Rethinking the Future International Security Environment
The Johns Hopkins University – Applied Physics Laboratory

Economics and National Security

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6:00 – 8:00 pm
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Outline of Remarks

Slide 1: Title

Introduction / Unclassified / Further Inquiry

A word on systems dynamics, applied mathematics, complexity, Hayek, icy roads

Video 1: CNBC Eamon Javers
http://www.cnbc.com/id/15840232/?video=1653093678&play=1

(for 1 minute 50seconds)

The Sovereign Debt Crisis and the Currency Wars (20 mins)

Slide 2: Measures of Sovereign Debt
Slide 3: Fault Lines in Europe

The Sovereign Debt crisis is a combination of:

Runaway deficit spending

Added on fiscal stimulus

Substitution of public debt for private debt; bailouts
(GM, Irish banks, Fannie Mae, AIG, Goldman, etc.)

Sovereign debt cannot be repaid in real terms

Traditional formula was higher growth and/or higher taxes

But growth now in deflationary collapse and taxes hurt growth

Problem with Euro

Failed to distinguish the currency from the bond issuers

Two different things: Corp v. Treasury in U.S.

Germany benefits from unified, weak euro but has tiger by the tail

Default inevitable – only issues are how

Outright default – the deflationary default

Confiscatory taxation – the fiscal default

Hyperinflation – the inflationary default

Some combination of the above

It's all one crisis – Dubai, Greece, Ireland, Portugal, etc.

Currency Wars happen when growth stagnates

When pie is expanding, people don't fight over shares

When pie is shrinking, people do fight over crumbs

GDP = C + I + G + (X – M)

Slide 4: GDP=C+I+G+(X-M)

When (X – M) is the only source of growth, currency wars begin

All advantage is temporary

Escalation is inevitable

Escalation includes:

Capital controls
Protectionism
Trade Wars
Gold
Shooting wars

Political Backlash has begun: Iceland v. Ireland

Video 2: European Parliament
http://www.youtube.com/watch?v=Fyq7WRr_GPg&feature=player_embedded
(entire clip)

What's in your Wallet? – Quantitative Easing, Inflation & Deflation (20 mins)

Slide 5: What's in Your Wallet?

The conundrum of inflation v. deflation and the illusion of price stability

The “Quantum of Loss” theory

Total losses are given based on misallocated capital & returns

Can be shifted in time

Can be shifted by identity of losers (banks v. taxpayers)

The “V” versus the “L”

Slide 6: Dynamics of the Housing Bubble

Americans have tolerance for pain and appetitive for growth

Americans have low tolerance for stagnation, unfairness

Fed wants inflation

Slide 7: When is an Asset not a Liability?

Reduces real value of debt

Supports asset prices

Creates negative real interest rates

But the Fed is not getting inflation

Being exported to China via exchange rate

Pull of intrinsic deflation is too strong

Velocity is plummeting ($MV = pY$)

Slide 8: MV=pY
Slide 9: Velocity of Money

Danger is Fed will do “whatever it takes” to the point of instability

Slide 10: Growth in Monetary Aggregates

Transparency, social media, mobilization are new phenomena

Dynamic model of dollar collapse

Slide 11: Dynamic Model of Dollar Collapse
Slide 12: Average Maturity of Debt – The Short Fuse

China, Russia and the Rise of State Capitalism (20 mins)

Slide 13: Rise of State Capitalism

Washington Consensus v. Beijing Consensus

Elements of Classical 17th-19th Century Mercantilism are:

Principal forms of wealth are tangible, i.e. land, commodities, gold

Acquisition of wealth internationally is predominately a zero-sum game

Sound policy includes favoring domestic industry, exclusive trading blocs, discrimination and protectionism

Export subsidies, import tariffs, exclusivity in trading relations are normative

Trade is the continuation of war by other means

Elements of the Globalized Washington Consensus are:

Free Trade

Freely Convertible Currencies

Freely Floating Exchange Rates

Free Flows of Capital, interest, dividends

Few Restrictions of Foreign Direct Investment

Mobility of Labor

Reciprocity and non-discrimination in overseas expansion of global companies

Protection of Intellectual Property, patents, trade names, trademarks, etc.

Protection of Creditors

Reasonable Anti-Trust enforcement

Non-protectionism, low or no tariffs, most favored nation treatment

General adherence to the Rule of Law

Elements of the Beijing Consensus are:

Wealth creation may not be strictly zero-sum but may be increased through sub-optimal policies

Intangible and intellectual property may
be a form of wealth but may also be amenable to mercantilist approaches

Mercantilist policy may be applied selectively rather than exclusively and still be advantageous under certain conditions

Evidence is large and growing the Russia and China are pursuing Neomercantilism

Differentiated taxation of rare earth exports by China

Captive mining industries in Russia and China

Large and growing role of the state sector – Gazprom, Sinopec, CIC

The German-Russian Axis, Nordstream

The concept of Greater China

Conclusions

These problems are not residuals or artifacts but are new and expanding

Neomercantilism rational in a world of diminishing marginal returns to complexity

Victory in a negative sum game is still victory. I lose, you lose more, I win

We are not helpless – The United States as Gold Superpower (20 mins)

Slide 14: Operation Grand Slam

Now for some good news

Brief history of gold in U.S. monetary policy

Destruction of paper currency / hyperinflationary episodes

Revolutionary War
Hamilton backed currency on gold/silver standard

Civil War
Grant deflated, returned to gold standard

1876-1914 Hey Day of Sound Money
Real growth with “good” deflation

1922-1936 Rise and Fall of the Gold Exchange Standard

1944-1971 Rise and Fall of Bretton Woods

Survey of Gold Powers today – U.S. as the "Saudi Arabia of Gold"

Slide 15: Not Like the Others
Slide 16: Central Banks: Paper versus Gold
Slide 17: The Implied Price of Gold
Slide 18 & 19: Total Gold Holdings by Country
Slide 20 & 21: Total Gold Holdings with Eurosystem
Slide 22: Gold Reserves as Percentage of Total Reserves
Slide 23: Gold Reserves as a Percentage of GDP

Conclusions

Gold standard associated with growth and rising living standards

In deflationary crisis, President will devalue against gold
FDR in 1933-1934
Nixon Shock of 1971
Bipartisan

Bernanke fighting inflation / seeking devaluation today
Will fail because currency wars always fail

Dangers are: Deflationary collapse, protectionism, trade war, etc.

Solution is: Reflation via gold and stability via gold standard

Question: Get there with planning or with chaos?

Policy and Prospects (15 mins)

Slide 24: Policy and Prospects / Civil Disorder

No way out of the debt crisis

Confusion, fear and anxiety on the increase

Loss of trust in elites and elite solutions

Dynamic instability of trying more and more of the same

Political backlash, finger pointing, "too much" v. "not enough"

No dry powder, financial system not robust to war, natural disaster, another financial collapse

In extremis, secure the gold under IEEPA / Offer Europe Treasury Receipts
Revert to global gold standard managed by U.S.
Develop contingencies now
Operation Unified Quest 2011

Slide 25: Operation Unified Quest 2011

Video 3: Rollover (5 mins)
http://www.youtube.com/watch?v=m1aQ-XGWors&feature=related
Begin at 1:35 and run until 5:30 (about 4 minutes)

Slide 26: Thank you / Contact Information

Questions (25 mins)