 - d. and again, free exchange is the only way to create economic value because it is **the only** process capable of using the **knowledge** about individual preferences and priorities on which value depends: a knowledge which is unavailable to any directing mind

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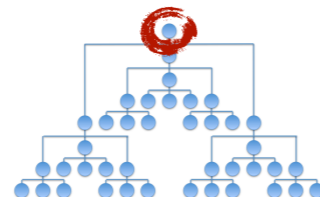
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References

“The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design” (Hayek)*

positive order

- order produced by **both** human action **and** human design: e.g., an **orchestra** or a **business**
- **unitary hierarchy of ends** (collective ends)
- primary use of **centralized knowledge**
- regulated by **positive law**



spontaneous order

- order produced by human action **but not** by human design: e.g., **free exchange economy** or the **market interest rate**
- **no unitary hierarchy of ends**: i.e. no collective ends, only individual ends (\neq egoistic ends)
- primary use of **decentralized knowledge**: **individual knowledge dispersed** among single persons and **unavailable** to any directing mind
- regulated by **negative Law**



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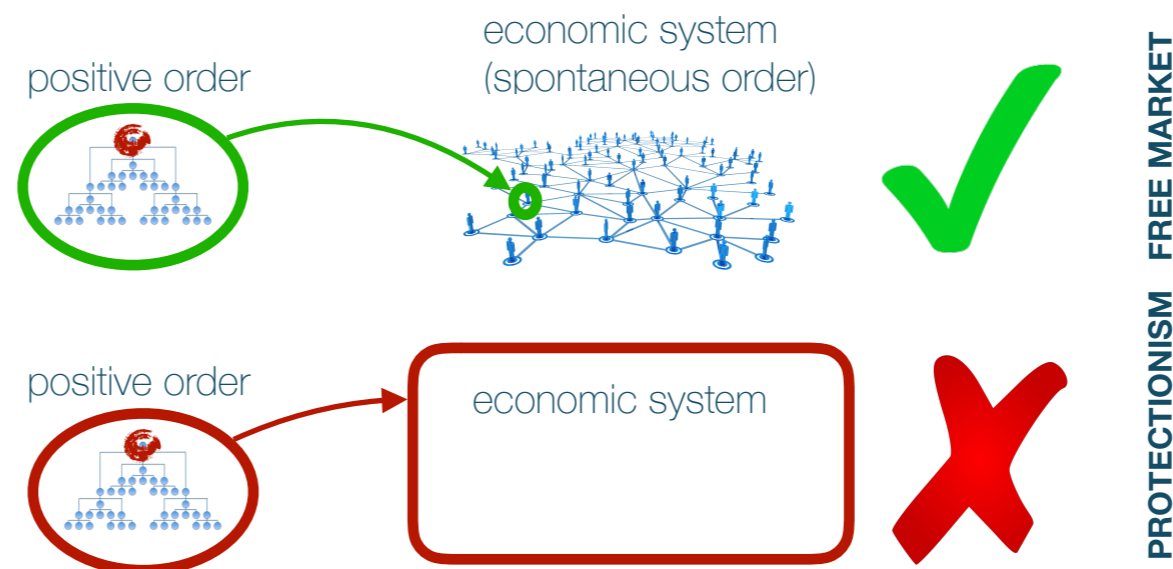
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- **which one** of the two social orders is better depends on the **knowledge** which is **relevant** in the particular case
- if relevant knowledge is **centralized** (e.g. if you want to play a symphony), **positive order** is the only possible one
- if relevant knowledge is **dispersed** (as it is in the case of the **economic system**: remember that economic value is **subjective**), **spontaneous order** is the only one compatible with liberty and prosperity
- **protectionism** (imposition of positive order on the economic system) is **scientifically incompatible** with economic science



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- to recap:
 - economics is the **science** which studies the **eternal** and universal **laws of human action**
 - these laws do not refer to the **particular details** of any individual's action but to its **general structure**
 - unlike what contemporary academia claims, economics is **not about statistics**: it is about **logic**
 - economic value is **subjective**
 - the **knowledge** relative to economic value is **individual** and **unavailable** to any directing mind
 - **only** the market process can make use of this knowledge
 - if a **free** exchange takes place, by definition **both** parties improve their situation
 - **only** free exchange can create economic value (**protectionism can only destroy it**)

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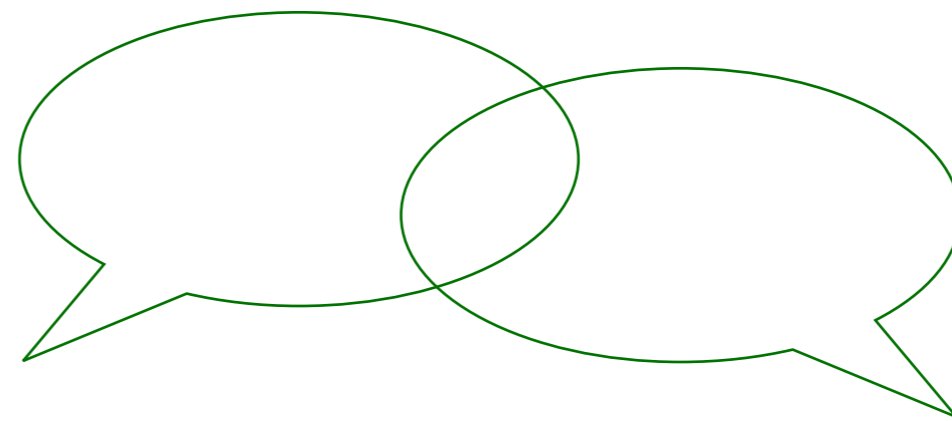
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let's discuss (fire at will)

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“The protectionists are out to cripple, exploit, and impose severe losses not only on foreign consumers [and producers, ed.] but especially on [domestic ones]. And since each and every one of us is a consumer, this means that protectionism is out to mulct all of us for the benefit of a specially privileged, subsidized few — and an inefficient few at that: people who cannot make it in a free and unhampered market” (Rothbard)*

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- in the **particular case of international trade** protectionism can take different forms, e.g.:

● **tariffs**

The New York Times
April 9, 2019

U.S. Readies \$11 Billion in Tariffs on E.U.

BUSINESS NEWS APRIL 12, 2019 / 5:10 PM / 13  **REUTERS**

Exclusive: EU tariffs to target 20 billion euros of U.S. imports -

● **subsidies**

BUSINESS NEWS MAY 2, 2018 / 4:10 PM / A YEAR AGO

 **REUTERS**

EU proposes to cut farm subsidies, France says unacceptable

● **quotas**

Bloomberg

Technology

Netflix, Amazon Forced to Fund European Video Under New Rule

By Natalia Drozdiak

2 ottobre 2018, 12:27 CEST Updated on 2 ottobre 2018, 15:07 CEST

● **regulations**
(incl. 'safety' regulations)

CE marking is a certification **mark** that indicates conformity with health, safety, and environmental protection standards for products sold within the **European** Economic Area (EEA). ... The **CE marking** is the manufacturer's declaration that the product meets the requirements of the applicable EC directives.

✓ **CE marking - Wikipedia**
https://en.wikipedia.org/wiki/CE_marking



ec.europa.eu

● **other...**

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- what distinguishes 'international trade' from 'trade' is the existence of **political borders**
- but what is the relevance of political borders to economic **science**?

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ZERO

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NO RELEVANCE WHATEVER

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- but what is the relevance of political borders to economic **science**?

NO RELEVANCE WHATEVER

“The best way to look at tariffs or [...] other protectionist restraints is to forget about political boundaries [which] have no economic meaning whatever. The absurdity of worrying about the balance of payments [and thus ‘trade deficits’, ed.] is made evident by focusing on interstate trade. For nobody worries about the balance of payments between New York and New Jersey” (Rothbard)*

(*) Rothbard M.N., 2012 [1995], pp. 356-357

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- “excessive trade deficits” are but **one** of the **countless nonsensical ‘reasons’** usually given by governments for imposing protectionist measures
- other **‘reasons’** are “fair prices”, “cultural identity”, “national security” (of course...), “safety”, “public interest”, “strategic sectors”, etc.
- from the previous sections we now know why **all** these ‘reasons’ are **nonsensical**
- for example, we know that:
 - the only **“fair price”** is the **free market price**;
 - because of the **subjectivity of value**, if a free exchange takes place **both** parties improve their situation;
 - a manipulation of free market prices necessarily hampers the **spontaneous order** of the free market process which is the **only way** to create economic value

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- in other words we **already know** the **fundamental scientific reasons** why protectionism is **always** bad (for liberty and for the economy)
- in what follows, we'll look more specifically at some **graphical aspects** of the **economics of protectionism** in the case of **international trade** with particular reference to **tariffs** and **subsidies**
- **graphical analysis** is helpful in order to see some particular aspects which otherwise would take too long to describe
- however, I strongly emphasize the fact that graphical analysis says **only a (small) part** of the story (and that it can be used to tell a **false** story)

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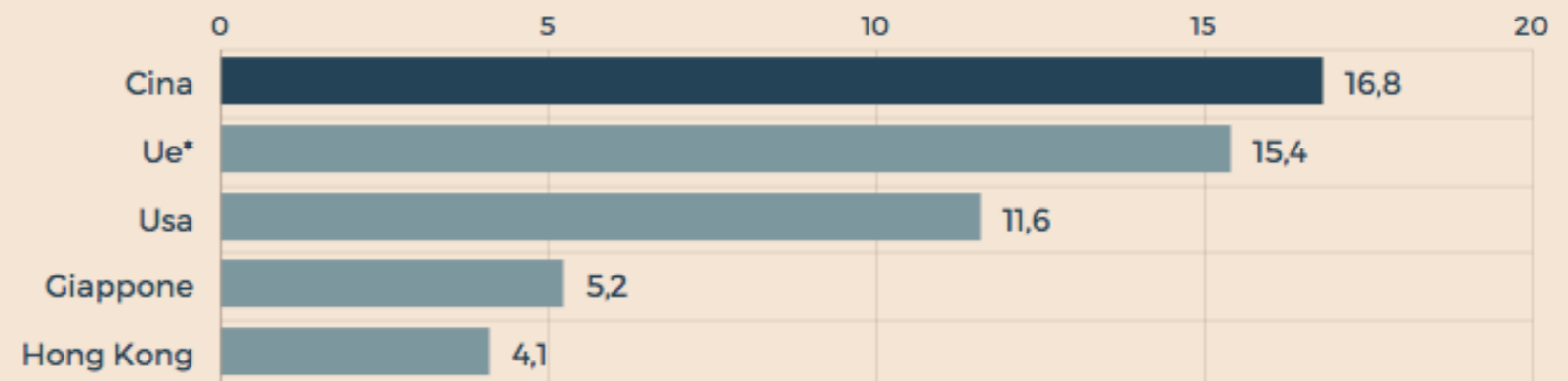
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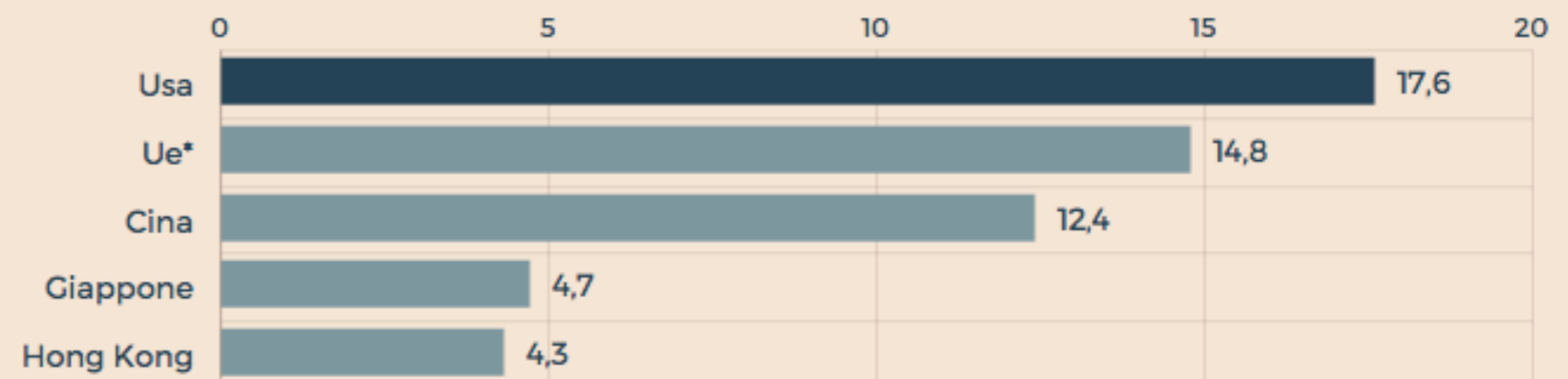
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PRIME 5 AREE ECONOMICHE PER ESPORTAZIONI DI BENI

Quota % sul totale. Nota: (*) esclusi gli scambi intra-Ue. (Fonte: Wto)

**PRIME 5 AREE ECONOMICHE PER IMPORTAZIONI DI BENI**

Quota % sul totale. Nota: (*) esclusi gli scambi intra-Ue. (Fonte: Wto)



<http://www.ilsole24ore.com/art/mondo/2017-04-12/economia-e-commercio-accelerano--ma-incombe-minaccia-dazi-131503.shtml?uuid=AEcLS93>

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US GLOBAL TARIFFS (2018/2019)			
date	object	tariff	"justification"
22-jan-18	washing machines	20%-50%	"global safeguard" to protect US producers
22-jan-18	solar panels	30%	"global safeguard" to protect US. producers
23-mar-18	aluminum	25%	"national security"
09-apr-19	planes, dairy products, wine, other...	*	retaliation against EU subsidies for Airbus (\$11bln)
may 2019°	cars and auto parts	N.A.	"national security"

EU TARIFFS ON US (2018/2019)

date	object	tariff	"justification"
22-jun-18	Harley-Davidson, bourbon, peanuts, blue jeans, steel, aluninum, other...	25%	retaliation against US tariffs
10-apr-19	planes, wine, other...	*	retaliation against US tariffs of 9-apr-19 (\$20bln)

* announced, to be confirmed (31 May)

° under consideration

Source: Reuters (<https://www.reuters.com/article/us-usa-trade-tariffs-factbox/factbox-tariff-wars-duties-imposed-by-trump-and-u-s-trading-partners-idUSKCN1PO06K> ; <https://www.reuters.com/article/us-usa-trade-eu/u-s-planes-tractors-on-eu-tariff-list-over-boeing-idUSKCN1RT12G>); <https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/>

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US TARIFFS ON CHINA (2018/2019)				
date	object	bln worth (\$)	tariff	"justification"
6-jul-2018	technology: including machinery, semiconductors, autos, aircraft parts, intermediate electronics components (\$50 bln worth)	50	25%	retaliation against China intellectual property practices
24-sep-2018	goods: including chemicals, building materials, furniture, some consumer electronics	200	10%*	response to chinese retaliation
threatened	all remaining imports: including cell phones, computers, clothing, footwear and other consumer products	267	N.A.	if agreement with China cannot be reached
CHINA TARIFFS ON US (2018/2019)**				
date	object	bln worth (\$)	tariff	"justification"
6-jul-2018 & 23-aug-2018	soybeans, beef, pork, seafood, vegetables, whiskey, ethanol	50	25%	retaliation for initial rounds of US tariffs
24-sept-2018	goods including liquefied natural gas, chemicals, frozen vegetables, food ingredients	60	5%-10 %	retaliation
threatened	all remaining imports including commercial aircraft	20	N.A.	retaliation
threatened	regulatory hurdles		N.A.	retaliation
(*) on May 6 2019 the US administration threatened to increase these tariffs from 10% to 25% (**) China has suspended a 25% tariff on US auto imports during trade negotiations Source: Reuters (https://www.reuters.com/article/us-usa-trade-tariffs-factbox/factbox-tariff-wars-duties-imposed-by-trump-and-u-s-trading-partners-idUSKCN1PO06K ; https://www.reuters.com/article/us-usa-trade-eu/u-s-planes-tractors-on-eu-tariff-list-over-boeing-idUSKCN1RT12G); https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/				

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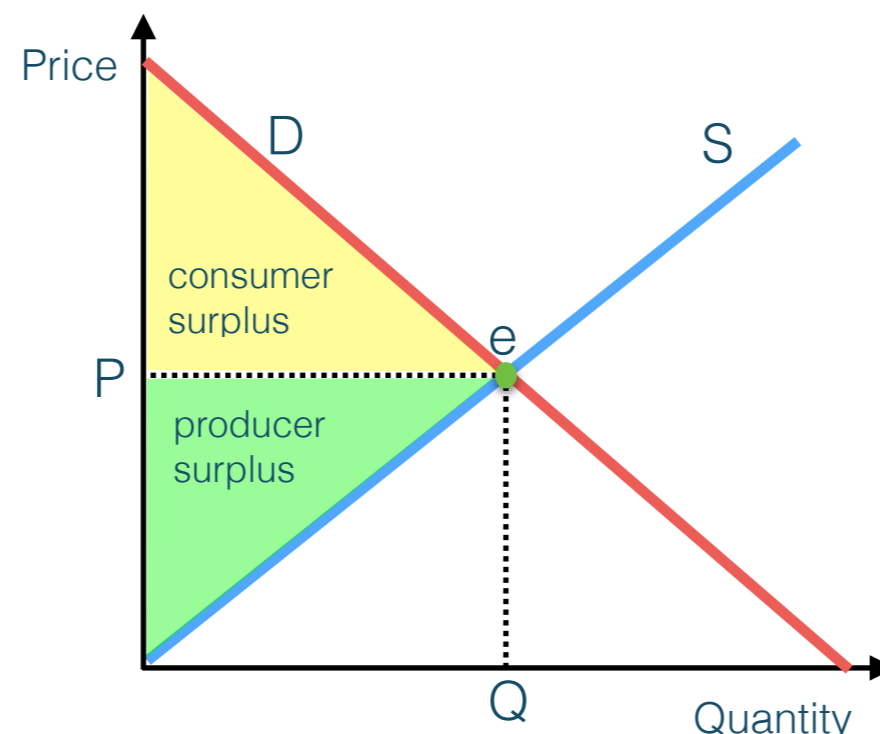
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- what follows is the **typical, graphical textbook analysis** of protectionism
- **D, S**: graphical transposition of **Laws of Demand/Supply**
 - **individual** D&S: **not** aggregate (macro **from** micro)
 - in realty curves are **irregular** and change in **time**
 - we'll assume trades in **global currency** (e.g. gold): it's simpler and it allows us to focus on the economic process (**monetary manipulation discussed in following section**)



- **consumer surplus**: value a consumer gets beyond what he pays
- **producer surplus**: profit: income above cost of production

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● The following SD analysis will show 3 things:

1. a **tariff (subsidy)** affects **all** parties participating in the exchange (e.g. consumer/producer): **not only those hit by the tariff** (or privileged by the subsidy)
2. the **proportion** in which it will affect the parties involved in the exchange depends on the **elasticity** of D & S (i.e. how sensitive the demand or supply of a product is to changes in other economic variables, e.g. price),
3. its **direct** effect on the consumer **and** on the producer is **exactly the same** whether the tariff is applied to one or the other

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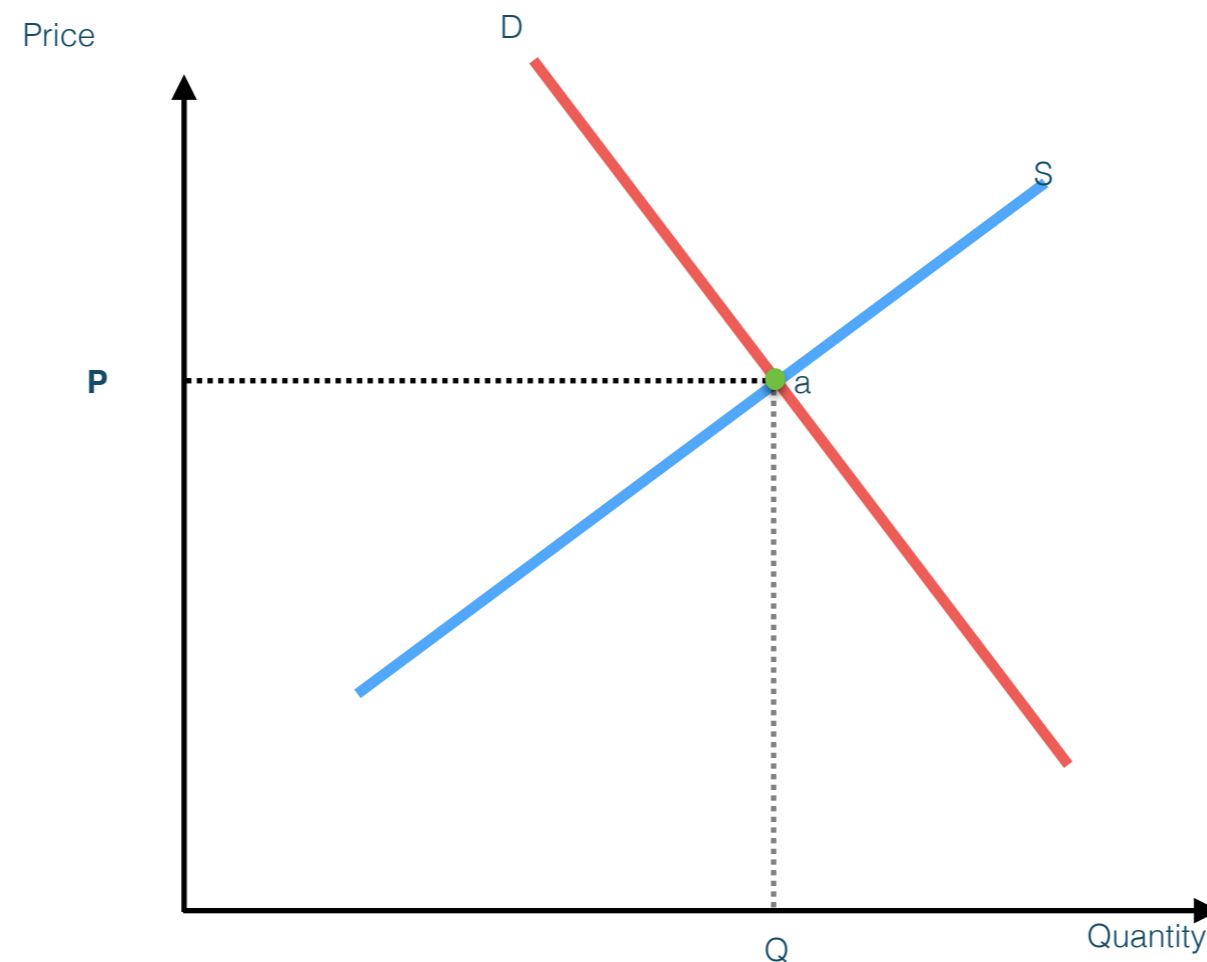
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● tax **on producer (tp)**Symbols:

- D: Demand
- S: Supply
- Q: Quantity sold under free trade
- P: Price under free trade (€)



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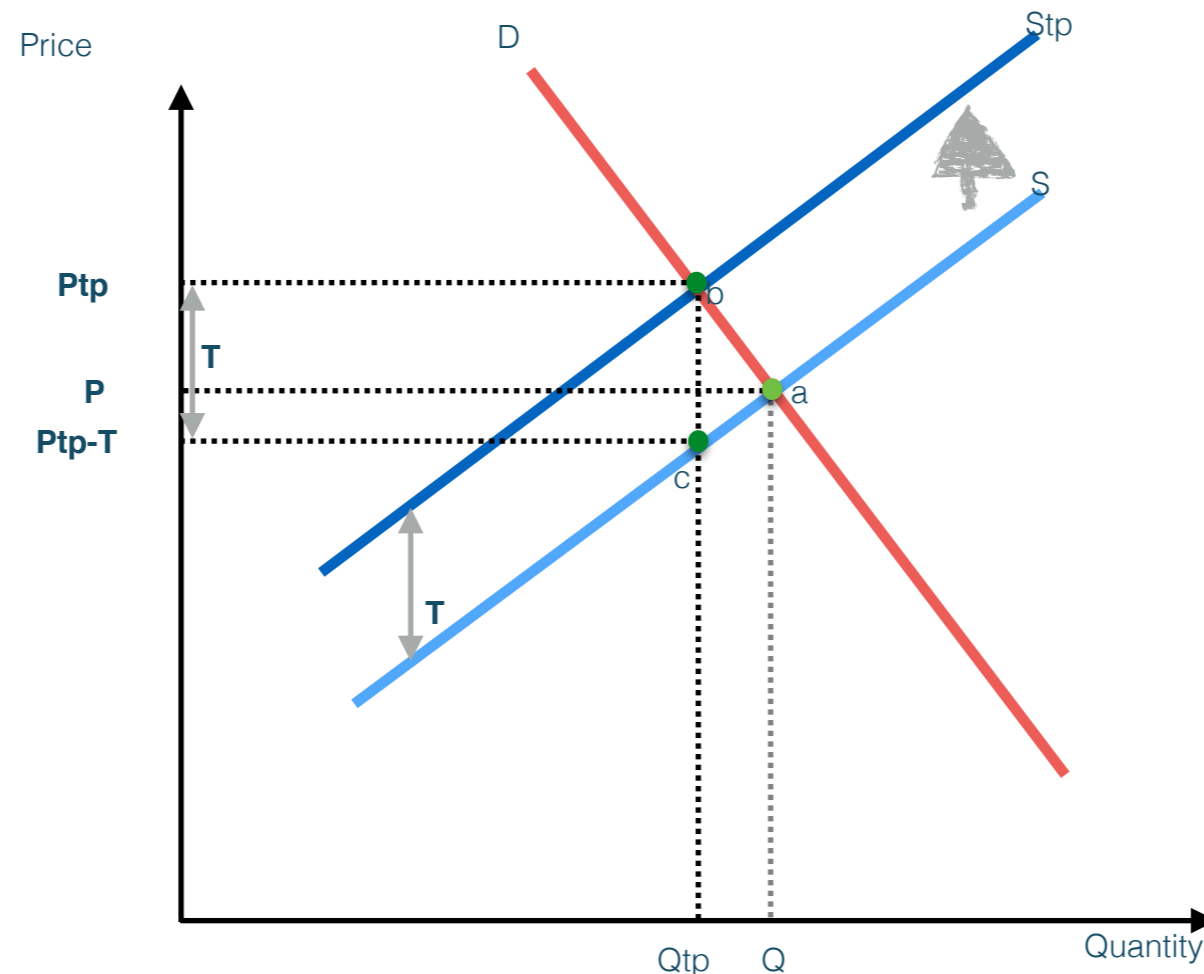
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References

● tax on producer (tp)

Symbols:

- D: Demand
- S: Supply
- S_{tp} : Supply after tax on producer
- T: Tax per unit (€)
- Q: Quantity sold under free trade
- Q_{tp} : Quantity sold after tax on producer
- P: Price under free trade (€)
- P_{tp} : Price after tax on producer (€)
- $P_{tp}-T$: €/unit received by producer after tax



1. Supply **shifts up** by **T** (T=higher cost of production per unit: producer is willing to supply a lower quantity at any given price)
2. In **new eq. (b)**,
 - **Consumers** pay **P_{tp}** ($>P$) and purchase **Q_{tp}** ($<Q$);
 - **Producers** receive **$P_{tp}-T$** ($<P$) and sell **Q_{tp}** ($<Q$);

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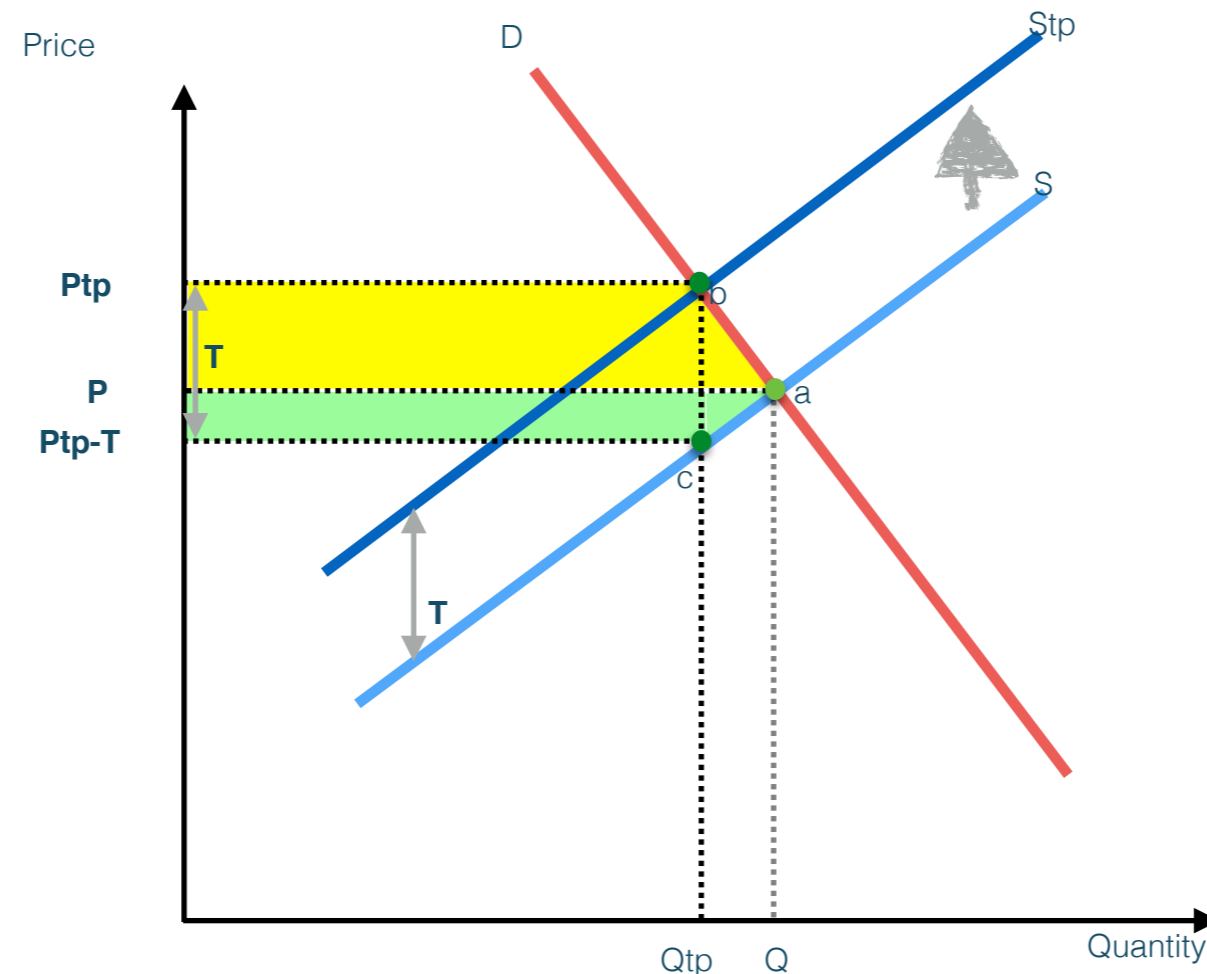
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 - **Producers** receive **$P_{tp}-T$** ($<P$) and sell **Q_{tp}** ($<Q$);

- **Yellow** area ($P; P_{tp}; b; a$): **loss of value to the consumer**
- **Green** area ($P_{tp}-T; P; a; c$): **loss of value to the producer**

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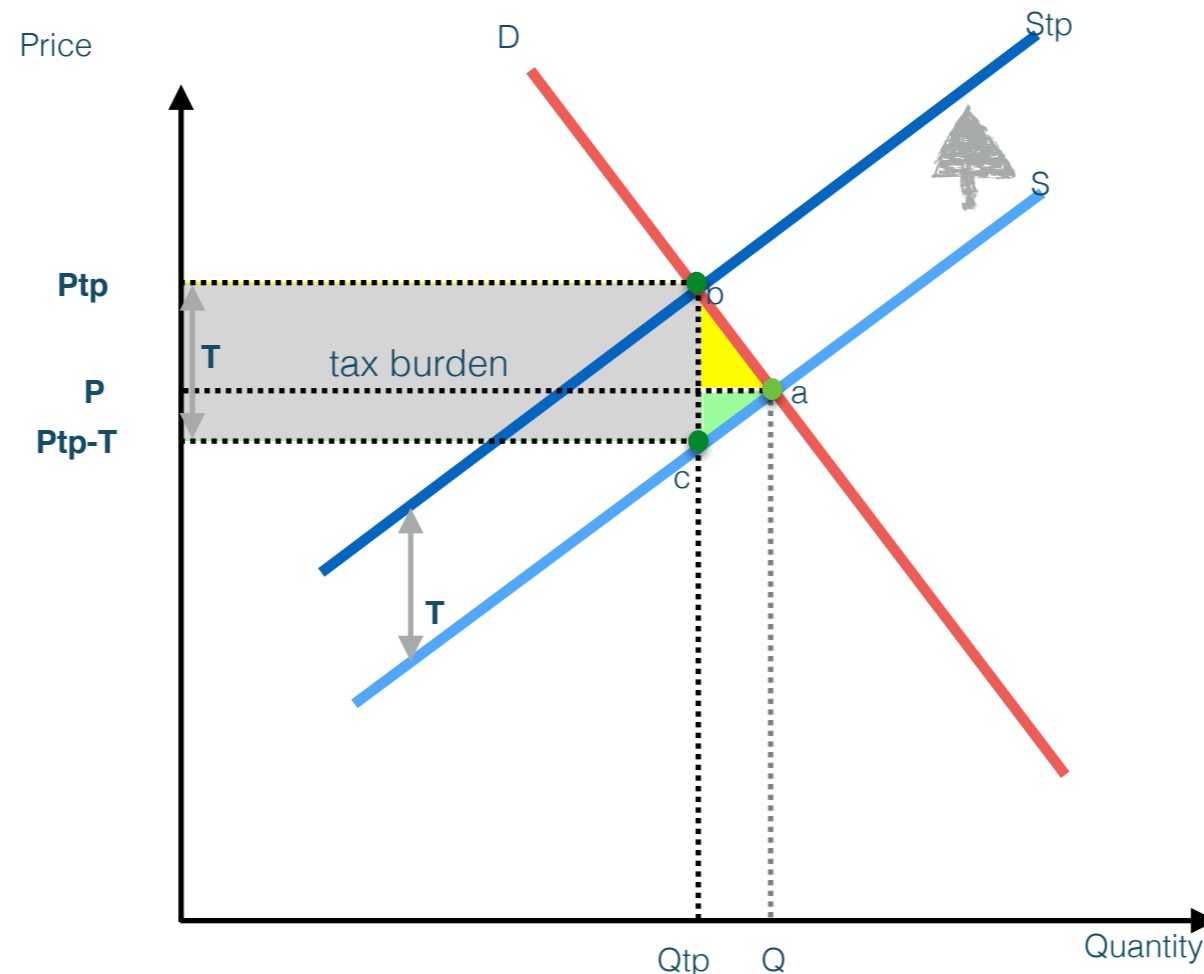
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 - **Producers** receive **$P_{tp}-T$** ($<P$) and sell **Q_{tp}** ($<Q$);

- **Yellow** area ($P; P_{tp}; b; a$): **loss of value to the consumer**
- **Green** area ($P_{tp}-T; P; a; c$): **loss of value to the producer**
- **Grey** area ($P_{tp}-T; P_{tp}; b; c$): **tax burden** (or 'tax revenue')
- the loss of value to the market participants $>$ tax burden (or 'revenue'): "**dead-weight loss**" ($a; b; c$)
- however, the concept of dead-weight loss implies that tax revenue = 'social gain'.
- 'social gain' **does not exist** (Section 2.c)

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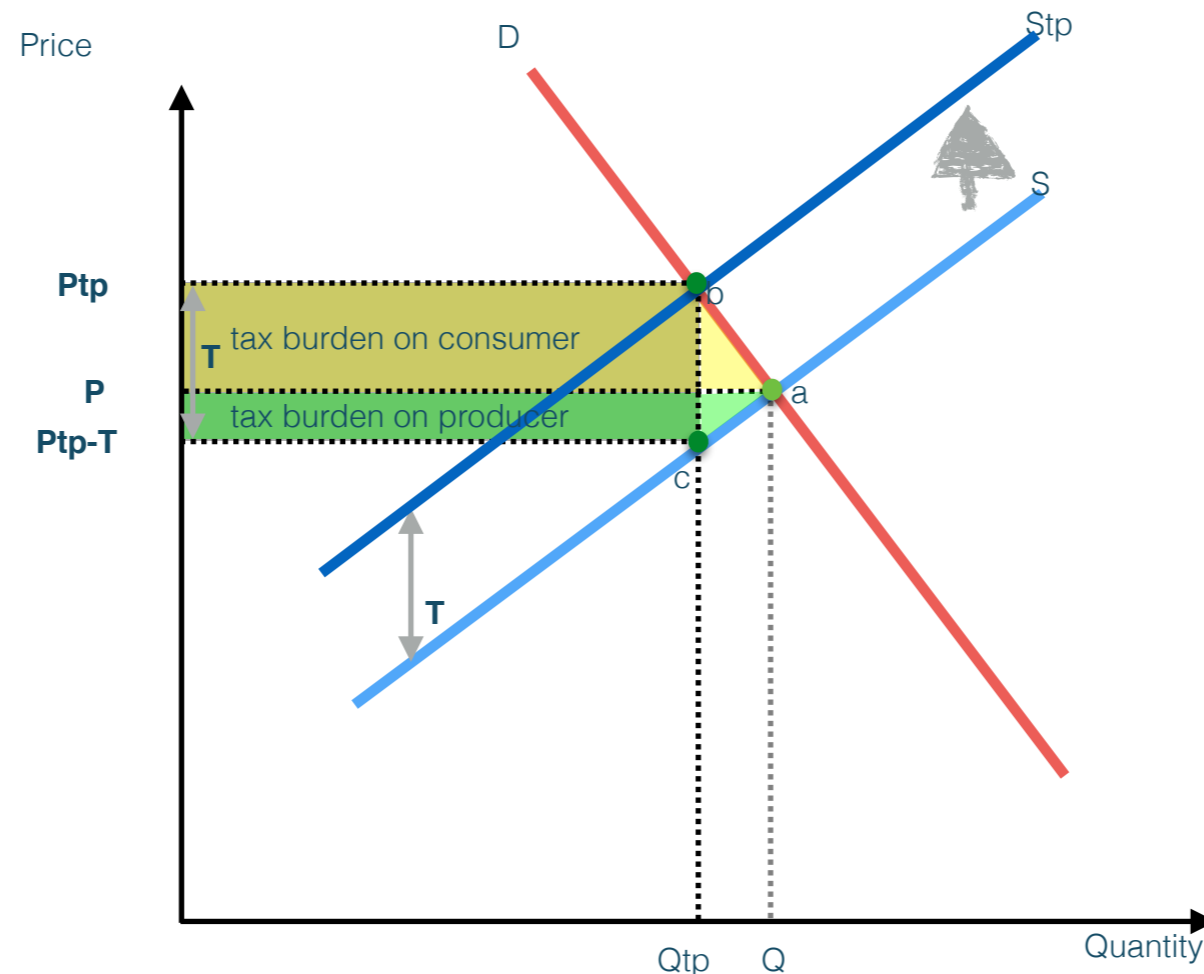
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● tax on producer (tp)

Symbols:

- D: Demand
- S: Supply
- S_{tp} : Supply after tax on producer
- T: Tax per unit (€)
- Q: Quantity sold under free trade
- Q_{tp} : Quantity sold after tax on producer
- P: Price under free trade (€)
- P_{tp} : Price after tax on producer (€)
- $P_{tp}-T$: €/unit received by producer after tax



1. Supply **shifts up** by **T** (T =higher cost of production per unit: producer is willing to supply a lower quantity at any given price)
2. In **new eq. (b)**,
 - **Consumers** pay **P_{tp}** ($>P$) and purchase **Q_{tp}** ($<Q$);
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- **Tax burden is distributed between consumers** ($P; P_{tp}; b; c$) **and producers** ($P_{tp}-T; P; a; c$)

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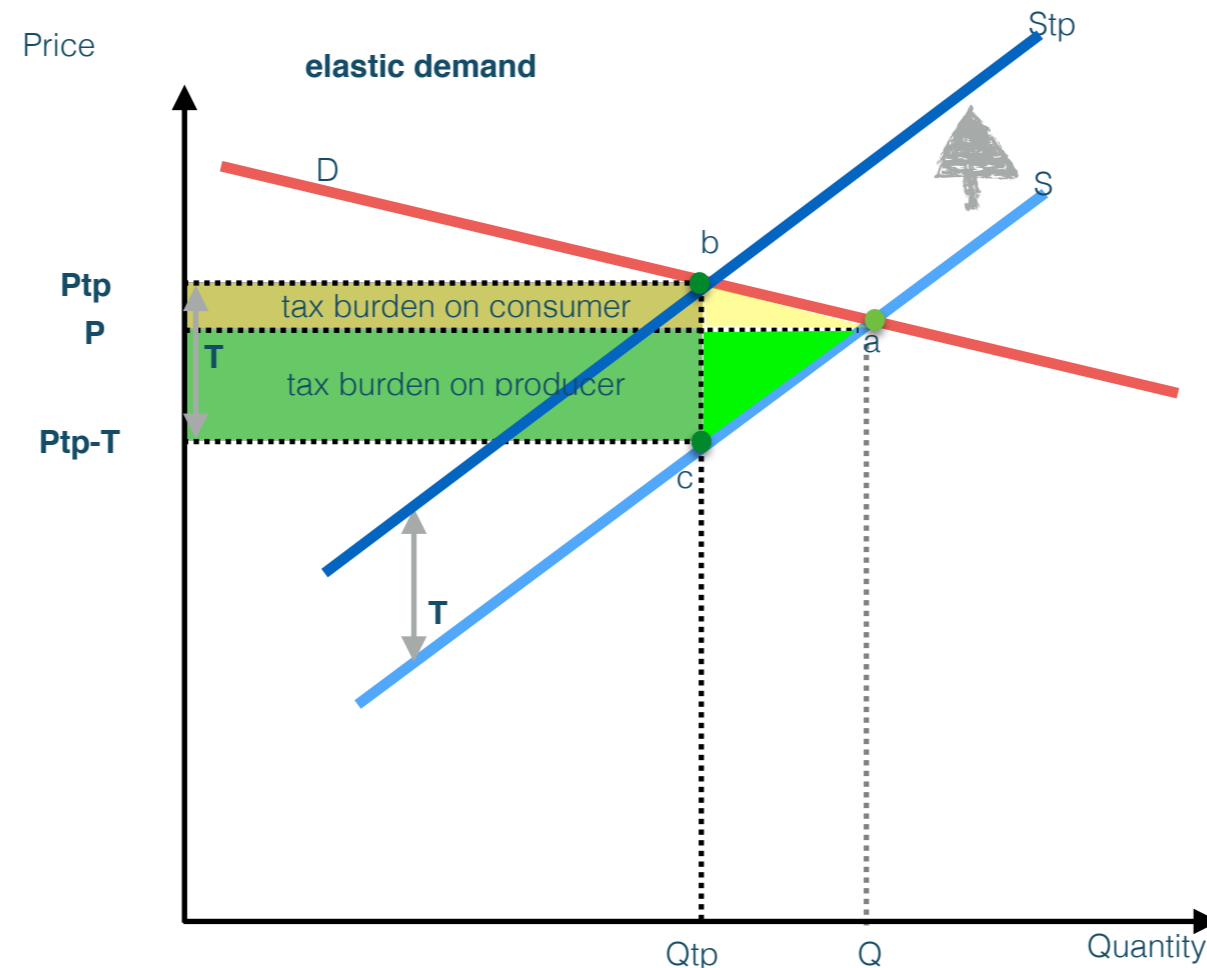
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- **distribution of tax burden depends on elasticity**: how sensitive the demand (supply) of a product is to changes in other economic variables (e.g. price)

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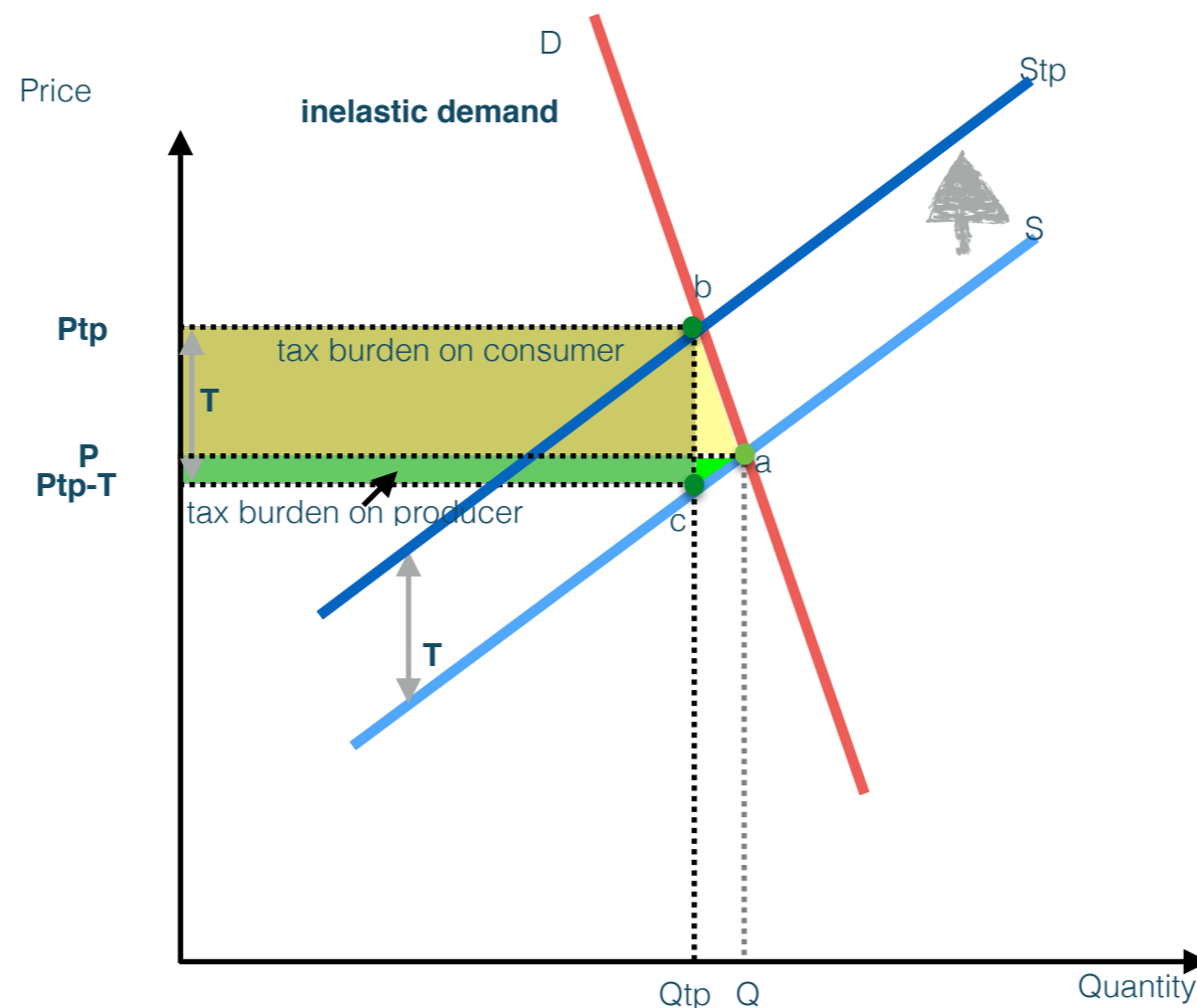
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- P_{tp} : Price after tax on producer (€)
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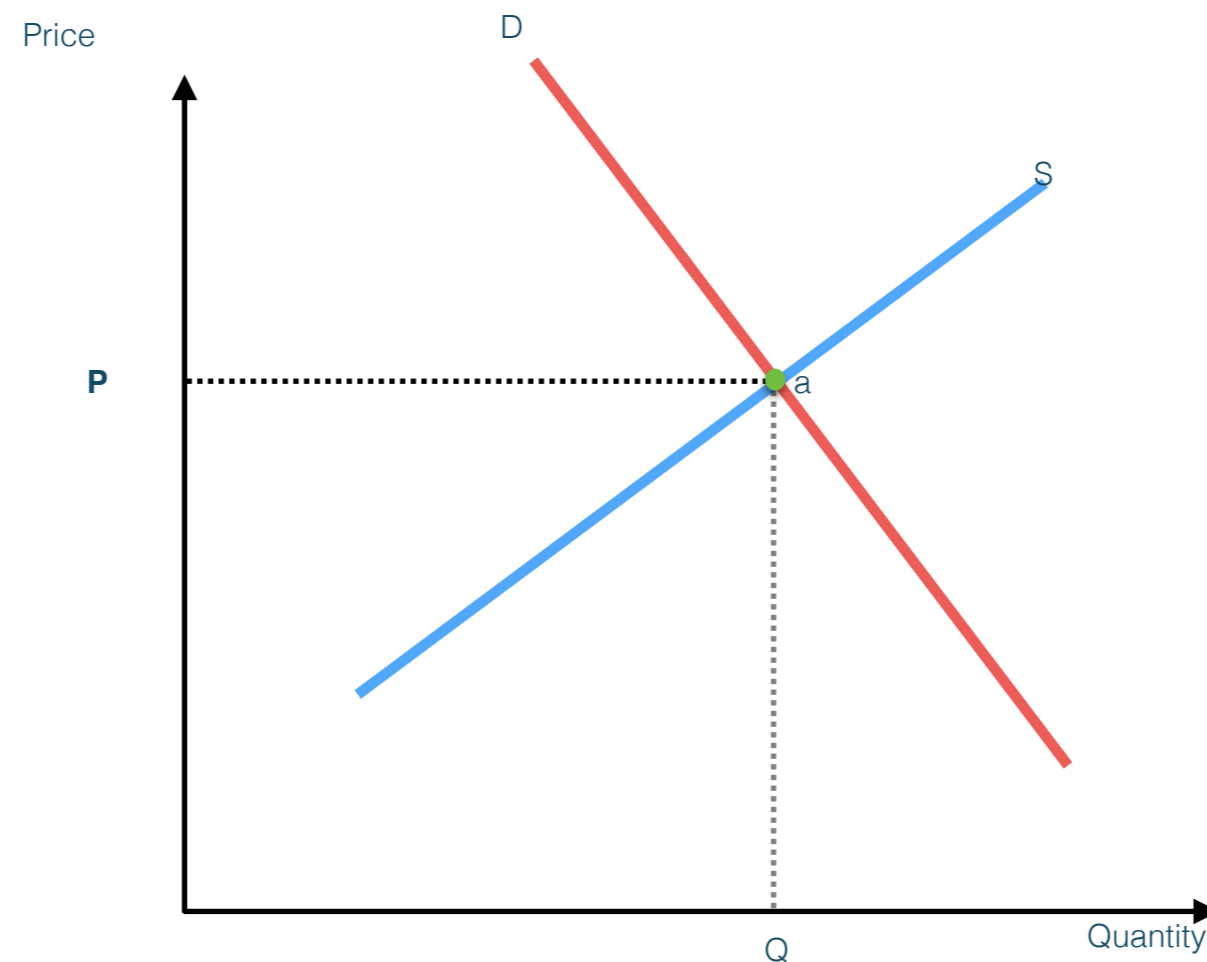
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● tax **on consumer** (tc)Symbols:

- S: Supply
- D: Demand
- Q: Quantity sold under free trade
- P: Price under free trade (€)



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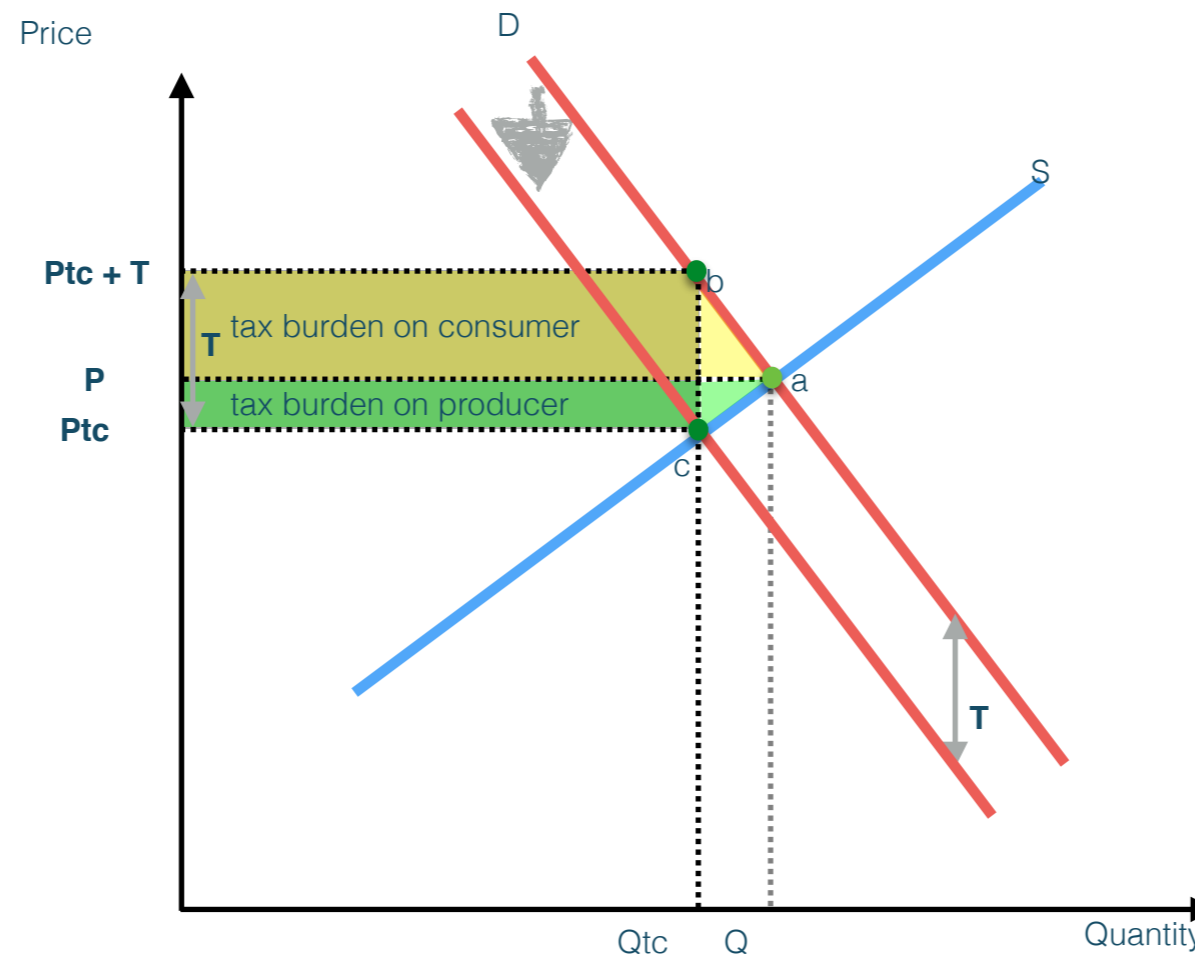
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● tax on consumer (tc)

Symbols:

- S: Supply
- D: Demand
- Dtc: Demand after tax on consumer
- T: Tax per unit (€)
- Q: Quantity sold under free trade
- Qtc: Quantity sold after tax on consumer
- P: Price under free trade (€)
- Ptc: Price after tax on consumer (€)
- Ptc+T: €/unit spent by consumer after tax



1. D shifts **down** by **T** (T=higher price per unit for consumer: consumer is willing to buy a lower quantity at any given price)
2. In **new eq. (c)**,
 - **consumers** pay **Ptc+T (>P)** and purchase **Qtc (<Q)**;
 - **producers** receive **Ptc (<P)** and sell **Qtc (<Q)**;
 - tax burden is distributed (**as before**) between consumers and producers

- **Yellow** area (P;Ptc+T;b;a): **loss of value to the consumer**
- **Green** area (Ptc;P;a;c): **loss of value to the producer**
- **Grey** area (Ptc;Ptc+T;b;c): **tax burden** (or 'tax revenue')
- the loss of value to the market participants > tax burden (or 'revenue'): **"dead-weight loss"** (a;b;c)
- however, the concept of dead-weight loss implies that tax revenue = 'social gain'.
- 'social gain' **does not exist** (Section 2.b)
- **Tax burden is distributed between consumers** (P;Ptc+T;b,c) **and producers** (Ptc;P;a;c)
- **distribution of tax burden depends on elasticity**: how sensitive the demand (supply) of a product is to changes in other economic variables (e.g. price)

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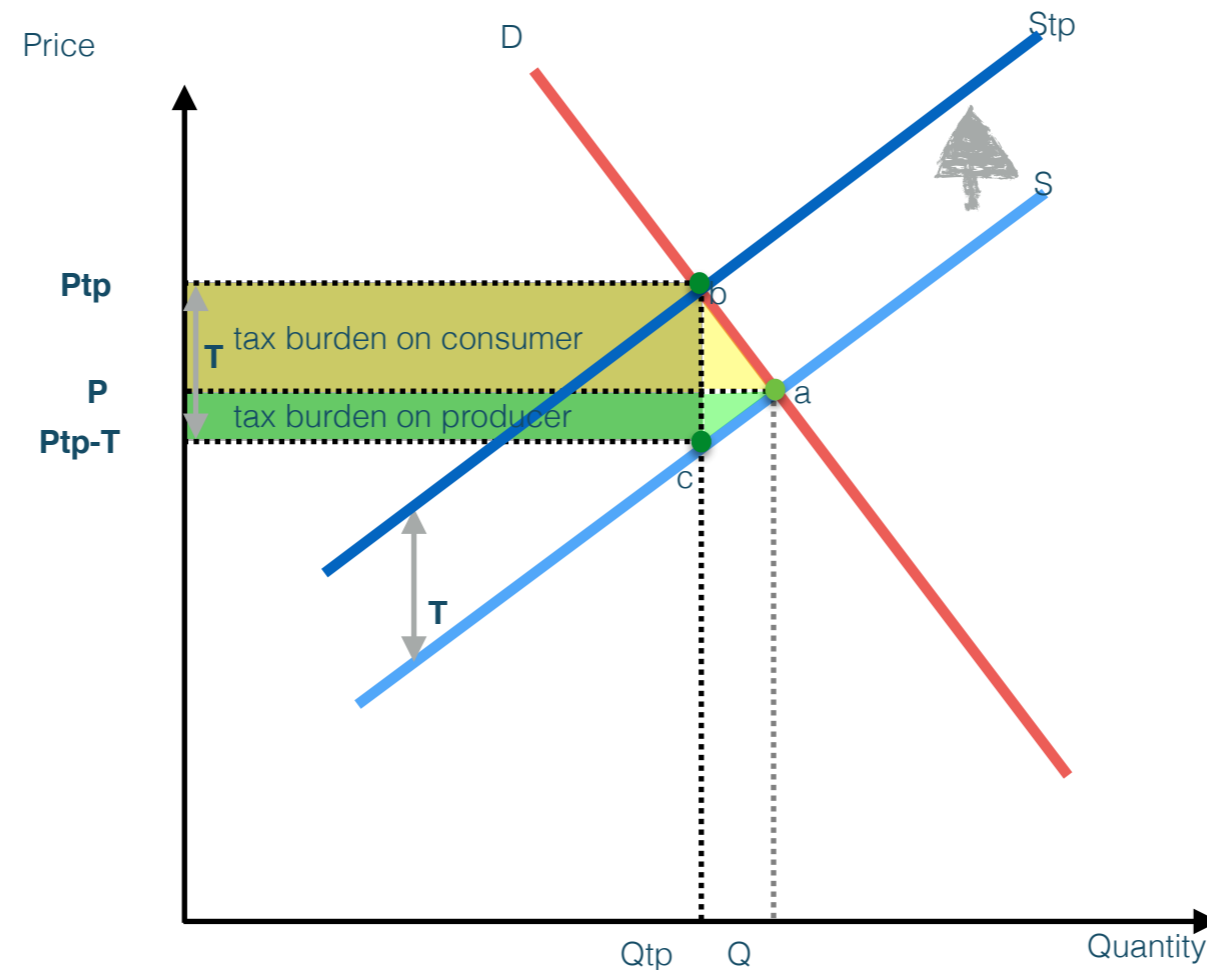
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- compare with tax **on producer (tp)**
- **exactly the same effect** as tax on consumer (tc)



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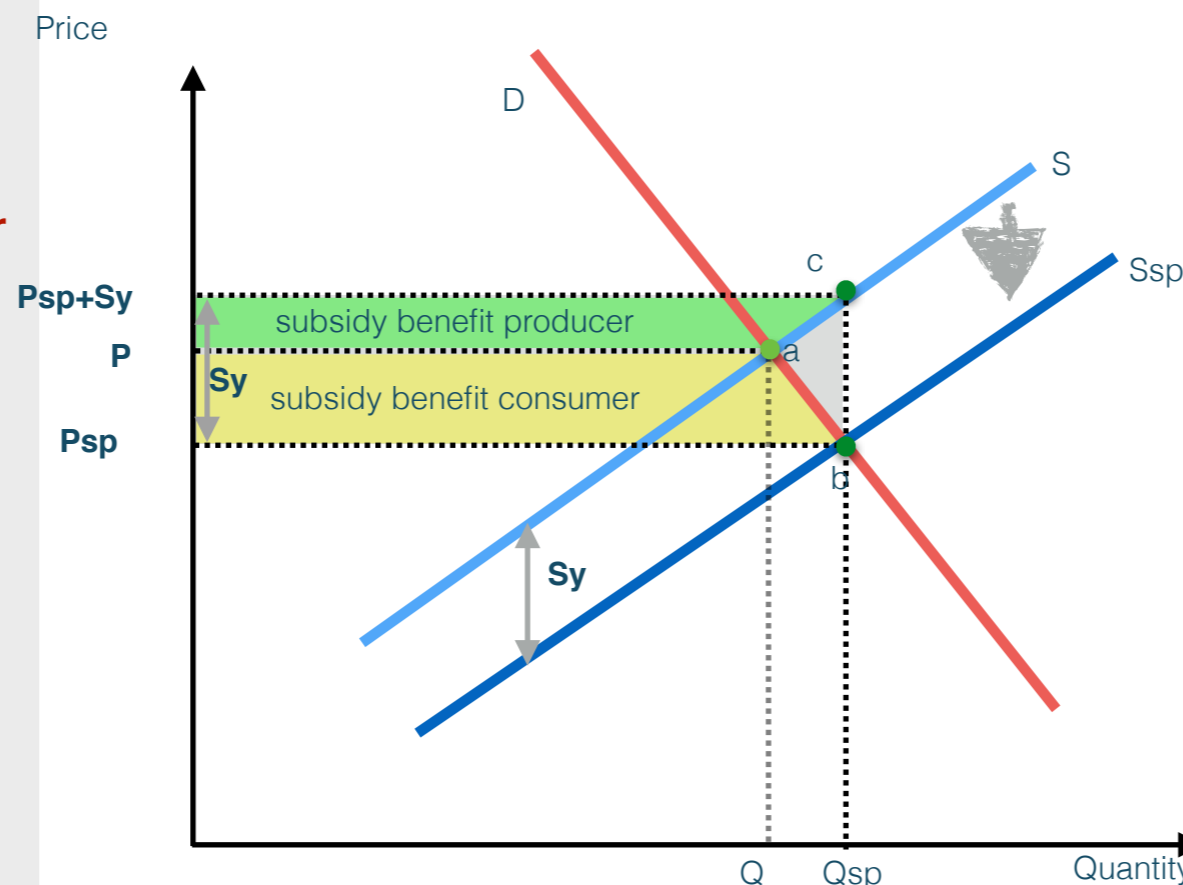
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● subsidy on producer (sp)

Symbols:

- D: Demand
- S: Supply
- Ssp: Supply after subsidy on producer
- Sy: Subsidy per unit (€)
- Q: Quantity sold under free trade
- Qsp: Quantity sold after subsidy on producer
- P: Price under free trade (€)
- Psp: Price after subsidy on producer (€)
- Psp+Sy: €/unit received by producer after subsidy



1. Supply shifts **down** by **Sy**
(Sy=lower cost of production per unit: producer is willing to supply a larger quantity at any given price)
2. In **new eq. (b)**,
3. **Consumers** pay **Psp (<P)** and purchase **Qsp (>Q)**;
4. **Producers** receive **Psp+Sy (>P)** and sell **Qsp (>Q)**;
5. **Subsidy benefit is distributed** between consumers (yellow area) and producers (green area).

- **Yellow** area (Psp;P;a;b): **subsidy benefit to the consumer**
- **Green** area (P;Psp+Sy;c;a): **subsidy benefit to the producer**
- (Psp;Psp+Sy;c;b): **tax burden** (or 'tax revenue')
- (b;a;c): subsidy benefit to market participants < tax burden (or 'revenue')

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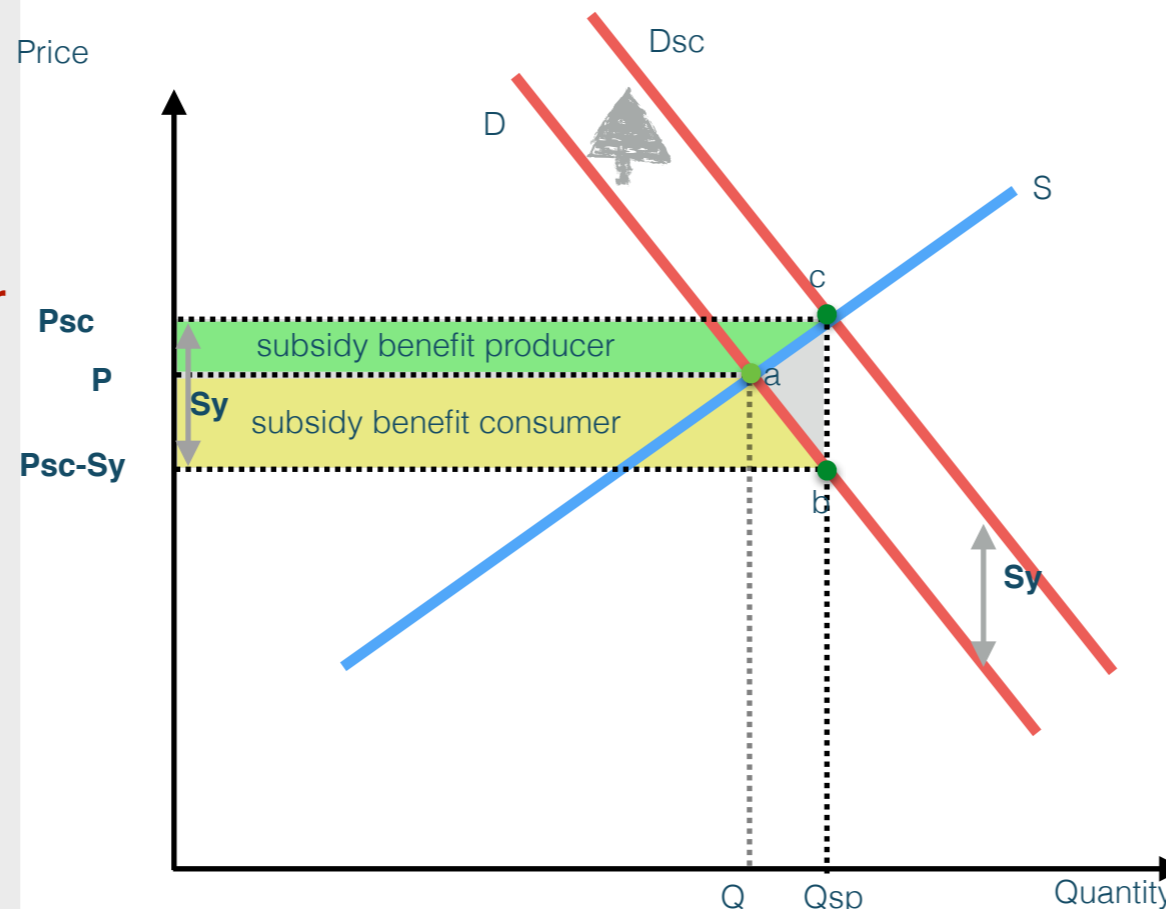
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References

● subsidy on consumer (sc)

Symbols:

- D: Demand
- S: Supply under free trade
- Dsc: Demand after subsidy on consumer
- Sy: Subsidy per unit (€)
- Q: Quantity sold under free trade
- Qsc: Quantity sold after subsidy on consumer
- P: Price under free trade (€)
- Psc: Price after subsidy on producer (€)
- Psc-Sy: €/unit received by producer after subsidy



1. **Demand** shifts **up by Sy**
(Sy=lower price per unit:
consumer is willing to buy a
larger quantity at any given
price)
2. In **new eq. (c)**,
3. **consumers** pay **Psc-Sy (<P)**
and purchase Qsc (**>Q**);
4. **producers** receive **Psc (>P)**
and sell **Qsc (>Q)**;
5. **subsidy benefit is distributed** between
consumers (yellow area) and
producers (green area)

- **Yellow** area (Psc-Sy;P;a;b): **subsidy benefit to the consumer**
- **Green** area (P;Psc;c;a): **subsidy benefit to the producer**
- (Psc-Sy;Psc;c;b): **tax burden** (or 'tax revenue')
- (b;a;c): subsidy benefit to market participants < tax burden (or 'revenue')

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References

1. **SUSTAINABILITY**: if the government subsidizes/taxes a product, the **structure of production** will be **distorted***. In the case of a subsidy, for example, Investments **will** be made in sectors where the market process, left to itself, would **not** have invested (or not to this extent) as it would not have been sufficiently profitable. And vice versa (investments **will not** be made in sectors where the market process, left to itself, **would** have made invested): this makes the productive structure **unsustainable**, as there's nothing less renewable than other people's money (being value subjective, it can be created only by free exchange)

- furthermore, the productive structure becomes **dependent** on the **arbitrary decisions of authority** rather than on what individuals value according to their **preferences (button room problem)**. In other words, the economic structure becomes **fragile**, and more so in **time**: it becomes **dependent on centralized decisions** rather than on **dispersed, individual knowledge**, courage, creativity, entrepreneurship

(*) See Rothbard M.N., 2004 [1962], pp. 319-366

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2. COMPARATIVE ADVANTAGES (CA*):

- (*) the theory of CA demonstrates that, given two individuals (A, B) and two goods/services (x,y), the exchange between A and B is **always mutually beneficial even if** one of them (say A) is more efficient than B in producing **both** goods/services
- competitive producers (e.g. producers that have a **comparative advantage** in the production of a particular good/service) hit by the subsidy are prevented from exchanging at market conditions and thus are **kept in a state of poverty**

“Why are the poor countries of the world poor? There are a number of reasons, but one of them [is] the trade policies of the high-income countries. [...] High-income countries of the world—primarily the United States, Canada, countries of the European Union, and Japan—subsidize their domestic farmers collectively by about \$360 billion per year. [...] The support of farmers in high-income countries is devastating to the livelihoods of farmers in low-income countries. [...] As Michael Gerson of the Washington Post describes it: ‘[T]he effects [of protectionism, ed.] in the cotton-growing regions of West Africa are dramatic . . . keep[ing] millions of Africans on the edge of malnutrition’ (Greenlaw, Taylor)*

(*) Greenlaw S.A., Taylor T., 2016, p. 782

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3. **SAY'S LAW**: in the long run, protectionism hits **also** the interests of **those who are protected**. In fact, if you prevent foreign producers from exporting **to** your country, in the long run you prevent them from **increasing their wealth** and therefore also from importing goods/services **from** your country

Say's law: "the more men can produce [and sell, ed.], the more they will [be able to, ed.] purchase" (Say)*

4. **TAXATION**: from the subjectivity of value we know logically that, even though taxation produces **short term benefits** for specific and **privileged** groups (as in the case of the subsidy), it always and necessarily implies a **destruction of economic value** because it **limits/eliminates free exchange** (which is logically the **only** way economic value can be created), **distorts its structure of production**** and allows the **government** to **expand**

(*) Say J.-B., 1967 [1821], p. 3

(**) See Rothbard M.N., 2004 [1962], pp. 914-938

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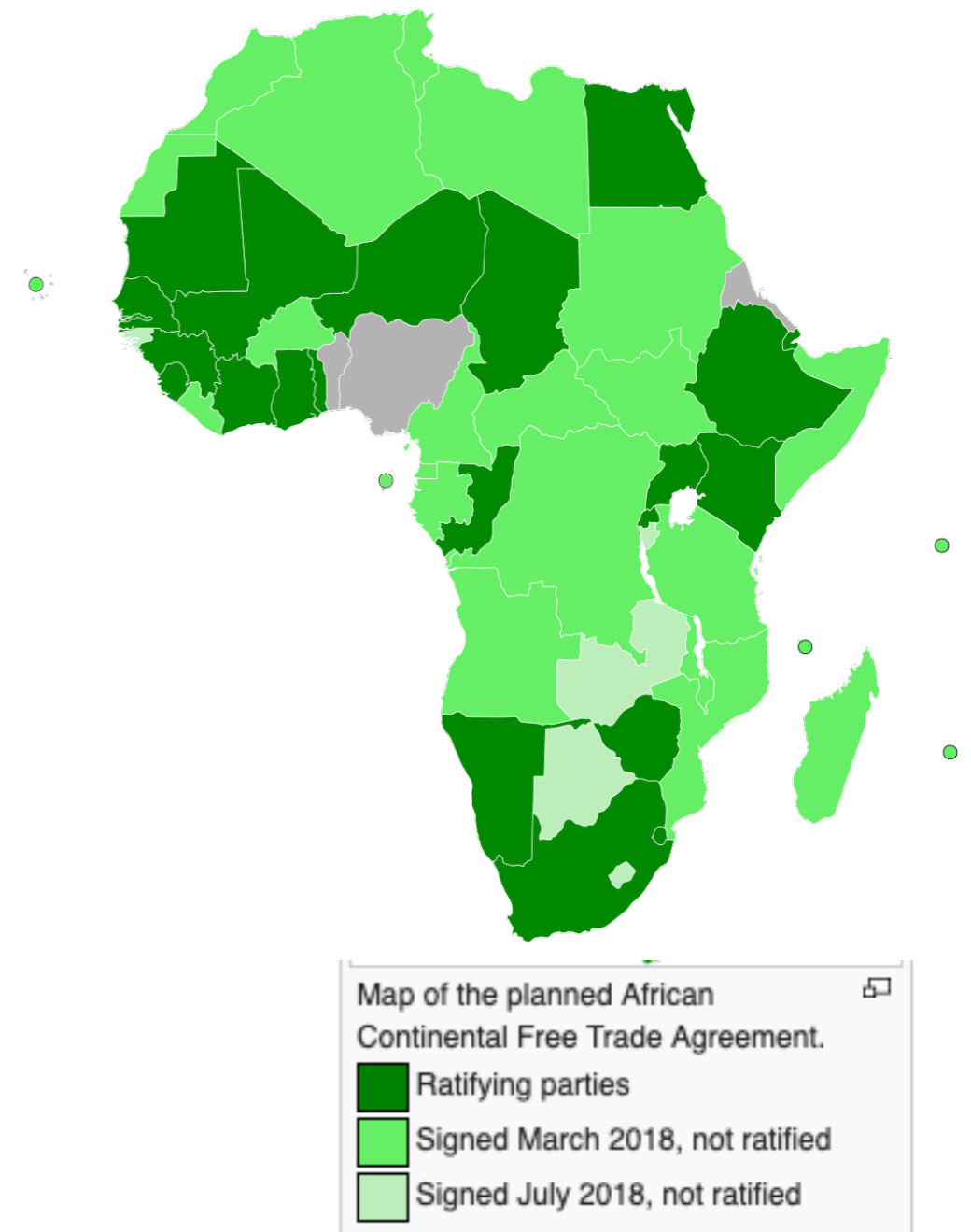
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- with **Brexit** and the **African Continental Free Trade Area** (AfCFTA) the issue of **'free trade' areas** is currently very much on the news



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- first of all, 'free trade' areas are **no such thing**: from section 1 & 2 we know that free trade (or exchange) is a condition that requires the **absence of protectionism**, not only that of protectionism in the **particular case** of 'international trade'
- 'free trade' areas **do** reduce the 'international trade' **component** of protectionism: though **only** for **some** of the businesses which operate inside the 'free trade' area (e.g. **not** for businesses **whose clients** are mainly **outside** of it, whose situation is usually made worse off by the creation of a 'free trade' area: see later)
- however, notwithstanding the **positive effect** on the 'international trade' component, the creation of **'free trade' areas can** (and often **do**) **increase** overall protectionism

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- in fact, **reduction** in protectionism deriving from less tariffs on international intra-area trade **could be** (and often **is**) **more than compensated** by an **increase** of protectionism deriving from:
 - the fact that the area directly subject to **other** forms of protectionism (namely **regulation**, **taxation**, etc.) is **larger** because of the creation of the 'free trade' area
 - **lower institutional competition** (possibility to 'vote with your feet')
 - **the greater the 'country'** the greater the possibility that the authority has to impose protectionist measures **on international (extra-area) trade**:
 - *"UK will cut most tariffs to **zero** in event [now ruled out, ed.] of **no-deal Brexit**"* (UK government)*
 - businesses **whose clients** are mainly **outside** of 'free trade' area are **likely to be worse off**

(*) The Guardian, 13 March 2019, [link](#)

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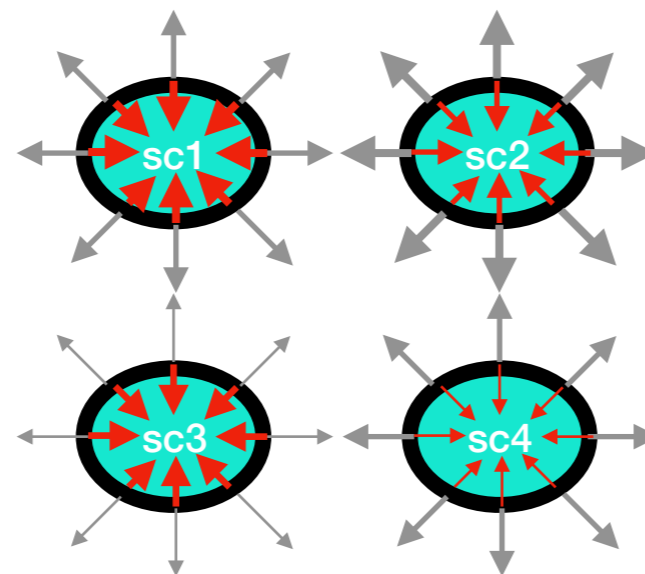
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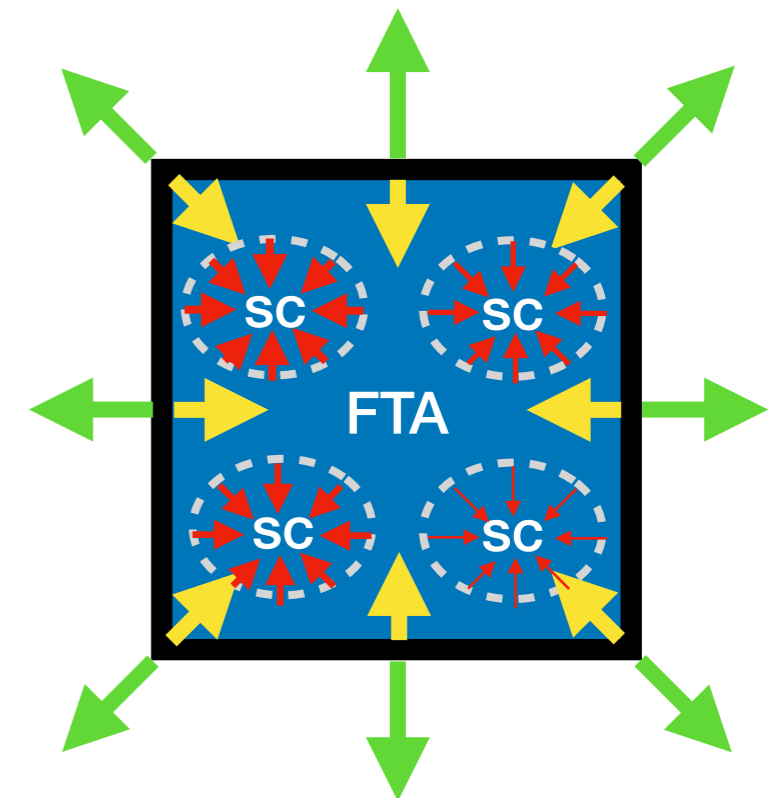
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References

- this is not to see the glass half empty, but just to remind that **protectionism is government** and therefore that a way out of protectionism **cannot** pass through government, even less through a **larger** government.
- government is always the problem, never the solution



FTA: 'free trade' area
sc: single country



- FTA foreign protectionism
- FTA domestic protectionism
- sc foreign protectionism
- sc domestic protectionism

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● to recap:

- protectionism coercively limits/prevents **free exchange** and therefore it **destroys economic value**: in fact, the process of free exchange is the only way in which **individual knowledge** about personal preferences and priorities, which is **at the heart of creation of value**, can be **used**
- protectionism is **not** a game of **domestic gains and foreign losses**: it is a game of losses for those who acquire economic resources through **economic means** (i.e. through free exchange) and (in the short term) of gains to those who acquire them through **political means** (that is, by coercion)
- the effect of a tariff is **exactly the same** quite independently from the fact that it is levied on the producer (the foreign exporter) or the consumer (the domestic buyer). Same for the subsidy. And this effect depends of **elasticity** of D and S, i.e. on **subjectivity of value**

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- protectionism arbitrarily forces market participants to exchange (or to abstain from exchanging) not on the ground of what **they** think is good for them, but on the ground of what the **policy makers** think is 'good for society'.
- In this way, by preventing the **only process** that can create economic value (free exchange), **value is destroyed/prevented from emerging**
- the **distortions** produced by one form of protectionism **cannot** be 'cured' with **further** protectionist measures
- media speak today of **"trade wars"** as if these were wars between 'countries'. No: they are wars **between governments**. And in these wars, each government is fighting **first of all, and above all**, against **its own citizens**. And, contradictorily enough, it does it in their own name, saying it is to 'protect' their 'country'

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if you could choose to be paid with money whose purchasing power **decreases** in time or with money whose purchasing power **increases** in time, **which** money would you prefer to be paid with?

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if you could choose to be paid with money whose purchasing power **decreases** in time or with money whose purchasing power **increases** in time, **which** money would you prefer to be paid with?

why aren't you allowed to choose which money you want to use? that is, why is the **free exchange in the sector of money** forbidden?

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- before discussing the basic economics of protectionism in the particular case of money we must understand **what money is**
- the two main functions of money are that of **medium of exchange** and that of **reserve of value**
- ok, but this **does not answer the question** of what money is more than “a means of transport” answers the question of what a train is (also a plane, a car or a van to transport prisoners are means of transport: are they the same thing?)
- so again, **what is money?**
- and again, this is a **scientific question**

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●in section 1 we saw that there's a **structural** difference between

– **positive** (or *fiat*) **law**:

- instrument** of arbitrary political power
- unscientific**
- dependent** on authority's decision
- created *and inflated* **out of thin air**

– **negative law** (or **NAP**)

- non-arbitrary **limit** to any coercive power
- scientific**
- independent from authority**
- cannot be created out of thin air** and **even less arbitrarily inflated**

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- a similar distinction can be made in relation to **money**

- **government *fiat* money (GFM):**

- **instrument** of arbitrary political power
- **unscientific**
- **dependent** on authority's decision
- *created and inflated* **out of thin air**

- **free market money ('money')**

- non-arbitrary **limit** to any coercive power
- **scientific**
- **independent from authority**
- **cannot be created out of thin air** and **even less arbitrarily inflated**

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- free market money is what emerged as the **most tradable asset** through a long spontaneous market process which solved the **main problem of barter** (double and instantaneous coincidence of needs and value perceptions)
- **gold**, which was previously used only in jewelry, decorations and such, was spontaneously selected by the free market process (**spontaneous order**) as **money** because of certain **characteristics** which made it a better tradable asset than other things:
 - **scarcity**: it could not be created out of thin air *and* inflated
 - divisibility
 - transportability
 - durability
 - and others

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- **scarcity** is what constituted a **problem** for governments:
- in order to finance their expansion, they needed a money which could be **created out of thin air** and **arbitrarily inflated** (just as fiat law)
- so (in Europe in 1914, in order to finance the first World War) they **outlawed gold** as money and they **coercively imposed their own fiat money**

“The modern gold coin standard lasted only for a century, 1815-1914. It broke apart because of World War I. Governments wanted to inflate, and the gold coin standard hampered this. So, politicians and central bankers abolished it by fiat” (North)*

- this is how **modern protectionism in the sector of money** starts: its objective is **always monetary inflation**

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- we'll **not** discuss the details of how does the **inflation process** is set into motion*

- in short, 3 channels

1. **commercial banks:**

- fractional reserve banking (FRB):
 - expansion of money from banks' **lending** of **deposited** money (from € 1k deposited, the banking system creates € 99k out of thin air**)
 - all fractional reserve banks are always **intrinsically bankrupt**

2. **central bank** (bank of banks; safety net for intrinsically bankrupt FRB banks)

- reduction of reserve ratio
- increase of total reserves
 - * increase loans to commercial banks (**amplify** effect of FRB)
 - * lower interest rate on loans to commercial banks (**amplify** effect of FRB)
 - * open market operations: unlimited creation of GFM money **out of thin air** (e.g. "quantitative easing, Q.E.")

3. **government:**

- insurance on deposits
- legal limitation of the use of cash
- other...

(*) For more detail see Rothbard M.N. 2008 [1983] and Huerta de Soto 2009 [1998] (**) We assume that reserve ratio is 1%, as is now

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- **key point:** the damage produced by protectionism in the case of money is **systemic**
- we have seen that, in the particular case of international trade, protectionism creates **sectorial** economic damages in order to protect particular, privileged, inefficient organizations
- in the particular case of **money**, protectionism creates **systemic** damages in order to facilitate the expansion of the most privileged and inefficient organization of all: the **government**
- damages are systemic because one of money's functions is to be **medium of exchange** and because, as we shall see, protectionism in this sector influences the **interest rate**, which is the price of **time**
- protectionism in the sector of money is the **most extreme** form of protectionism (**absolute socialism**) and, because of its systemic consequences, by far the **most damaging one**

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- protectionism in the sector of money consists in a complex and **inter-dependent network** of **coercive positive ‘laws’ and institutions** aimed at **preventing the free exchange** (and thus **free choice**) in relation to money. These positive ‘laws’ and institutions include:
 - **legal tender**: use of GFM imposed by force of people
 - **competition** simply **outlawed**
 - privileges to commercial banks (e.g. **fractional reserve banking**)
 - **central banks’** existence and functions
 - central banks’ **legal monopoly** of **GFM**
 - limits on use and withdrawal of cash
 - many others...

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- we said that the **objective of protectionism** in the sector of money (GFM) is **monetary inflation**: i.e. the **increase in the quantity of GFM**
- in fact, other things being equal, inflation produces **the loss of the purchasing power of GFM**
- **why** does the government like the loss of purchasing power of its 'money'?
 - stealth, **additional taxation** (and therefore also **war**)
 - but, unlike taxation, **no political cost**
 - **transfer of resources from creditors to debtors** (and therefore mainly to the **government**)
 - transfer of resources from those who receive the new money **later** to those who receive it **earlier** (banks and bureaucracy)

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- these are all negative things for non-privileged individuals
- however, the **most damaging aspect** of protectionism in the sector of money (maybe **after war**) is the so-called “**business cycle**”: that is, cyclical, economic crises*
- in order to understand why, it is necessary to understand two things:
 1. **the interest rate** and
 2. the **structure of production**
- **market interest rate** has three components:
 1. **time preference** (primary component): the higher the time preference, i.e. the preference for present time (consumption) vs. future time (saving), the lower the amount of **resources available for investments**, the higher their price: the interest rate

2. **risk**: the higher the risk of insolvency, the higher the interest rate

(*) See Hayek F.A., 2012 [1931], Mises L., 1998 [1949], Rothbard M.N., 2004 [1962], Huerta de Soto J., 2009 [1998], Murphy R.P. 2010

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2. **risk**: the higher the risk of insolvency, the higher the interest rate
3. **purchasing power of money** (PPM): the higher are the expectations of loss of PPM, the higher the interest rate

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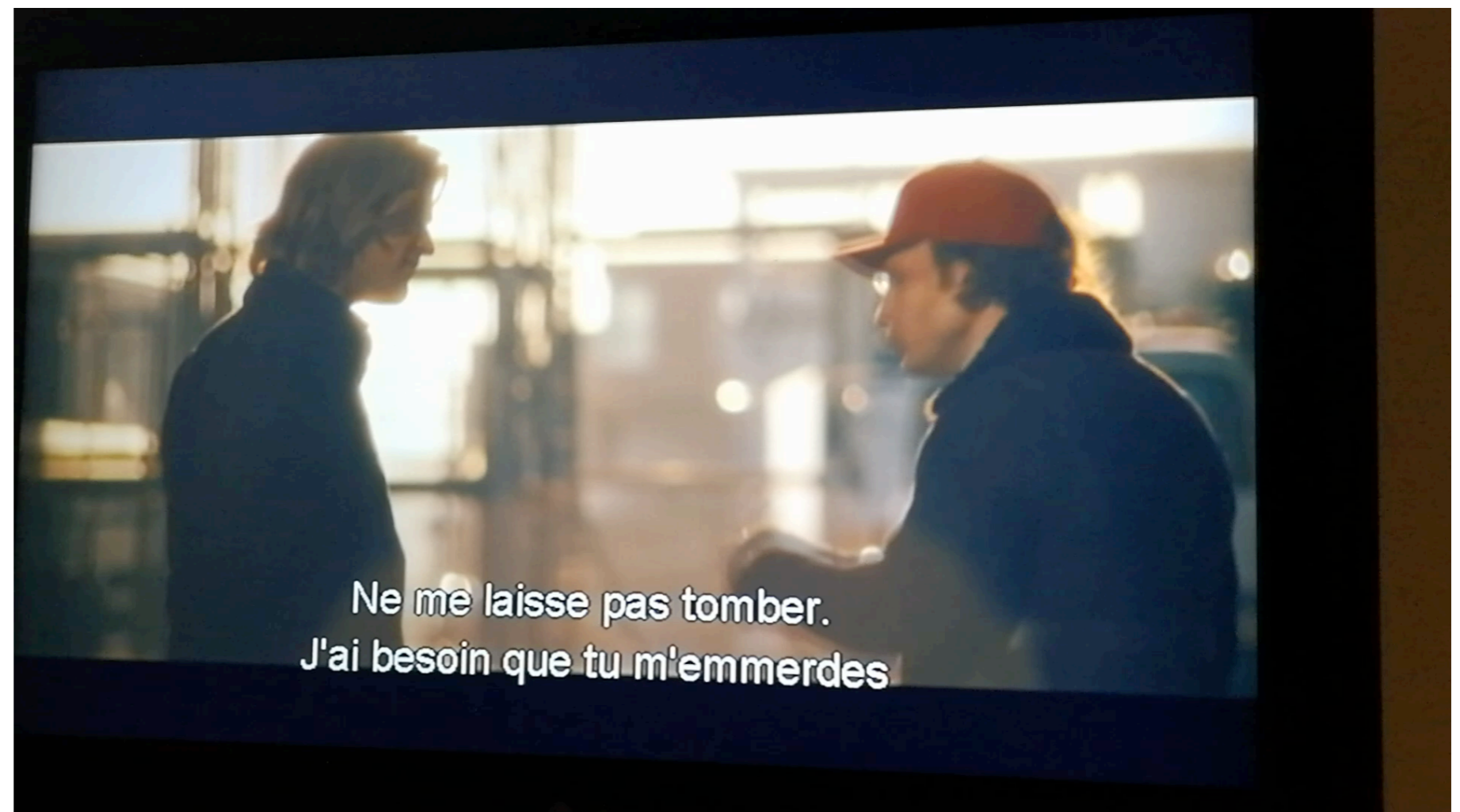
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- market interest rate is a **spontaneous order**: use of **decentralized knowledge** (about individual time preferences)
- protectionist interest rate, on the contrary, is a **positive order**: use of **centralized knowledge** (**arbitrary decision** of monetary authority)

from the movie *Rush*, 2013 by R. Howard

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- the economic **function** of market interest rate is to **coordinate savings and investments in time**: this function **requires** to use the knowledge relative to **individual** time preferences
- because such knowledge is **decentralized** and **cannot** be available to any directing mind (e.g. a central banker), **only** the market interest rate can perform this function
- protectionist interest rate **cannot** perform this function because those who fix it do not have access to the relevant knowledge about time preferences
- it is **a scientific, objective fact** that the protectionist interest rate will **always** produce **cyclical economic crises** (the **business cycle**)
- to understand why we must look at the **structure of production**

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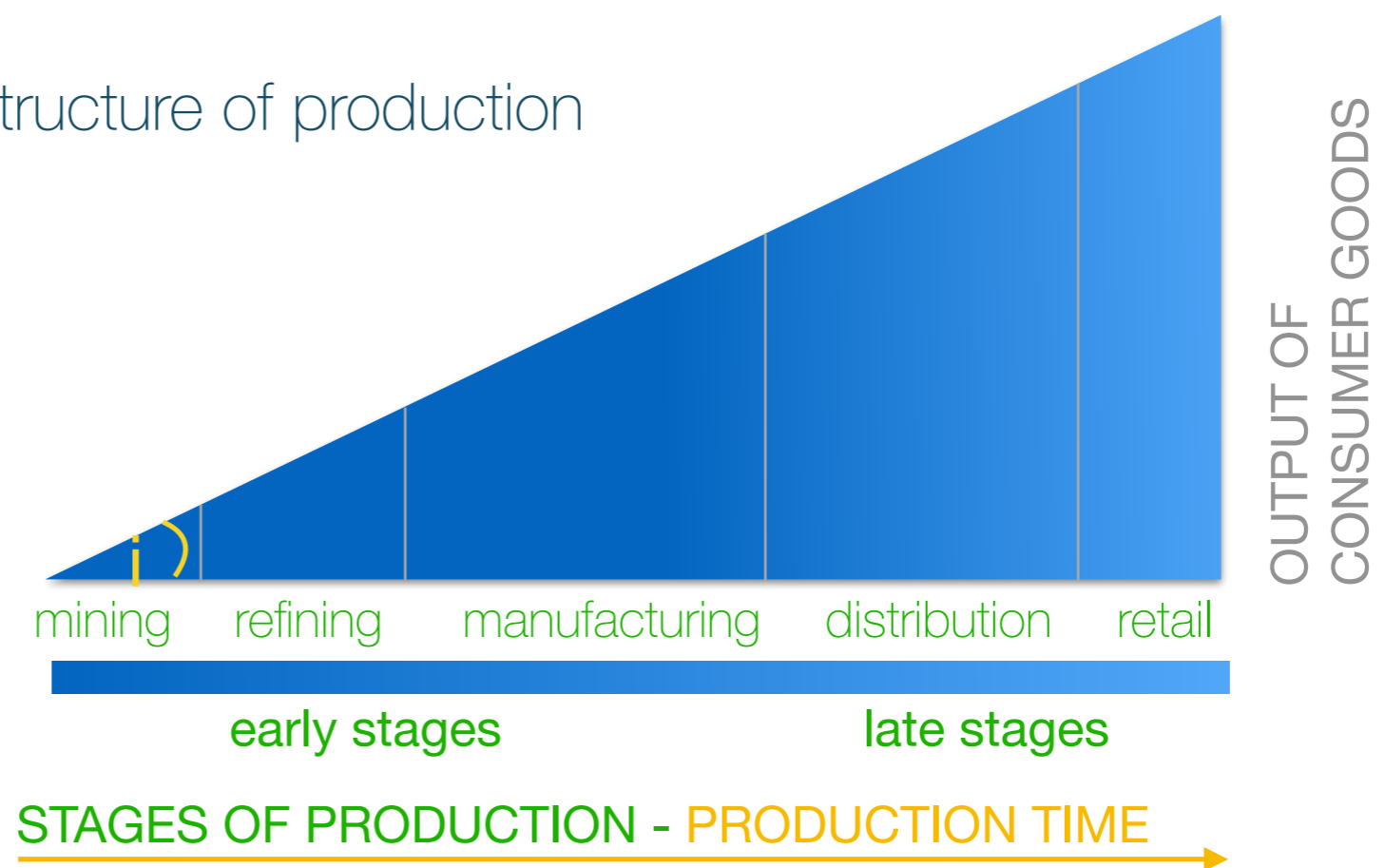
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Structure of production



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- in **time**, **lower** market interest rate (i.e. higher savings = **less consumption** = lower **time preferences**) will allow
 - **longer term**, sustainable investments
 - **longer and more complex** productive structure
 - **more** sophisticated, **capital intensive** products/services
 - i.e., **structural growth** (an economically **sustainable** increase of productive capacity)
- and vice-versa: **higher** market interest rate will produce
 - **shorter term**, sustainable investments
 - shorter and **less** complex productive structure
 - **less** sophisticated, capital intensive products/services
 - i.e., **less** structural growth (**if** there are net investments)
 - (if the investments are **not enough** to maintain the **economic value of existing productive capacity** there's capital consumption and therefore **negative growth**)

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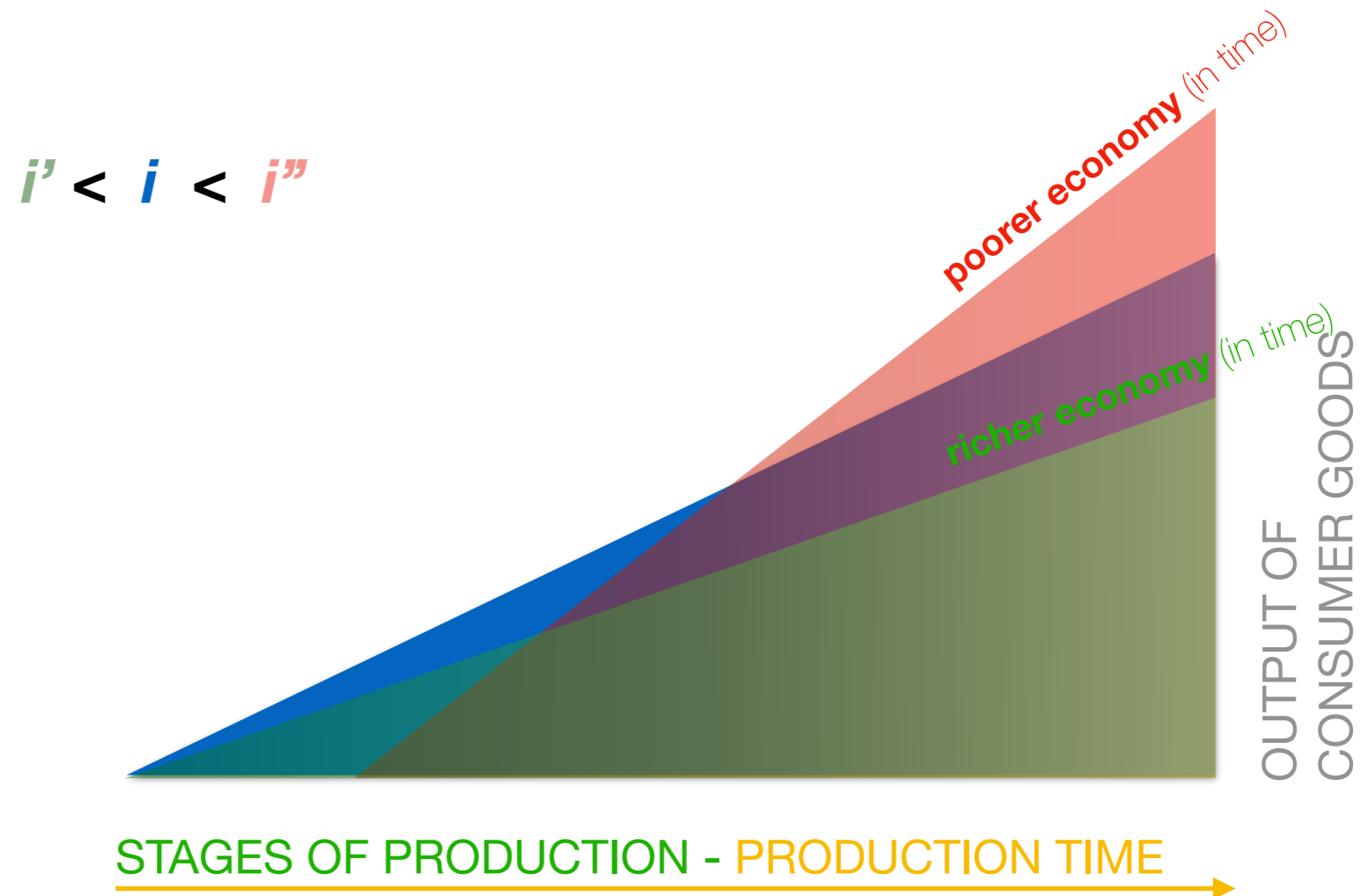
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- in extreme synthesis, the **business cycle**'s dynamics is as follows:
 - **protectionist interest rate** is **artificially low**
 - this **signals** investors and businessmen the presence of **abundant resources available for investments**
 - on the ground this information, **ambitious**, long-term **investments** are started (economic “boom”). There is a **misdirection of production**: the structure of production is **distorted** in an **unsustainable direction**
 - however, the information conveyed by the interest rate is **false**: **time preferences** have **not** changed; resources available for investments have **not** increased. The interest rate which has induced those ambitious investments was **artificial**
 - when the actual scarcity of resources available for investments **becomes evident**, the interest rate **rises** and a series of **necessary** events creates an **economic crisis** (“bust”)

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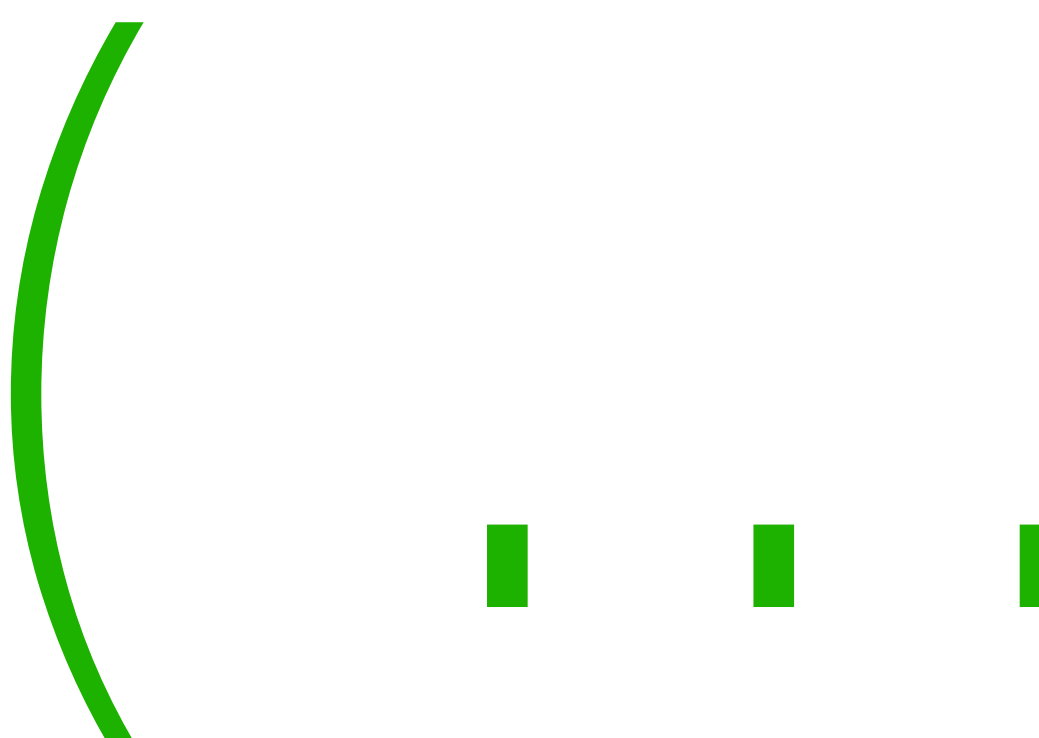
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- 
- what follows is a slightly **more technical exposition** of what synthetically described above
 - if necessary, i might **skip it** in order to leave more time for discussion
 - however, I will make the **slides available** in case someone was interested

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- let's see, in a nutshell but into more detail, the sustainable, **healthy economic process** induced by lower time preferences (less C = more S):
 1. **lower time preferences** (=higher savings S) produce **lower market interest rate i**
 2. this induces
 - a. long term investments: i.e. higher demand **of capital goods** (goods produced in **early stages of production**); thus, higher prices **of these** goods
 - b. lower demand of **consumer goods** C (goods produced in the **late stages of production**), and thus lower prices of these goods
 3. because of 2a & 2b, it becomes less profitable to invest in the production of consumer goods (late stages) and more profitable to invest in the production of capital goods (early stages). There is therefore a **transfer of resources (including labour) from late stages to early stages**
 4. there's **no increase in nominal wages**: less demand for work in late stages is **compensated** by higher demand for work in early stages. However, **real** wages have **increased** because of lower prices of consumption goods
 5. when the dust settles, there's a **longer and more complex (richer) productive structure, more capital-intensive goods, higher real wages**: the process is **virtuous** and economically **sustainable**

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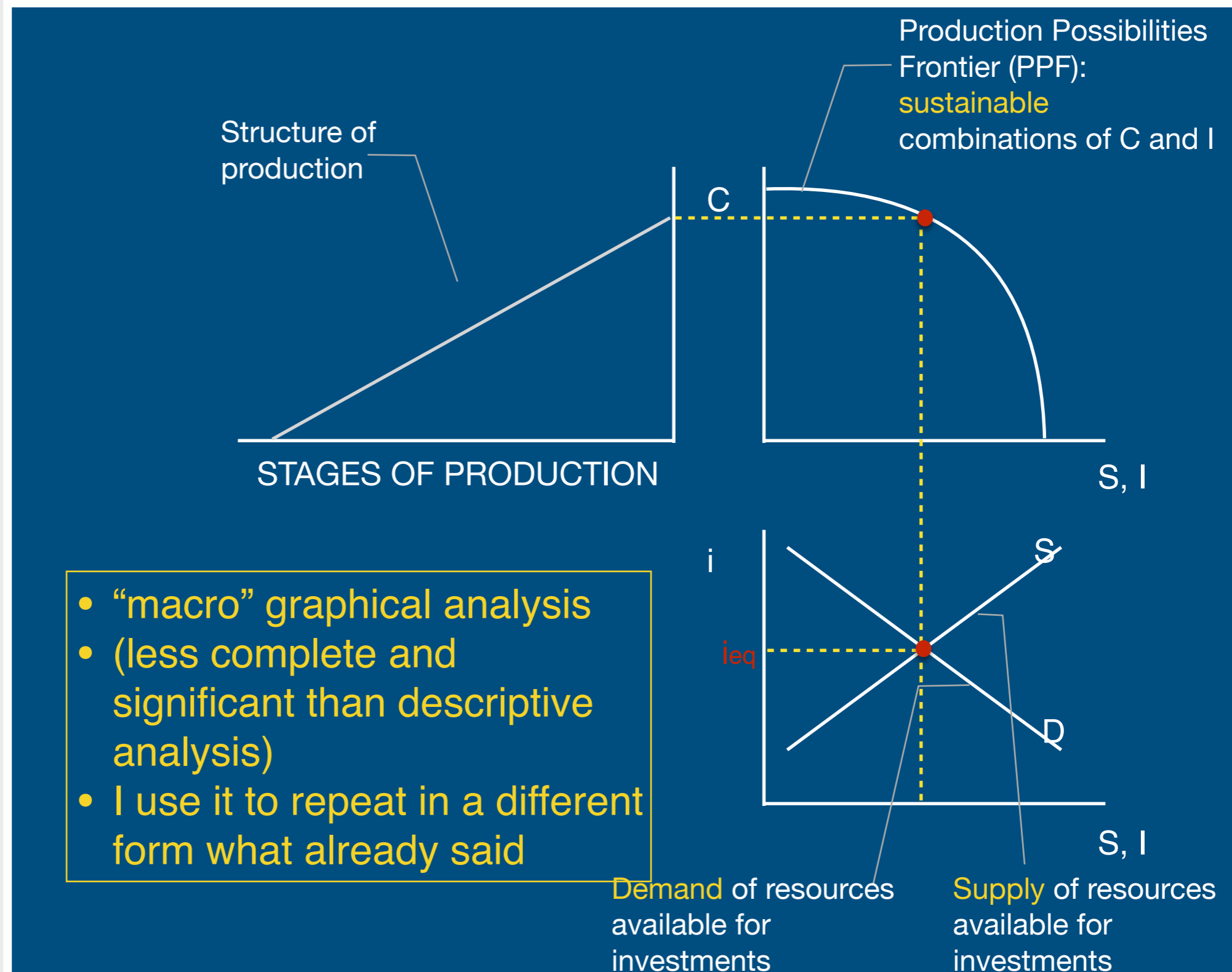
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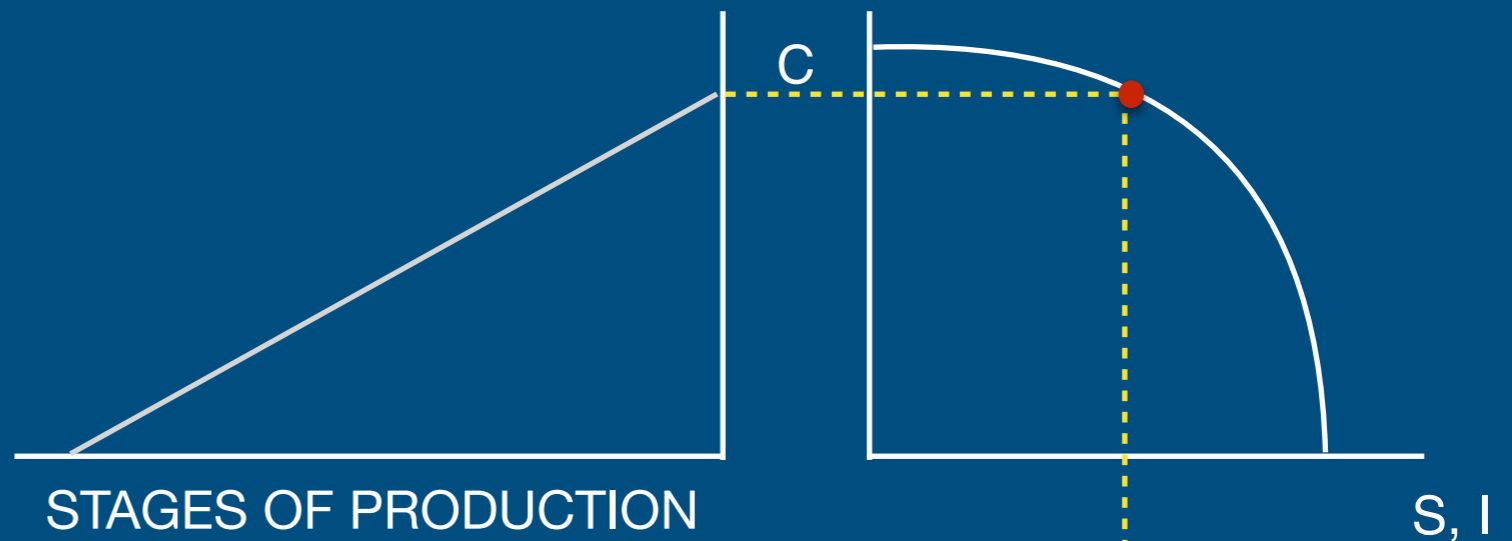
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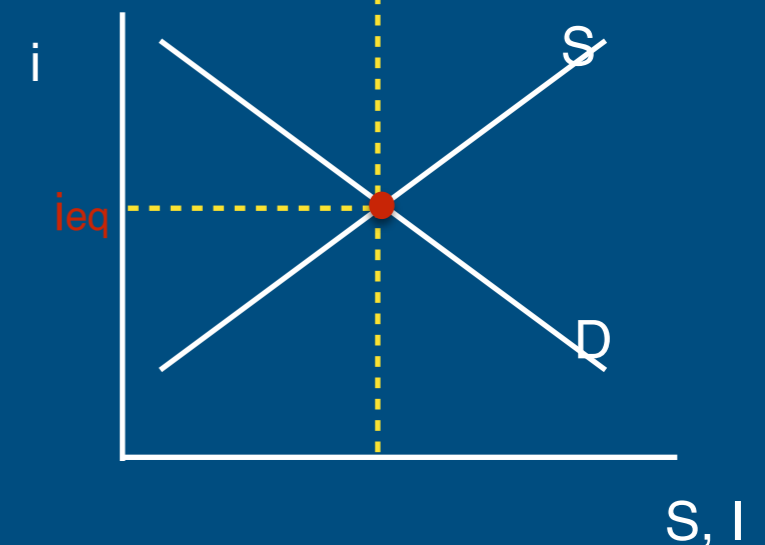
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initial situation



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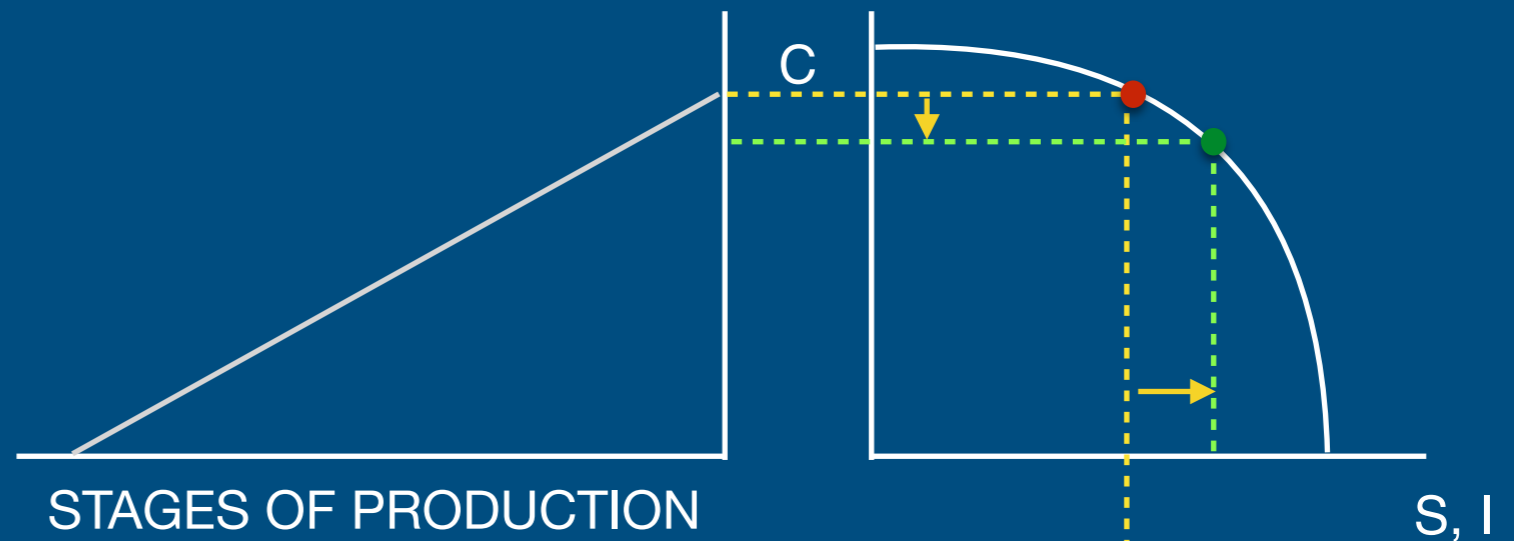
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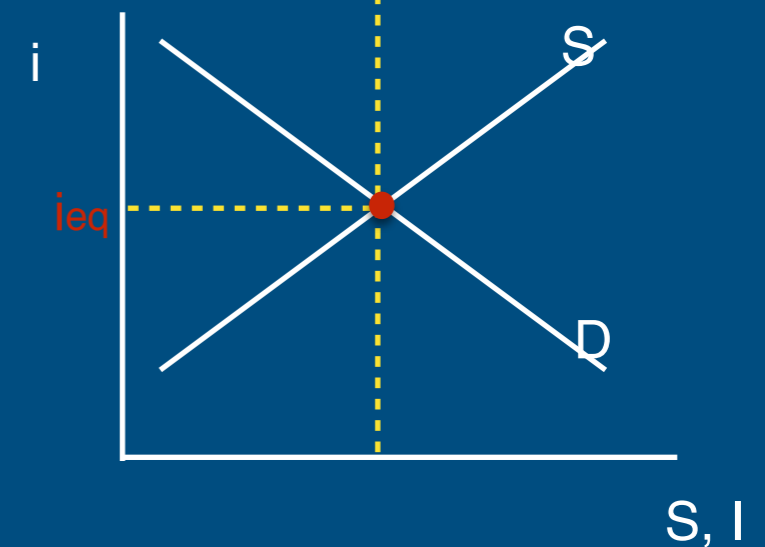
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change of time
preferences
(higher S = lower C)



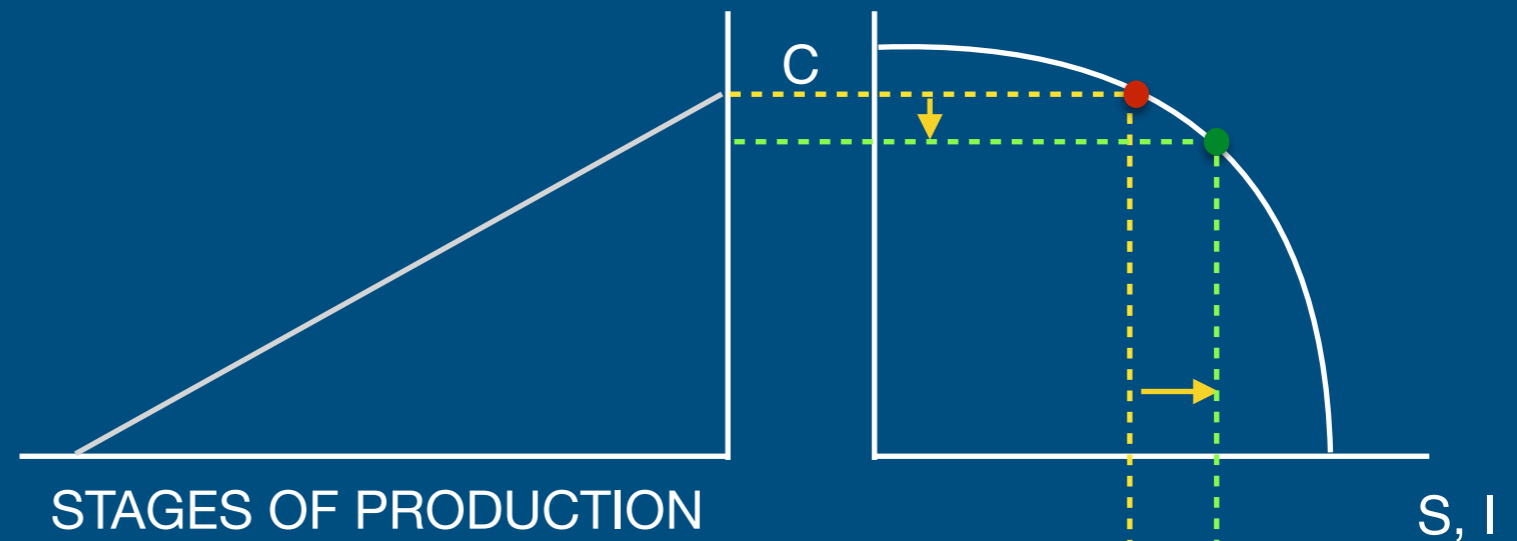
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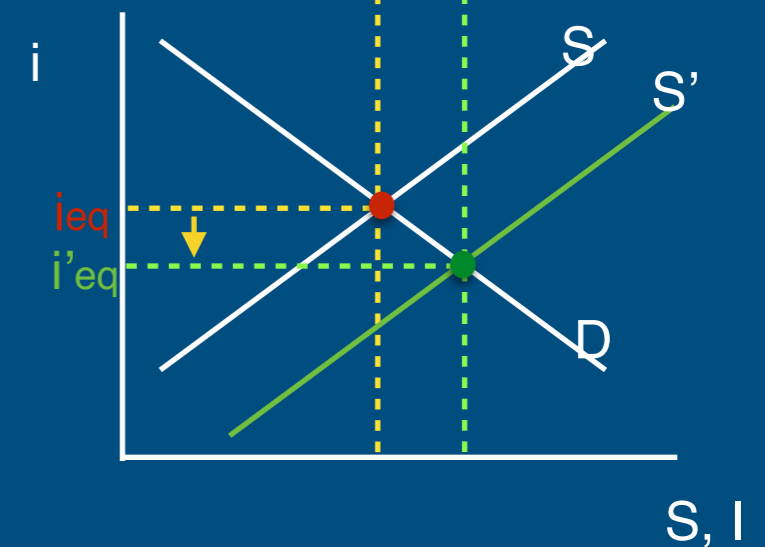
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more resources
available for investments



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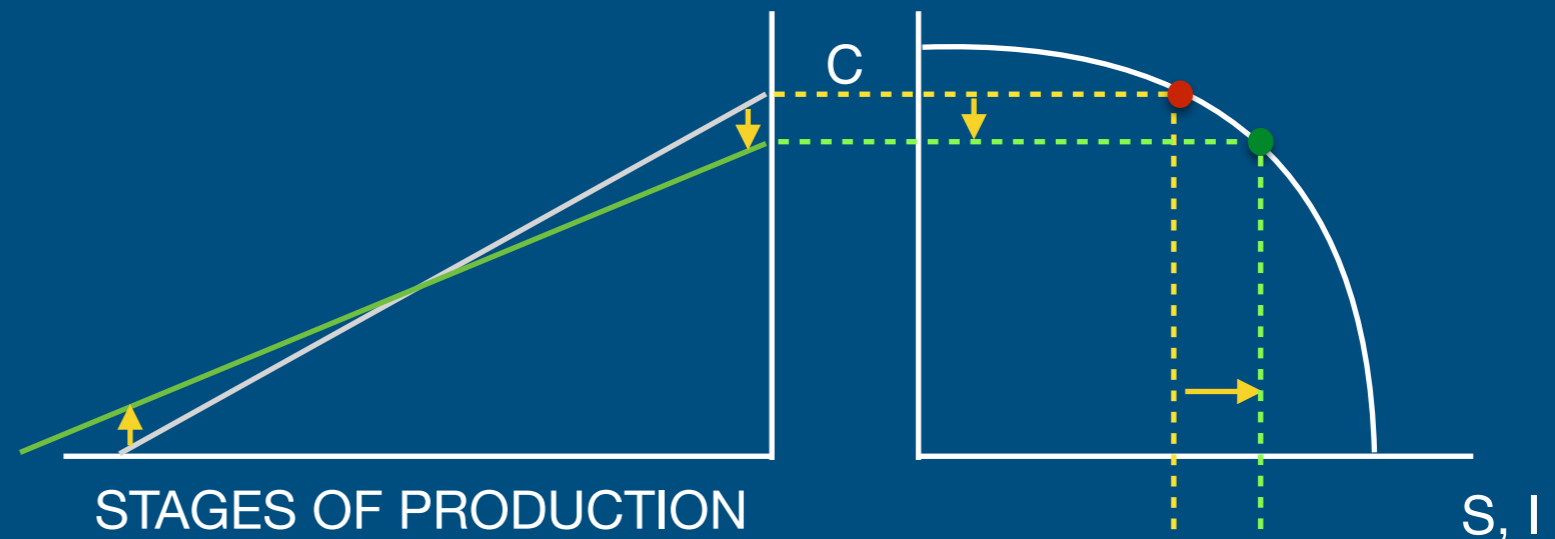
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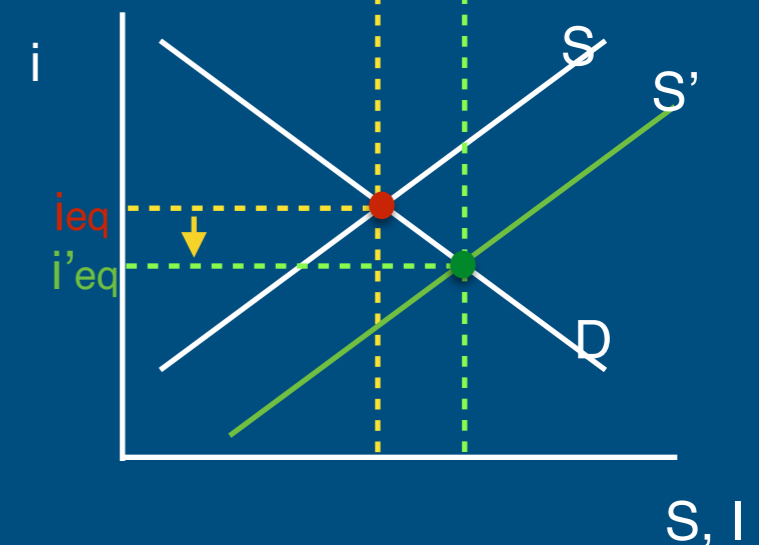
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- longer and more complex productive structure;
- more capital-intensive goods/services;
- structural growth;
- healthy, sustainable process



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- **cyclical crises** arise when the interest rate is **artificially** low: i.e. when the lower interest rate is **not** the result of lower time preferences (= lower C = higher S) but of **protectionism** in the sector of money (i.e. of **inflation**)

1. (**artificially** lower) interest rate i induces
 - a. **as before**, long term investments: i.e. higher demand of capital goods (goods produced in **early stages of production**); thus, higher prices of **these** goods
 - b. however, in this case (**unlike the previous one**) savings have **not** increased (i.e. consumption has **not** decreased). **On the contrary**, (artificially) lower i has discouraged savings and thus further **encouraged** consumption (overconsumption). Therefore there is **also, at the same time**, a higher demand for goods produced in the **late stages of production**
 - c. Therefore **also** we have **higher prices of consumption goods/services**
2. because of 1.a and 1.b, even though the resources available for investments **have lessened**, it appears to be more profitable to invest **both** in the production of capital goods (1.a) **and** in the production of consumer goods (1.b): **malinvestment**

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3. new demand for labour in early stages of production is **not compensated** by less demand for labour in late stages: **nominal wages rise** (boom). However, because of 1.c, **real wages diminish**
4. in short, lower i (inflation) has produced the following situation:
 - I. higher investments in the early stages
 - II. higher investment in the late stages
 - III. less resources available for investments
5. the situation is **not sustainable**: when the scarcity of resources becomes evident, there starts the **crisis**

“The different aspects of the market process set in motion by a monetary injection ... are not mutually compatible. They work at counter-purposes. ... [With market interest rate] investment increases to match the increase in saving. [With artificially low interest rate] these two magnitudes move in opposite direction. ... Market forces reflecting the preferences of income-earners are pulling in the direction of more consumption. Market forces stemming from the effect of the artificially cheap credit are pulling in the direction of more investment. ... In sum, credit expansion sets into motion a process of capital restructuring that is at odds with the unchanged [time] preferences and hence is ultimately ill-fated” (Garrison)*

(*) Garrison R.W., 2001, p. 70

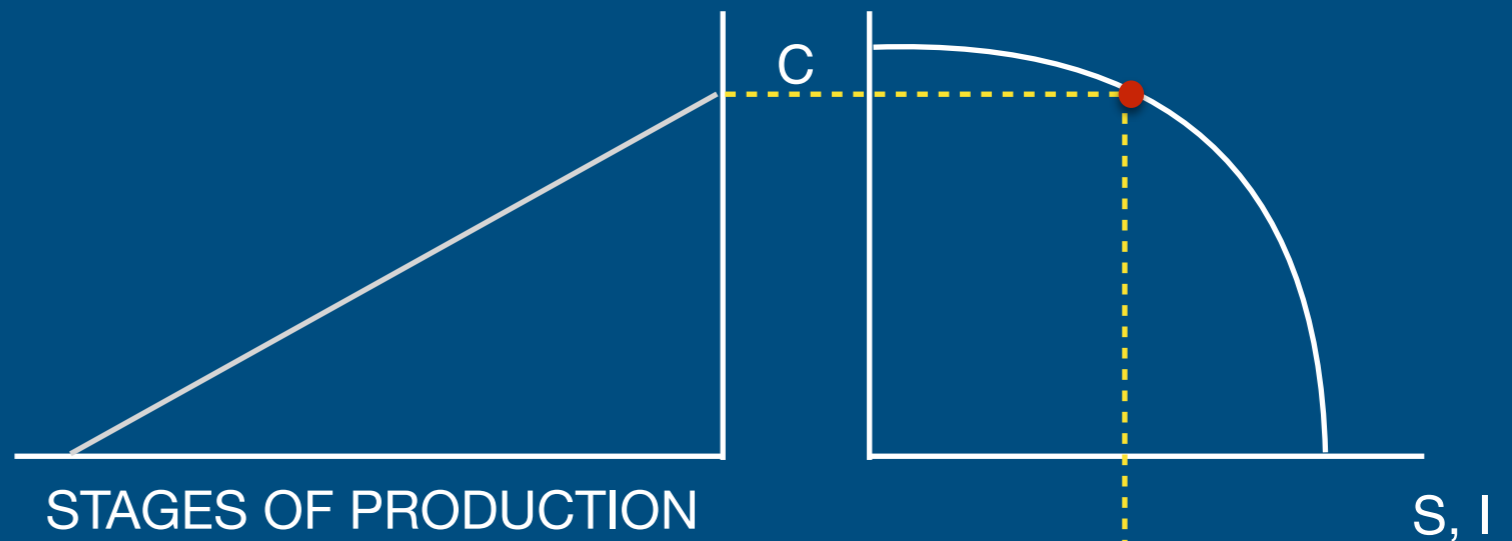
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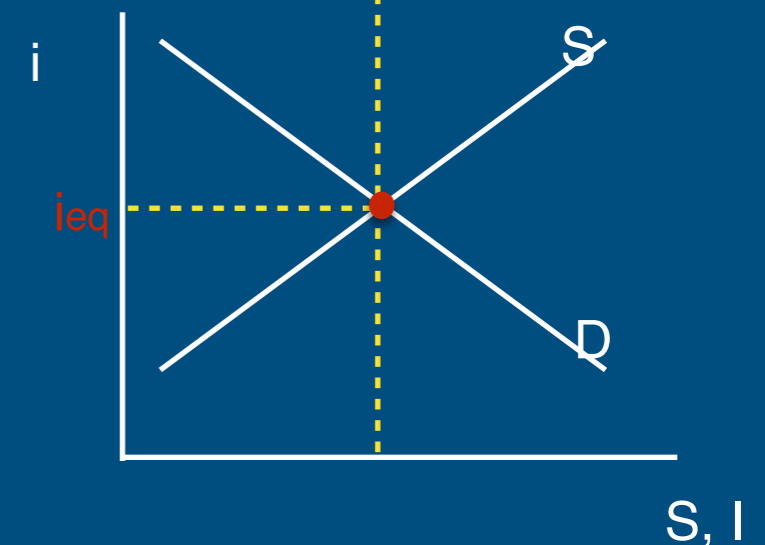
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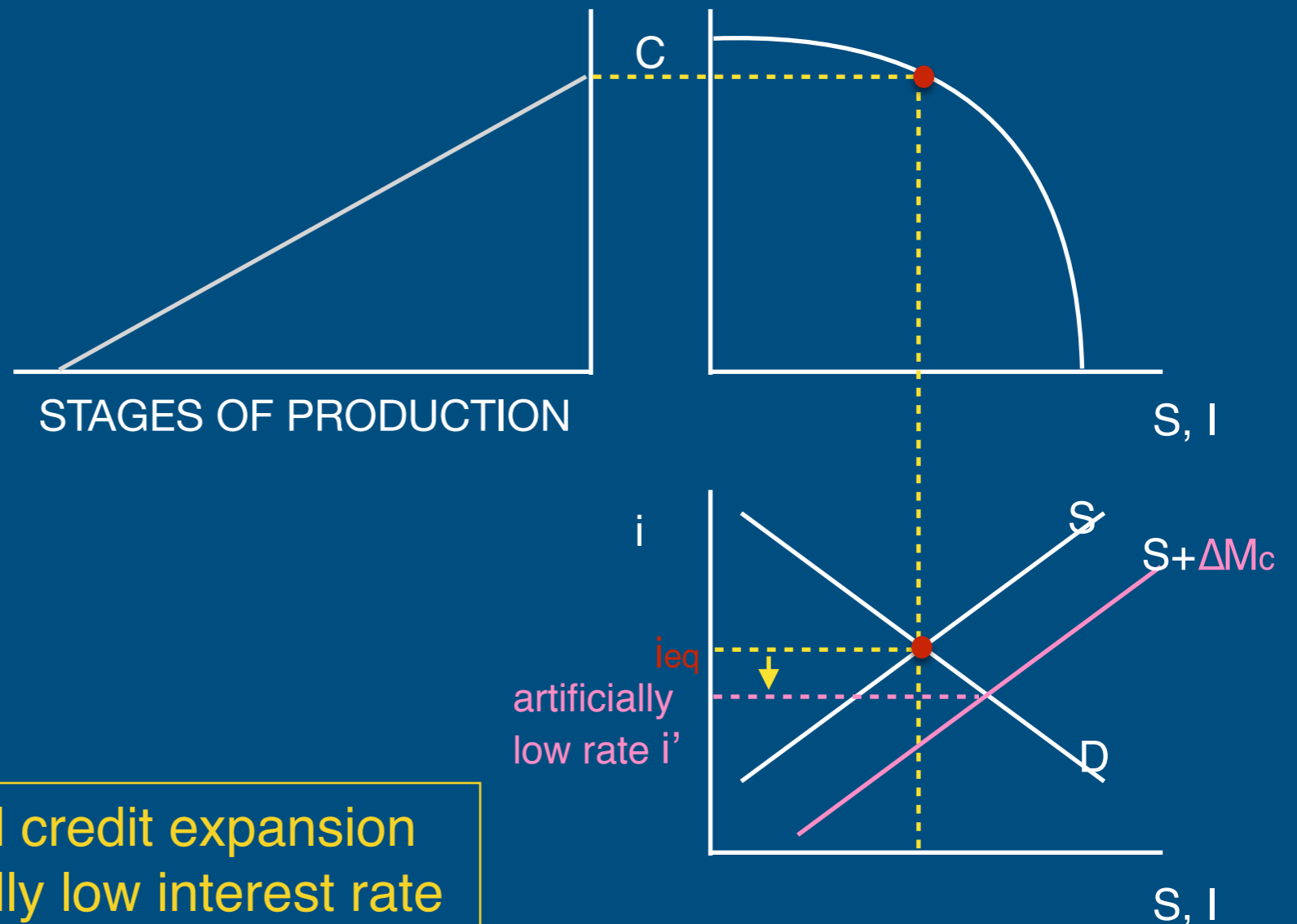
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- artificial credit expansion
- artificially low interest rate

$\Delta M_c =$
new money lent into existence:
(may not translate fully into credit
expansion: hoards)

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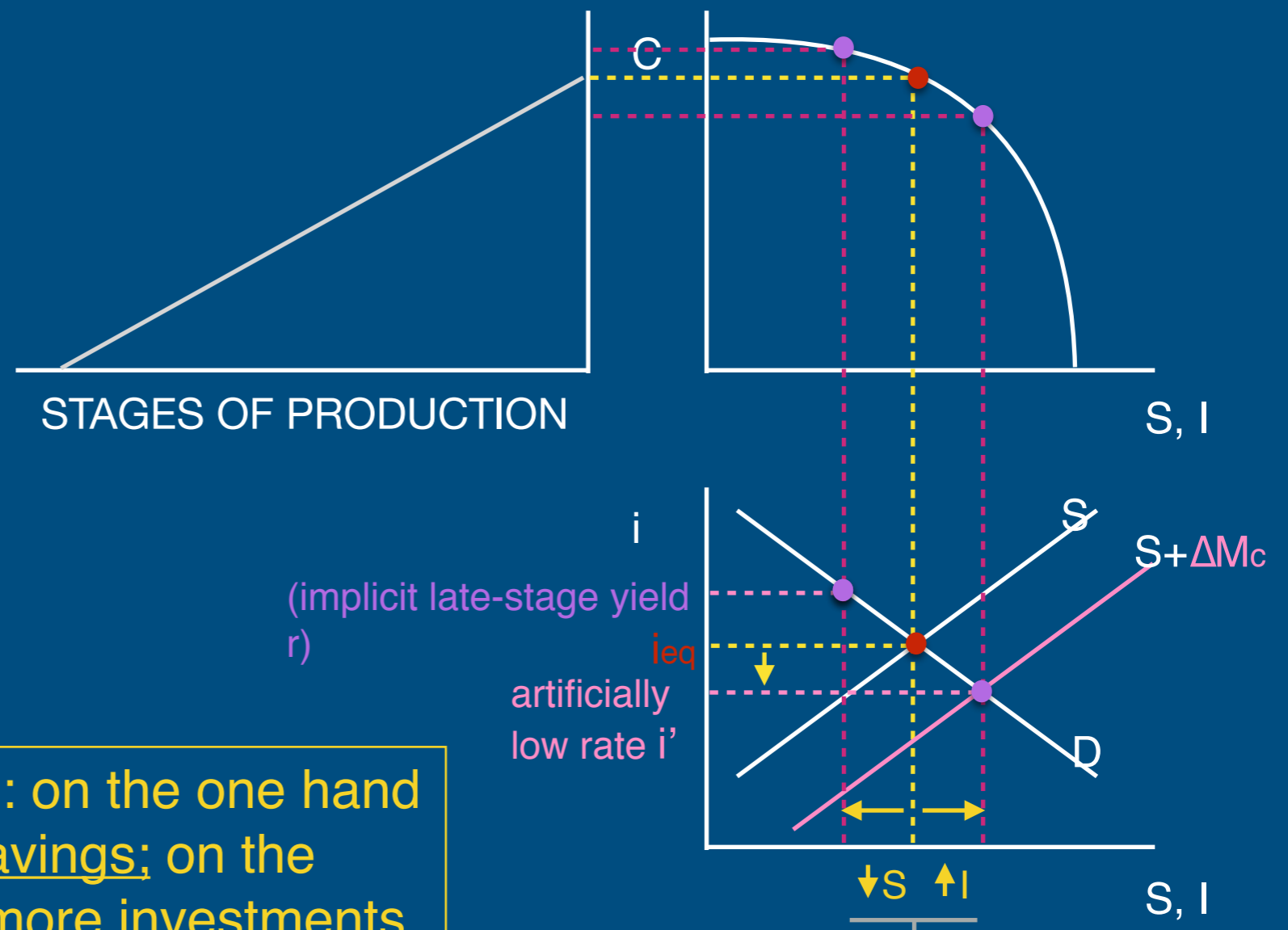
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wedge: on the one hand
less savings; on the
other more investments

$\Delta M_c =$
new money lent into existence:
(may not translate fully into credit
expansion: hoards)

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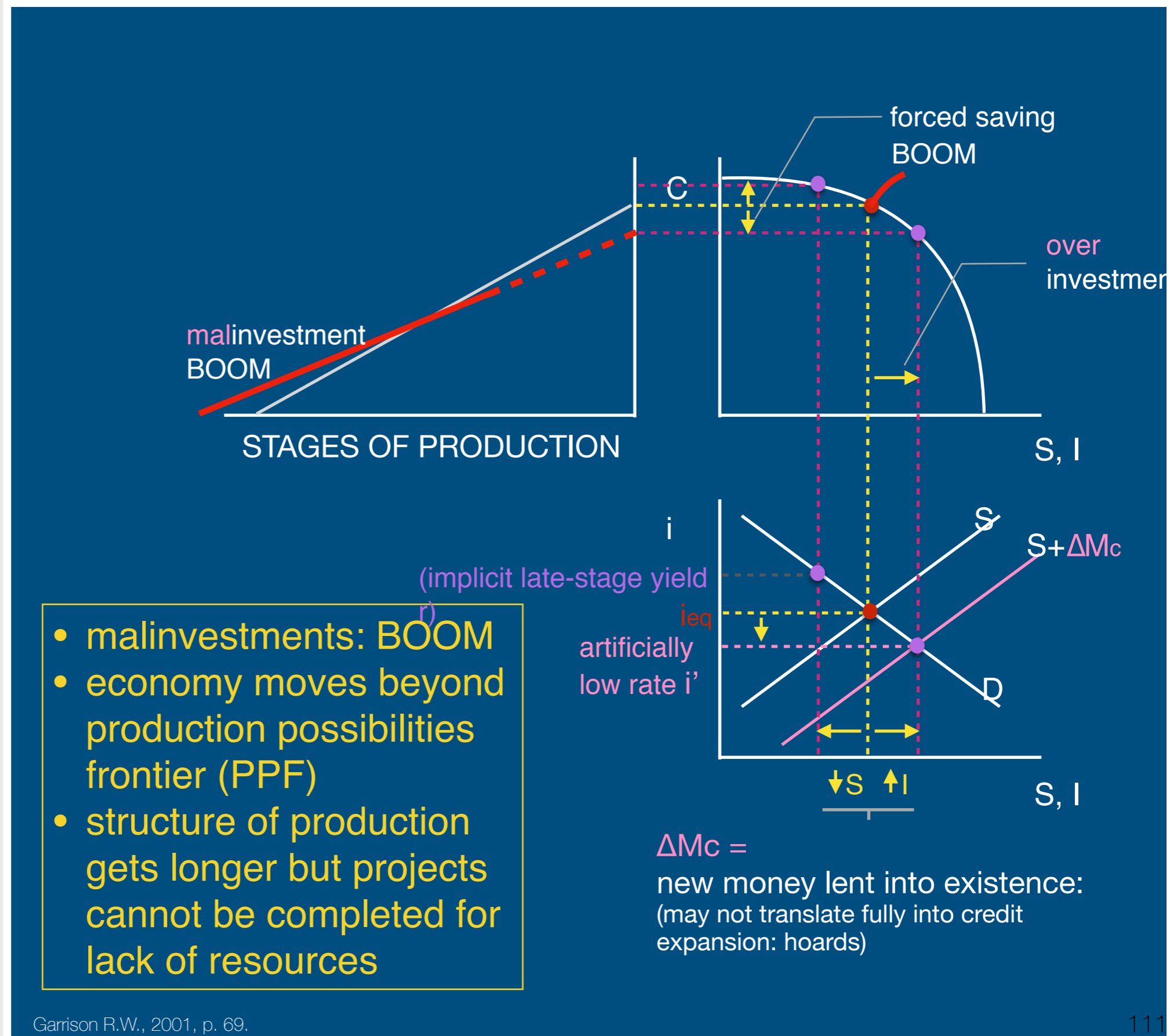
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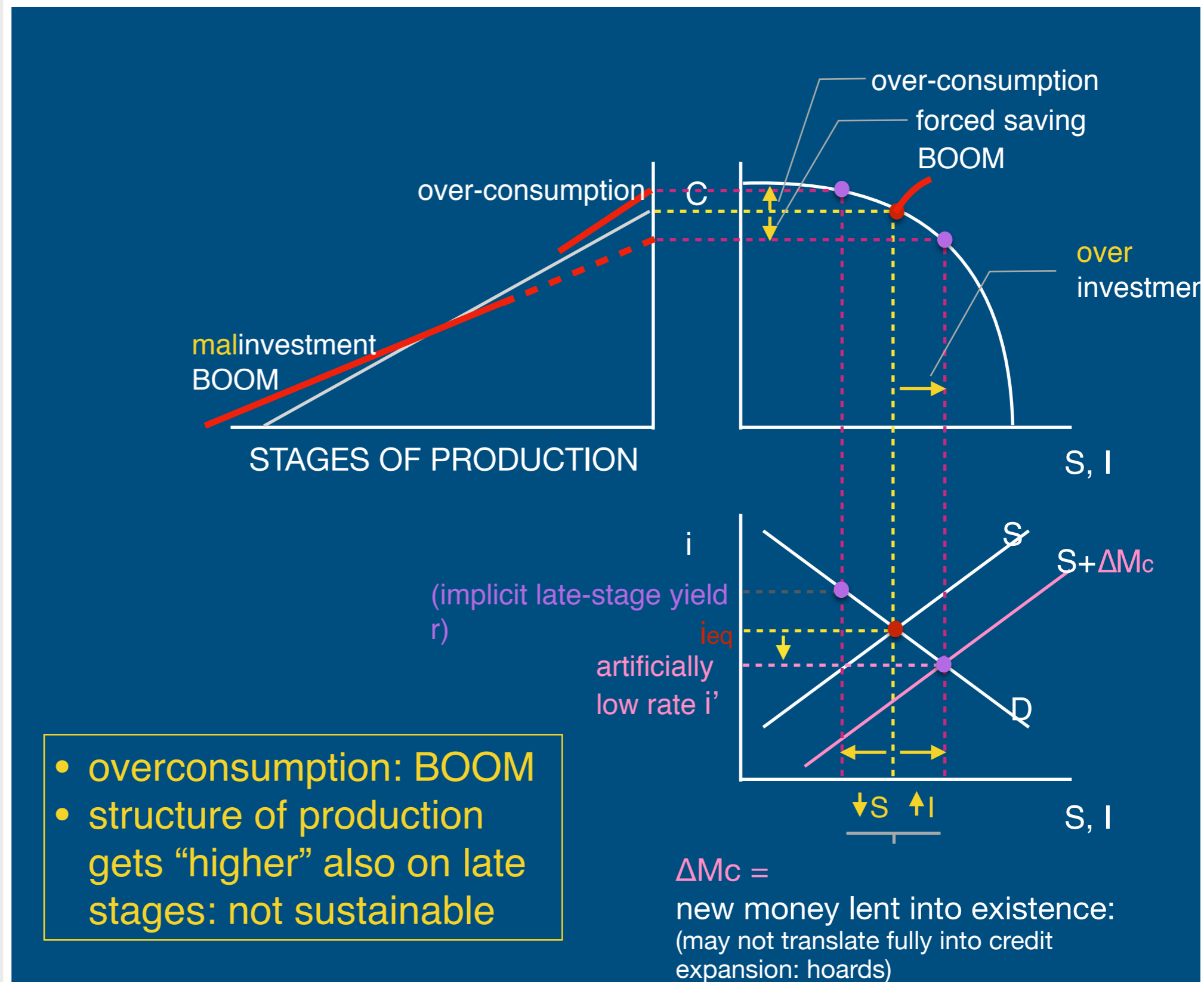
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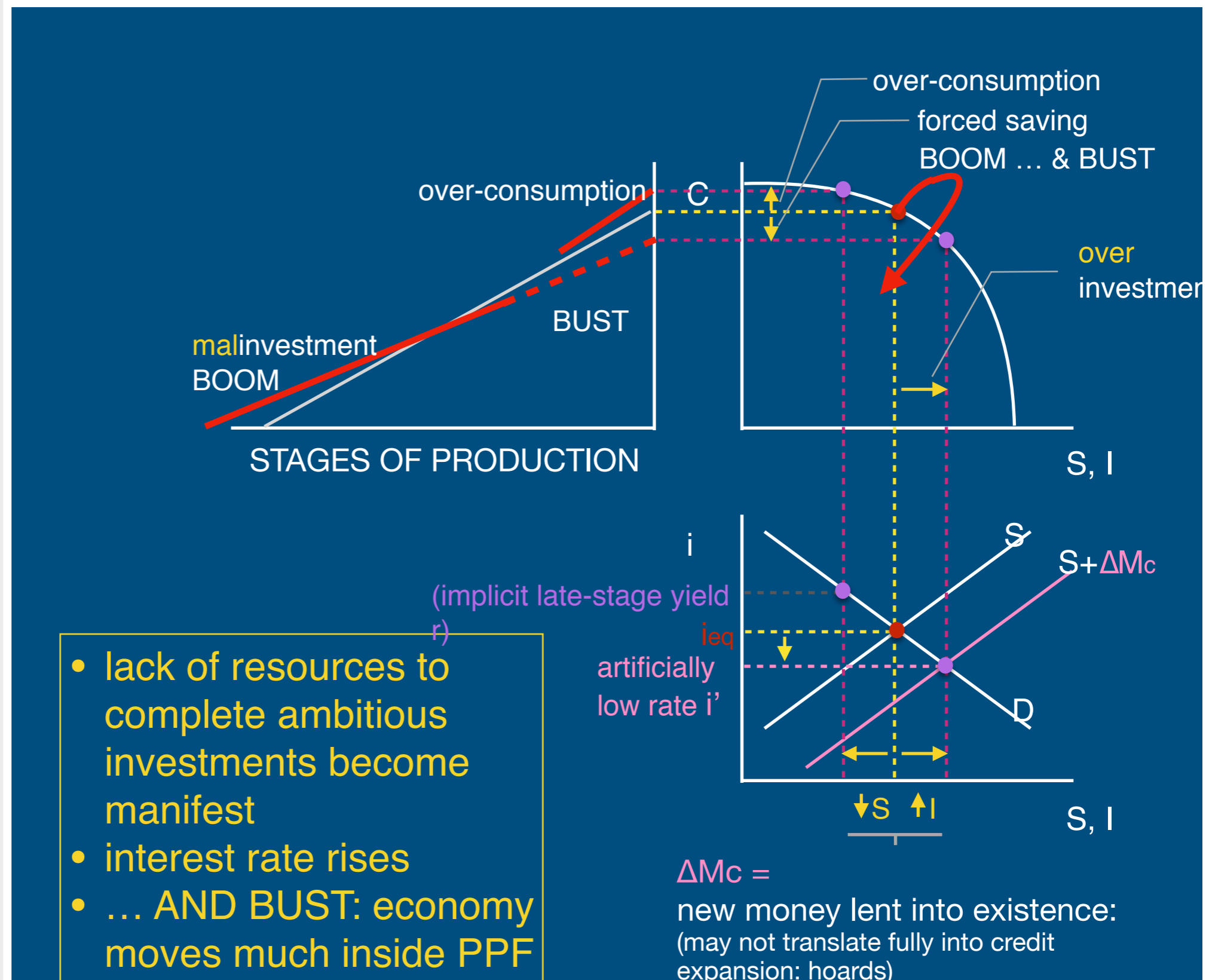
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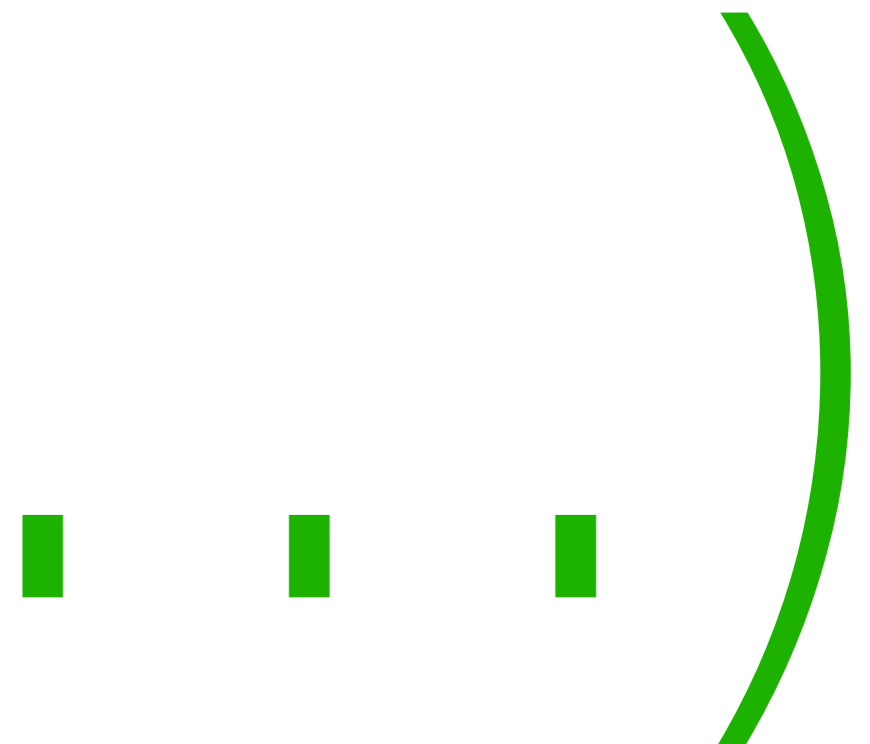
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● end of the technical part



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- because cyclical crises are produced by protectionism in general, and by protectionism in the sector of money in particular (artificial expansion of money and credit), they **cannot** be ‘cured’ with more protectionism

“To combat depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about; because we are suffering from a misdirection of production we want to create further misdirection” (Hayek)*

- because of the subjective theory of value, the **only** possible cure is the free market:
- this will free the economy of the economically unsustainable investments (**malinvestments**) **induced by government intervention** and create the conditions for sustainable ones

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- however, not surprisingly governments inevitably tend to ‘cure’ the ills **produced by protectionism** with **more doses of protectionism**, thus creating further crises (usually bigger)

“In fact, if we list logically the various ways that government could hamper market adjustment, we will find that we have precisely listed the favorite ‘anti-depression’ arsenal of government policy [...]:

1) Prevent or delay liquidation [...];

2) Inflate further [...];

3) Keep wage rates up [...];

4) Keep prices up [...];

5) Stimulate consumption and discourage saving [...];

6) Subsidize unemployment” (Rothbard)*

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“You never change things by fighting the existing reality. To change something, build a new model that makes the existing model obsolete” (Fuller)*

(*) Fuller R.B., 1982

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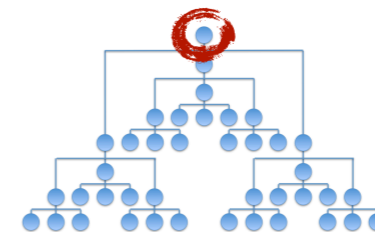
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- in the previous analysis we have seen:

1. that **protectionism**, though legal, is **illegitimate**
2. that it always **destroys economic value**
4. that its existence (and continuous expansion), especially in the money sector (but also in the international trade and even in the legislation sectors), **depends on** a legal, **institutional, economic and social structure**



which is **incompatible** with the structure of a free market and of a free society



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- the **bad news** is that this structure **cannot be reformed**
 - **neither through politics** (politics is always the problem, never the solution)
 - **nor through historical experience** (if nazism and communism were not terrible enough experiences to change abstract idea of law...)
 - **nor through culture** (free thinkers who have a scientific structure of thought will always be an insignificant minority)
- the **good news**, is that **it does not need to be reformed**: it can be “**forked**”

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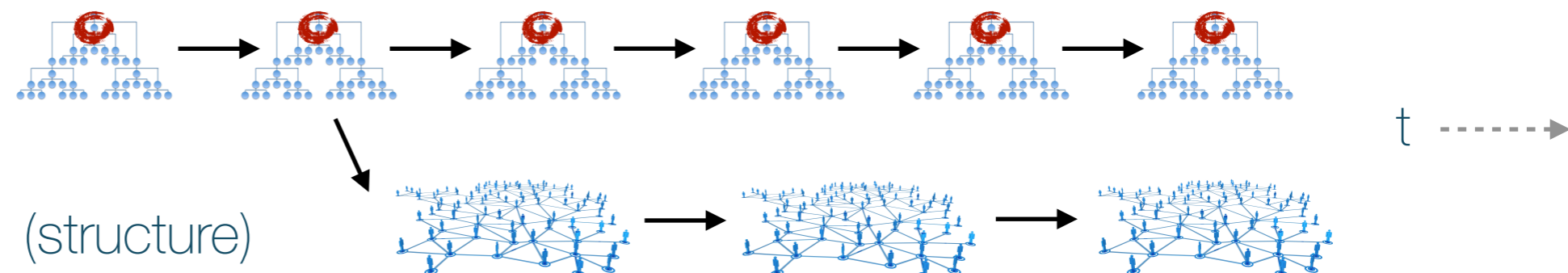
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from the movie Interstellar, 2014 by C. Nolan

“we’re not meant to save [government *fiat* money]. We’re meant to [fork] it”



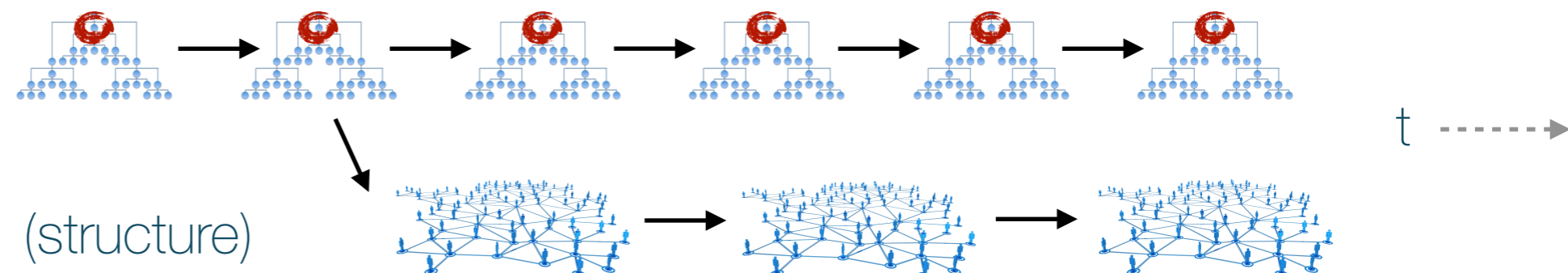
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- what does it mean that the structure of protectionism can be **“forked”**?
- It means that a **new, censorship-resistant, free-market structure** can be placed **nearby** the protectionist one

“forks ... may be a blessing in disguise. The reason is that forks potentially represent a welcome innovation in the way people can resolve their differences. Simply put, forks offer the possibility of exit. They give dissident minorities a third option beyond trying to change the majority's minds or adapting to their preferences. A fork is a bloodless, 21st-century form of secession” (Hochstein)*



(*) Hochstein M., 2017

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- **bitcoin** has shown that **if** the new, free-market structure has the following characteristics

1. is **fully** in accordance with the scientific laws of economics and of liberty
2. is **parallel**, not alternative, to the protectionist structure (its aim is **not** to replace the latter but to make it **obsolete**)
3. it is **censorship resistant** (the government cannot attack it)
4. it is decentralized (more precisely, **distributed**: no-one can arbitrarily control it)
5. it guarantees full **anonymity** (bitcoin has to further improve on this)

then, in time, sector by sector, the new free-market structure can gradually expand

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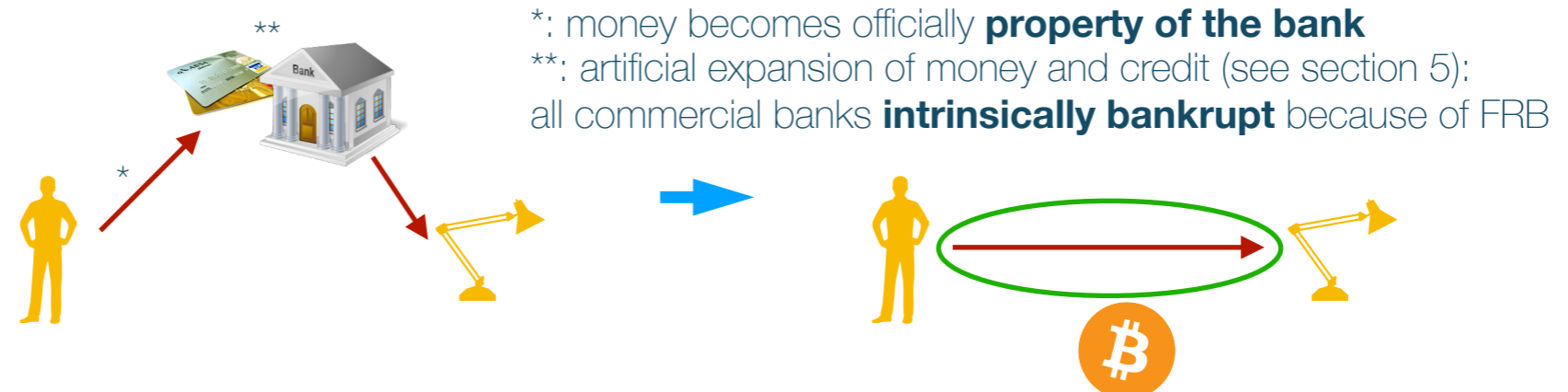
APPENDIX: What is bitcoin? A non-expert synthesis

● **bitcoin-blockchain** is:

- a **distributed** and **censorship-resistant** system of **certification (blockchain)**
- this system works **thanks to** a structure of free-market **incentives** provided by a scarce and non-physical **asset (bitcoin)**. Bitcoin *is fiat* money but, unlike GFM, it cannot be arbitrarily inflated.

- not only is bitcoin-blockchain a **medium of exchange** (and arguably free-market **money***) but **also** a **payment system** which is distributed (peer to peer) and censorship-resistant

(*) some people believe it is the former but not the latter: I disagree



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- the **blockchain** is a complete **ledger of bitcoin transactions**
- its called “blockchain” because the transactions are registered in **consecutive “blocks”** (each block being like a page of the ledger)
- this ledger is not centralized. On the contrary is decentralized: more precisely, it is **distributed** among dispersed “nodes”, each one of them having a ledger identical to the others
- **anyone** can be one of these nodes by downloading the necessary software
- the **ownership** of the bitcoins referenced to in the blockchain is **uniquely determined**: not via government IDs but **via cryptography**
- thus bitcoins are **scarce** and always private property of someone

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- the **great innovation of the blockchain** lies in the fact that it certifies that the information included into the different ledgers is **exactly the same everywhere** (the blockchain **prevents the ‘double spending’** of the same bitcoins)
- this result, which would be very easy to obtain with a centralized ledger (i.e. of distributed *copies* of a single centralized ledger), is **“mechanically” impossible** to obtain in a distributed ledger
- the blockchain obtains this result not “mechanically” but through a **structure of incentives**, that is through a **free-market process**
- all those who first update a copy of the ledger (the “accountants” or “**miners**”) have an **economic incentive** that all the others have **exactly the same info** on their ledger, and vice-versa

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- this **economic incentive** is given:
 - by the **commission** on the bitcoin transaction
 - by the **new bitcoins** that are given to the miners as compensation for their work (registration and verification of one block of transactions). This is how new bitcoins enter the market
- since the **total amount of bitcoins is fixed** (see later), these new bitcoins can be given to the miners (“extracted”) only as long as the maximum amount of bitcoin “in circulation” has not been reached
- the amount of bitcoins given to the miners per block registration is **cut by half** every 210.000 blocks (4 years approximately). (it was 50 BTC in 2009, today is 12,5 in 2020 it will be 6,25)

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- **who** gives the miners these new bitcoins? not a company or a person, but **an open-source, software protocol**
- this protocol is constantly updated by a community of developers and **cannot be arbitrarily modified**, not even by who invented it
- the quantity of bitcoins that the protocol can give to miners is **21 million**, not a cent more. Each bitcoin is currently divisible until the 8th decimal digit
- in order to verify the transactions and thus get these new bitcoins, miners must resolve **complex problems of calculus** by using **computer machines**
- the difficulty of these problems **increases** with the amount of “computing power” dedicated to their solution (and vice-versa)

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- this is to make sure that, in normal conditions, the registration time for every block is about **10 minutes** (the last bitcoin will be “extracted in the year 2140; 99% of bitcoins will be extracted by 2030; today roughly 83% of bitcoins have been extracted)
- this is an important fact that economically **distinguishes bitcoin from gold**: when demand for gold increases, other condition being equal its price increases. This creates an incentive for more powerful extracting technology that **decreases** the difficulty of extraction. The effect is an increase of the supply of gold: this slows the gold price increase
- on the contrary, in the case of bitcoin the difficulty of extraction **increases** with the power of extracting technology. Thus, unlike the case of gold, the supply of bitcoin **does not** increase as a result of an increase of its demand (in the long run, its **price** tends to rise instead) and the trend of that supply tends to be much **more predictable in time** than that of the gold supply

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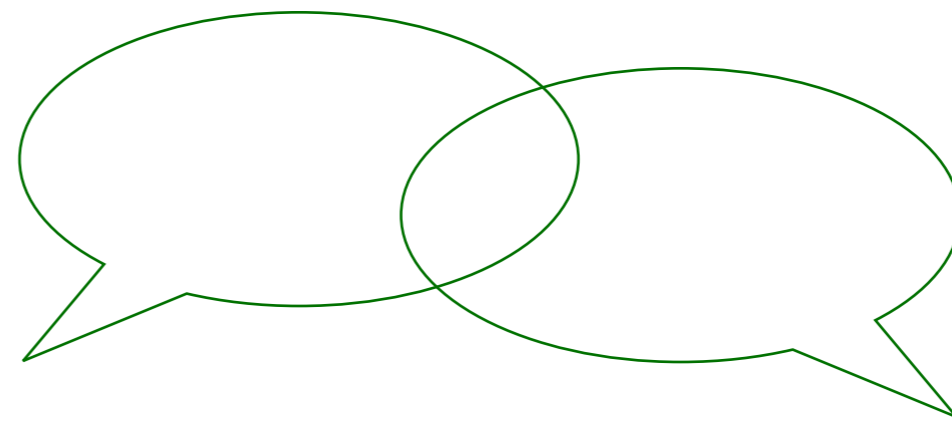
“It is a favorite conceit of modern [individuals] that skepticism, the attitude that nothing can really be known as the truth, is the best ground work for individual liberty. The fanatic, convinced of the certainty of his views, will trample on the rights of others; the skeptic, convinced of nothing, will not. But the truth is precisely the opposite: the skeptic has no ground on which to stand to defend his or others' liberty against assault. Since there will always be men willing to aggress against others for the sake of power or pelf, the triumph of skepticism means that the victims of aggression will be rendered defenseless against assault. Furthermore, the skeptic being unable to find any principle for rights or for any social organization, will probably cave in, albeit with a resigned sigh, to any existing regime of tyranny. Faute de mieux, he has little else to say or do.” (Rothbard)*

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let's discuss (fire at will)

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thank you

should you have any questions, feel free to contact me at

giova@catallaxy.org

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