



## Episode 1,036: What Are Other Economists Missing About the Economy?

Guest: Mark Skousen

**WOODS:** I'm glad to see that your textbook is now in a fifth edition with all the data updated and fresh. That's called *Economic Logic*, as I was just telling folks, and we definitely want to talk about some stuff that's in there. I want to start off with a topic that is in the news and of course is the kind of topic you'd see covered in your textbook. But that is the tax reform proposal that we are hearing about coming out of Washington. And it seems to be, or at least for quite a long time it's been evolving in terms of the number of brackets involved and the deductions that will be allowed or not allowed. What's your overall impression of it?

**SKOUSEN:** Well, the more I look into it, the more disappointed I am, because there's no simplification here. The rules and regulations, I mean, this is going to be a thousand-page tax reform bill. It's not really going to reduce the tax brackets. I mean, maybe they will to some extent, but even the Senate is adding new ones. And they're fearful of not taxing the rich enough and so they're thinking of adding a new tax bracket for the wealthy. They're talking about removing part of the deductions. There's nothing there that would fit Steve Forbes' definition of a postcard tax return, which is what we really need to be headed towards. So I think it's pretty disappointing.

The other thing that's disappointing from an investor point of view, when we worked long and hard to get the cost of long-term capital gains down to 15% under George W. Bush and now it's up to 23, almost 24%, and there's no indication that there's any kind of tax relief particularly in the area of capital gains, interest, and dividends, which I think is really important. So there's a lot of things that I don't really like about it, but from the stock market point of view, everybody's hoping for tax reform, some kind of tax relief, and that's why the stock market has performed as well as it has. So you take that away, if they don't get tax reform, if they don't replace Obamacare, then Trump is going to be viewed as a failure, and I think there's a real concern now that the Republicans will lose the House next year, and the Democrats taking over the House will immediately try to impeach Trump. And it's just going to be a mess.

**WOODS:** Yeah, I've got an ongoing bet with David Stockman, who does not think Trump is going to make it through 2018, and I just feel like Trump is such a great fundraiser for the Democrats, or at least potentially he is —

**SKOUSEN:** [laughing]

**WOODS:** – I don't think they'd want to get rid of him, you know? He's the biggest punching bag they've ever had. So they may talk a good game about that, but I'm not sure they're actually go through with it. Anyway, who knows? That's an honorable disagreement among gentlemen. Just one other thing on tax reform. You hit on a phrase, tax relief, that I think is significant, because you can have tax reform without having tax relief. You can just shuffle the taxes around, and where they get shuffled and which deductions are preserved or expanded or eliminated depends on which side has the best lobbyists and lawyers on its side. And I'm afraid that's what this is turning into.

**SKOUSEN:** Yeah, I agree with you 100% on that. It's tax reform; it's not tax relief.

**WOODS:** Now, you were talking about – you mentioned the stock market. In your book, one of the nice things about your book is that, first of all, it's written for the average American of reasonable intelligence. It's not for people – you don't have to have a huge background in economics. You'll get the background in economics by reading the textbook. And you have some good material on financial markets, which of course you know about as a newsletter publisher for many years. You explain the terminology that I bet a lot of people wish they did and they don't know how to find out. Stocks, bonds, everything's covered in here.

You address the question: is the stock market really just a giant casino, as we often hear it said. How do you answer that claim?

**SKOUSEN:** You're right, I do have a whole chapter on Financing Capitalism: The Stock and Bond Markets, and I think this is an area that had been short shrifted by economists. Very few textbooks, they hide it in the appendix. I bring it out front, mainly from my own experience. I wrote this entire textbook, *Economic Logic*, based on my own experiences, and that's why I start with a P&L income statement instead of supply and demand. I do cover supply and demand, but it doesn't happen till chapter six. So I'm the only textbook out there that starts with something that people understand, and that is an income statement, a profit and loss statement. I think that's chapter two.

And then I talk about the factors of production, land, labor, and capital, but when I come to capital, then I have a whole chapter on the stock and bond markets. And I introduce it, when I teach this course, I hold up to the students a lottery ticket and a stock certificate. And I ask the students, are these the same or are they different? And it develops a wonderful debate among the students, because some say it's a lottery ticket, that it's like Las Vegas, Wall Street is like Las Vegas. And I even show them a book of that title, *Wall Street, The Other Vegas*. And then I hold up the stock certificate and I quote Peter Lynch, the famous financial advisor and money manager of Magellan Fund at Fidelity who said, "Never forget that a stock certificate is part ownership in a business."

And so we really get into the fundamentals of the differences between – you can use the stock market as a speculative, gambling vehicle, and a lot of people do that sort of thing. But I think if people take a long-term view and see the stock market as a way to raise capital and to be invested in entrepreneurship and new companies and new technologies, it's really – You know, I come across as very much a pro-investor,

encouraging people to participate in the — I generally have a rather positive view about Wall Street in that chapter.

**WOODS:** Now, when I had you on — I've had you on a couple of times, but once it was to talk about your opinions on investing and your view that sometimes Austrians get this strategically wrong because they're — I think your view more or less was they're always holding back on getting into the stock market because they feel like the bust is always coming. And while they're waiting for the bust to come, they're missing out on huge potential gains. Am I summarizing that roughly correctly?

**SKOUSEN:** Yes, definitely, and I have a chapter on the business cycle in addition to the stock market. But in the stock market chapter, I reproduce Jeremy Siegel's chart for stocks for the long term. And in it, it shows that the stock market has had a tremendous upside. Now, this is the United States only, and I make a very big point about this, that the only reason the U.S. stock market has a long-term upward trend that defies the doom-and-gloomers is because we're essentially still a free market, capitalist system that has the rule of law.

And so I do point out that other countries have not had the same performance as America. I mean, Japan has still not recovered from its 1990 top, and here it is 30-some years later. You have Argentina that closed the Bolsa for many years. Israel — I mean, there's lots of countries where things went badly for long periods of time. So I don't want to dismiss the Austrians who warn us constantly about the coming bear market, but it doesn't seem to work in the United States.

And my main point is, for some reason, the Austrians have focused on the bust, on the crisis, on the crash, the coming crash based on both Hayek and Mises, primarily Mises, who was always famous for "someday there's going to be a great crash," pointing to the Creditanstalt and predicting the 1929-1932 debacle and never recovered from that. They've always been bearish since then. And so I said, look, in my chapter on the Austrian theory of the business cycle, which I cover very precisely, I said, you know, there's a boom side to the Austrian theory of the business cycle. Let us not forget that the stocks go up during the boom phase, so yes, it may be artificial, but it can last for years. So why not play both sides of the market and use some protective stops or maybe the inverted yield curve, which I think is an Austrian way of anticipating that the boom is going to turn into a bust. So that's how I handle that in the latter chapters of *Economic Logic*.

**WOODS:** So let's then go to your discussion of so-called gross output as a metric for getting a fuller picture of what's going on in the economy than the traditional national income accounting figures. This gross output figure is — Well, first of all, explain what it is and why does it matter, because there are economists who think it doesn't matter for some reason.

**SKOUSEN:** Yeah, so this is where I'm kind of promoting my textbook as squaring the Mises circle, if you will. It's introducing an Austrian concept, the supply-side Austrian concept, into national income accounting and into the textbooks. And by the way, gross output, since it's been adopted by the federal government — and I know this will be a shock to a lot of your listeners — it actually renewed my faith in the federal government that they might actually be able to do something right.

And so the BEA, the Bureau of Economic Analysis, since April 2014 have been releasing or publishing quarterly gross output data. What is gross output? It's Hayek's triangle. It's a measure of Hayek's triangle. And this should be really happy news. This is a triumph of Austrian economics. This is the biggest triumph in Austrian economics since Hayek won the Nobel Prize in 1974, and I think it's unfortunate and I don't understand it, why Austrian economists at GMU and elsewhere are reluctant to see this great breakthrough. This should be a wonderful celebration that the government is measuring all stages of production.

I call it – and this is my background in finance. So it came to me as kind of an epiphany that this is a topline in national income accounting. We always had the bottom-line in national income accounting of GDP, which is a measure of finished or final goods and services, but we never had a topline like you have in financial statements. Every quarter, publicly traded firms come out with their financial statements. They have a topline, which is sales, and a bottom-line, which is earnings or profits. So my argument is that with GO, economists have finally caught up to the accounting and finance departments and now have a topline and bottom-line in accounting.

And gross output, as a measure of Hayek's triangle, first of all shows you that business is so much more important than we realized. And by "business," I put in that category savings, investment, capital investment, entrepreneurship, innovation, technology, all the aspects of supply-side economics is in the supply chain. And GDP, a lot of people don't realize this. GDP leaves out the supply chain. All the B2B spending that brings the production process to the final product is left out.

Now, of course, economists, as Peter Drucker said, are slow learners. A lot of economists are slow learners and they just call it double counting because GDP is, you don't want to measure the same commodity used over and over again. But in the supply chain, double counting counts. In fact, it's absolutely essential to move the production process from the earliest stage to the finished stage. And I use a four-stage model of the economy, kind of a universal, four-stage model of the economy that people can see in the textbook. So it's resources, production, distribution, and final output.

And so gross output is an extremely important measure, because the reason it's not just double counting is because you're moving the supply chain along the supply chain and the product is changing. So the coffee bean is getting roasted and then it's being crushed and then it's packaged and then there's location economics. The wholesaler distributes and moves it over to the retail. And business has to spend their – you know, business cannot run on value added only, which is what GDP is. Business requires you to raise capital to pay for all your expenditures, including the supply chain, including the products that you need to purchase to move it along the production process.

So I know that's kind of a lengthy response to understanding what gross output is, but it's a major breakthrough. I called it a paradigm shift in macroeconomics, and I just finished reading Thomas Kuhn's famous book, *The Structure of Scientific Revolutions*. Tom, I don't know if you've read that or not, but it is so applicable to all disciplines where there's the theory, the model that you currently have, the macro model that we

currently have of GDP. It creates a lot of problems. There's a lot of problems associated with it. So then someone comes along and develops a new way of looking at things. It's held with great skepticism. I mean, Tom, I can't tell you how many papers, my papers on gross output have been rejected. I mean, I've had some published, but there's been a lot of skepticism in the profession. And I would say I'm finally making some progress since the government is using the statistic.

But we also have five textbooks now – and none of them are Austrian, by the way. But I have five textbooks that have now adopted gross output, and they include Roger LeRoy Miller; McConnell, Brue, and Flynn – Sean Flynn is the principal writer and he's a free-market guy; Colander – I can't remember all of them that I've got, but there's five textbooks. But I'm struggling to have the other textbooks take a look at it. They just don't see the need for it.

**WOODS:** Well, can you take an industry people are familiar with and, just to put some meat on the bones here, give an example of what aspects of that industry, what parts of the process would be left out of the traditional accounting and are included under your gross output?

**SKOUSEN:** Right, so a micro example would be the production of coffee, and I mentioned that previously. So you have four stages of production to make coffee at Starbucks or at whatever other coffee house you have. So you have the coffee beans that are produced by the coffee farmer, and that's the resource stage. And then it moves to the stage where the coffee is cooked and burnt and crushed and made into a package, so that's the production stage, and you add value. Then it's sold to a wholesaler, and the wholesaler transfers that package from the producer over to the final use at Starbucks. And then Starbucks takes that package and turns it into coffee and again adds value. So what started off as an unfinished, raw commodity now becomes a consumer product that's added value along the way.

And so GDP will measure only the coffee itself, the final consumer good. But it will not include any of the measures of all the money, all the capital investment that the coffee farmer, the coffee manufacturer, the wholesaler, all of those what I call the make economy. GDP will only measure the final product that you consume. So when we look at  $C + I + G$  – this is what consumers, business, and government buys that are finished products, and then it leaves out the supply chain. The entire supply chain is left out of GDP.

And so if you look at Hayek's triangle, what are Hayek's triangles – and he never did try to apply it to government statistics that we have today – Hayek's mistake, in my opinion was that he maintained only a high theory level. And so my objective was to take Hayek's original work in prices and production and put some meat and bones on it by describing, and that's what I do in my book *The Structure of Production*, which came out in 1990, published by NYU Press, and now is in its third printing with a new introduction. So there's been a lot of advance in Hayek's triangles, because it measures the supply chain. And that's why this is such an important breakthrough that all Austrians should be alert to and start doing research and writing on it.

I should mention also that apparently GO has a lot of predictive power. In fact, David Ranson, who's a chief economist with HCWE, which is a private consulting firm on Wall

Street, he did some preliminary work and found that the supply chain and gross output, acts as very strong predictive power and can predict what GDP will be 12 weeks in advance. So that's another important reason why GO should be looked at.

And my textbook *Economic Logic* is the first textbook to fully integrate topline and bottom-line accounting, GO with GDP and make it complete. This is why I say GO is the missing link in macroeconomics. And it's an Austrian supply-side concept, so I'm really hopeful through your podcast and through others and reading that they will capture the vision of how important this is to kind of complete the macroeconomic puzzle. And so that's why I, again, call it squaring Mises' circle here, is what's happening here with this advance.

**WOODS:** Let's take a bird's eye look at your textbook as a whole. It seems to me to be somewhat eclectic. Is that how you would describe it in terms of the influences that you bring to bear in your presentation? In other words, it's not a pure Chicago presentation or a pure Austrian presentation.

**SKOUSEN:** Yeah, in fact, I dedicate the book initially to both Hayek and Friedman, so I try to take the best of both the schools. But I'm also very eclectic like Kenneth Boulding was in believing – you know, my background, a liberal arts education, and I have a PhD in economics, but I'm an applied economist in finance and business. I've run businesses. So if I had written this textbook 30 years ago, I would not have started with the P&L statement. So I start with that, the profit and loss statement. I have a whole section on the four financial statements, which includes economic value added, EVA, that Joel Stern discovered.

I have an influential economist at the end of each chapter. So my first one is Adam Smith and *The Wealth of Nations*. And Ludwig von Mises is the highlighted economist in the second chapter. I also have other Austrians like Rothbard and Hayek highlighted, Schumpeter of course. And then with the Chicago school, I've added Milton Friedman and George Stigler and Gary Becker and Robert Mundell.

But I've also reached out to people who are fellow travelers, if you will, who did not consider themselves academic economists. So I highlight with Peter Drucker in management, so I have a lot of business – a lot of my students consider my course kind of a business economics course. And I also have Edward Deming in there, who is famous for his cost controls and efficiency methods, so I highlight Edward Deming, Peter Drucker and Deming. And then I also have Muhammad Yunus, who won the Nobel Peace Prize for his microcredit, so I have him juxtaposed with Karl Marx. I have a whole chapter on Keynes. I put Keynes in the chapter on deficit spending and national debt, because that paradigm shift with Keynes has had some unintended negative consequences when it comes to controlling the budget and the size of government and that sort of thing.

So my basic thesis is a totem pole approach. I don't do left and right; I do up and down. So Adam Smith and the free market economists reign throughout my textbook, but I do have full chapters on Keynes and Marx and the enemies of free market economics. So it's a full textbook. As you say, I think it's written for the layman. A lot of people use it in homeschooling. And in a lot of ways, you can consider it as lessons in economics rather than just chapters of a textbook.

**WOODS:** I hope I can ask you one more thing before letting you go?

**SKOUSEN:** Yes.

**WOODS:** Okay, and if this is too hard to handle on a podcast, I totally understand, but one of the selling points at the beginning of the book is that you provide an alternative to the so-called circular flow diagram of the way the economy works, and that's what most students get in their textbooks. What's wrong with that diagram?

**SKOUSEN:** Well, the problem with the circular flow diagram is that it doesn't show the importance of time. And the circular flow diagram also tends to promote the idea that final consumer spending drives the economy. Rather than consumption driving the circular flow in the economy, you have investment, business spending, and the factors of production driving the production and consumption of the economy, and then consumer spending is used up and depreciates, which is a more accurate view. So this Ekin is the author of this that I reproduced in the chart. It's just a beautiful chart or diagram of what really drives the economy.

And by the way, another reason gross output is so beneficial as a true measure of total spending in the economy, it shows that business is the biggest sector in the economy and not the consumer. Consumer spending is 70% or two-thirds of GDP, but that's because it only measures final output. But as you look at gross output, which is \$41 trillion in this last year, business spending is by far the biggest sector of the economy. It's over 60% of gross output, so it's a much more accurate view. So this is another reason why we need to look at GO. And that new diagram that I have showing investment is what really drives the economy.

And of course I use lots of examples in my classroom and in my textbook. I use Seattle as an example. It's innovating companies that have made Seattle rich, not consumers. Consumer spending is the effect, not the cause of prosperity. And that's what Say's law basically says, so I'm a big supporter of Say's law in my textbook, which has been underplayed. I think we're too much victims of Keynes' law that we say that consumer spending drives the economy, and we need to look at Say's law, which says that business and innovation and entrepreneurship – or that he popularized – is what drives the economy.

**WOODS:** Mark, you were telling me there's a way curious people can get this textbook without having to pay textbook prices. And what would that be?

**SKOUSEN:** So Capital Press, which is part of Regnery, charges \$79.95, so it's another one of those high-priced – Now, that's still only half what most textbooks charge these days. But I actually – if they go through my connection, which is Ensign Publishing, they can get the book for 39.95. If they're in the U.S., that includes the shipping costs. So the phone number for that, for Ensign Publishing, the new addition for 39.95 is 866-254-2057. And by the way, if there are any – if you have anyone outside the United States, this textbook, I shipped one the other day for \$57. That's how much the post office charged me to mail the textbook abroad, so you need to add \$57 if you're ordering it even in Canada. Isn't that one of the great tragedies, Tom, that I can mail this book for \$3 or \$4 to Detroit, from New York to Detroit, but to send it to Toronto just across the border, it's \$57?

**WOODS:** That's just insane. Well, first of all, let's find — the good news of that is it's a great, big book, so I just want people to understand they're getting quite a lot of value here.

**SKOUSEN:** 700 pages.

**WOODS:** It's over 700 pages.

**SKOUSEN:** Yeah, but it has wide margins so it's easy to read [laughing].

**WOODS:** Right, right. It definitely is easy to read. Yeah, no, it's not — yeah, that's right. It's very, very attractively laid out. Well, Mark, thanks for your time. Especially thanks for tearing yourself away from an event you're at, and best of luck with the book. And of course, it's a little bit far off, Freedom Fest, but you are the man behind Freedom Fest every July in Las Vegas, so I'll try and get you back on as we get a little bit closer to that.

**SKOUSEN:** Well, thank you for mentioning Freedom Fest. Next year, it'll be July 11th through the 14th, 7/11 in Vegas. And we're working together very closely with the Reason Foundation that's celebrating their 50th anniversary, so they're doing their Reason Media Awards and two breakout special Reason days there. We'll probably have several thousand people there. And we are trying to get Tom Woods to come out there, and we hope to do that pretty soon [laughing].

**WOODS:** [laughing] We will see what next year brings, but thanks so much for talking to us today.

**SKOUSEN:** Okay, thank you, Tom.