Episode 741: David Stockman: What the Fed and the Feds Have Done to Us, and How to Reverse It

Guest: David Stockman

WOODS: All right, so you have this new book, *Trumped*. I've been reading it, and just when I think you're about to say something I don't agree with, then you stop and you say, on the other hand, Trump says all these terrible things. So I'm pretty much in agreement with you; I've had several people on with whom I have come to the conclusion that the destruction of the Bush family was a great service to America, and I credit Trump with that. And discombobulating the elites, I credit him with that. I just wish he could be a different person than who he is. I wish you saw the true causes of our problems, and unfortunately, once in a while you get a glimpse from him — he'll say that the Fed is causing bubbles and this and that. But then on the other hand, as you point out in your book, he says he's a low-interest-rate man. So sort out for us who Donald Trump really is/

STOCKMAN: Okay, first of all, let me be very clear. This book is not a brief for Trump; it's an indictment of 30 years of what I call Wall Street-Washington policy of the ruling elites, centered on debt at home, war abroad, and a rogue central bank that is out of control. It's basically destroyed price discovery, as we well know, in the financial markets, turned everything into a casino, and ultimately that does more immediate damage in the short run — in the long it wrecks everything, but in the short run it hits flyover America the hardest, because the last thing flyover America needs — and that's the whole that spans between the coasts. The last thing it needs is to have inflation pushing its nominal wages higher. That's how we lose jobs, good jobs to the China price on goods and the India price on services.

Inflation doesn't rise in lockstep like Yellen and Bernanke and the rest of them thing. In fact, the working classes lose to inflation, because their wages are going up but not as fast as their cost of living. So it's a double whammy. Some jobs are lost, and the wages they earn buy less. Flyover America can't afford to gamble in the stock market or high yield bond funds. What meager amounts they can save out of their current income has to go in the bank, and they earn nothing. It is being recycled to the banks into Wall Street in the form of this perverse and inverse Robin Hood policy.

So the point of my book is to say the Trump phenomenon has happened because flyover America is awakening politically, and his rhetoric about the system being rigged is resonating with them, even if the substance of his program, which for the most part is hard to pinpoint and to assess, isn't necessarily the answer to the problem. On the other hand, I call Hillary Clinton a 30-year bag of deplorables. That's what her policy is. And I'm not talking about her supporters; I'm talking about her policies, her ideas, and her record. She is the embodiment of the status quo, the embodiment of a system that wants more debt, more wars, and more financial bubbles.

So we have to pay our money and take our choices, and in this election the choice, as unappetizing as it may be in some ways since Trump is out of control on law and order and walls on the Mexican border and terrorists lurking everywhere, nevertheless I think you don't have any choice but to at least say that a Trump presidency would stop the machine cold and at least offer the possibility that when everything collapses — and I think it would. It would destroy confidence in the Fed and the financial markets; there'd be a huge meltdown; there would be a recession; there would be trouble everywhere that would undermine entirely this phony or fantasy world of economics that we've had for the last 20 or 25 years. So that isn't a very hopeful prescription, but it's kind of the core thesis of the book.

WOODS: Let me throw one curveball at you with regard to that. I've had more or less the same opinion of the situation, but then the extent to which Trump is really anti-establishment I think is called into question when you look at the people he surrounds himself with. In foreign policy he keeps adding neoconservatives to his team, and he's surrounded by, what? Chris Christie, Rudy Giuliani, Ben Carson, and Newt Gingrich. I mean, this is the team that's going to upend things?

STOCKMAN: Well, the only thing you can say about that is the team around Hillary is worse, okay?

WOODS: (laughing) Okay.

STOCKMAN: Why in the world are we in a fight for the moment, at this moment, with Putin and Russia? Why is NATO encroaching on the very borders of Russia? It's because of the neocon policy coming out of the Clinton State Department, and frankly Victoria Nuland, as you know, is about as neocon as they come: married into the family, likely to be the leading candidate for Secretary of State. And at least on things like that, Trump has said, wait a minute; I'm a deal guy; maybe I could make a deal with Putin. That seems like a thin veneer of hope, but at least it's not Hillary harumphing that Putin is a modern-day Hitler, which is utterly ridiculous, or something I posted on my blog that your listeners I think should go listen to it — it's 10 seconds — about her chortling and giggling about her accomplishment in Libya — "We came, we saw, he died — and then she goes into hysterical laughing. So between Trump maybe getting some bad advice from recycled neocons and Hillary being a pedigree warfare state bag-carrier, again, as I said before, you pay your money and take your choices. And at least, as I said in the book, and I think this is kind of all we have to hope for, Trump is not schooled in 30 years of Beltway mythology, pretense, arrogance, and kind of the Kool-Aid that is dispensed in the Imperial City.

So that gives you at least some hope that a few people with different views might sneak into his administration or he might be confronted with problems that are so severe and pressing and urgent that he may have to look for a new way to go, and I think that's going to happen on defense. I don't know who the heck has advised him that we are behind on defense and we need to increase the defense budget, but when he gets there and economy has buckled into recession and the forecasts for the next year for the deficit go to +1 trillion, all of a sudden he may have to rethink whether there's any money that can possibly be put into the defense budget. So you know, it's kind of — that's the story on many of these issues: the Fed, defense spending, big government, the deficit, and all the rest of it.

WOODS: I bet when you go on TV people say things to you like, "Look, David, the employment figures are great; the stock market is booming. You're just a permabear. What's the matter with you?" Now, in your book you have what I consider one of the most revealing statistics ever used by anyone, which is your statistic about breadwinner jobs since the turn of the century.

STOCKMAN: Right.

WOODS: So tell us, what is really going on with the economy?

STOCKMAN: Well, you know, you have the BLS, which has created really mathematical models of the job market, which more or less once they get recovery momentum going, and there's been a real recovery — a partial recovery, a weak recovery, but I say that's the inherent regenerative powers of capitalism after the collapse in 2008, 2009 caused by the Fed. But anyway, you get a little economic expansion going; they lay down their model, which projects and forecasts job growth at certain rates, and then they do surveys that more or less prove it. This is another whole long story that we can get into another time. But I don't put much stock in those numbers. They get constantly revived; they never see a recession coming. I demonstrated this again in this book, that between May 2008 and May 2009 there was 7 million jobs lost, and no one saw that coming. And it's in the numbers today and wasn't in the numbers at the time initially, because the BLS was way over-forecasting jobs.

So I go back to the beginning; I sort out their numbers, and I say let's divide the so-called establishment survey into three buckets: breadwinner jobs, which are full-time, full-pay, average $50,000 plus or minus a year. There are manufacturing, construction, mining, and energy; the white-collar professions: finance, insurance, real estate, information technology — those kinds of sectors. Then the second one is part-time jobs, which are basically bars and restaurants and retail gigs and temp agency employment and so forth. And then the third is the HES complex: health, education, and social services. The key point of that is almost all of the revenue from sales, which support jobs in that sector, come from government budgets, which are more or less busted.

My point on all of this is since Bill Clinton was packing his bags to leave the Oval Office in January 2001, there has been a 1.4 million loss of this first basket, the breadwinner basket. There were 72.5 million breadwinner jobs then in the categories I described. There's only 71-and-some million in that category today. You've gone a whole century so far, and you haven't created one breadwinner job. What they count and we get in "Jobs Friday," you know, once a month, is part-time jobs that come and go as the cycle booms and busts because of what we know the Fed is doing, or an expansion of what I'd call the HES complex that at some point has to grind to a halt or everybody's going to be working in hospitals and kindergartens. But there's no productivity coming out of there and there's no way to support real, long-term growth, productivity, and prosperity when it's simply government-created economic activity or government-funded economic activity that is reaching its limits. So that's the first big thing I have in the book, and I show that dearth of breadwinner jobs for a whole decade — or 16 years.

The second thing I did in the book, and I think it's really important to emphasize, is we went back and took apart the CPI, which I know a lot of people understand really under-measures true inflation, what people in flyover America, as I call it, face in terms of the big four — and by that I mean medical costs, housing costs, food costs, and energy. And we measure those correctly. I mean, the BLS totally under-measures the cost of health, which has been soaring. They totally under-measured the cost of housing because of the methods they used. My point is in the book that the average inflation rate with a proper CPI (consumer price index), which we call the flyover CPI, two-thirds of it consist of those big four items that I mentioned, has been 3% a year since Greenspan took over the Fed in '87, and it hasn't slowed down, even in this so-called world of deflation and lower oil prices and so forth. Even last year it was up 2%, then the CPI was flat, and the Fed insisted there was a dearth of inflation.

Now, when you take that as the deflator for all these different numbers we're always looking at, like median household income or retail sales or lots of other measures — when you deflate those numbers with the flyover CPI, you get a totally different and far less positive picture than what the establishment puts out and what the Obama White House crows about. In fact, the median household income in 2015 was 20% lower in real dollars with the flyover CPI than it was in the year 2000. So let's just think about that then. For the last 16 years, no breadwinner job gains at all, and the purchasing power of what wages remain in flyover America down 20%. Now, is there any wonder why, as we say, the rubes are coming out of their houses and marching to the political rallies and hopefully to the ballot box with this kind of economic deterioration and setback underway? It's no wonder the phrase "We're not going to take it anymore" has developed the resonance that it has.

WOODS: David, I want to shift gears and ask about trade in a minute, but first let's thank our sponsor.

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Let's shift gears and talk about one of the major themes Trump has raised, which is trade. And early on in your book you reject the idea that people should be blaming trade for the current situation with the US economy and the situation of US workers. But yet you can surely see there's a kind of plausibility to what he's saying, that we have these trade deals, and then in the wake of them, well, we see people's wages falling and employment prospects falling. We see whole towns wiped out. We see their manufacturing hollowed out. And I think these people say, "Who am I supposed to believe: my own eyes or your economic theories about the benefits of free trade?" So how do you answer that?

STOCKMAN: Well, that is the great question. I think it's the heart of what needs to be thought about creatively. I have a whole chapter in the book, Chapter 5, and it's entitled, "Trump Isn't All Wrong About Trade: The Betrayal of American Workers by the Fed." And I think this is really important to understand, and the slogan I use is "the most toxic combination imaginable economically is free trade and free money." Free trade is great. Free money is terrible. You put them together, and you tremendously distort the entire economic process, and in particular — and this is where I go right to it — Fed policy with the inflation targeting that Bernanke formalized but was there all the way back to Greenspan is the worst thing that could happen in the world where borders are open, where trade is relatively free, both in services and goods, and where workers in the middle and lower end of the spectrum face the China price on goods and the India price on services. Because the Fed says we inflate happily together in lockstep. You know, inflation doesn't mean anything, 2% a year. Wages are up; prices are up; rents are up; everybody lives happily ever after. Totally wrong. A destructive myth.

What happens is the average hourly wage in the United States went from $9 an hour in 1987 to around $22 an hour today. That sounds like improvement, but actually adjusted for the flyover CBI, real wages are way down, and even by the BLS CPI they have been flat to down. So what happens is on the margin the nominal wages increasing by a factor of two or three means that jobs are going to China or its supply base, or the back office jobs in sales and data crunching are going to India. So the last thing we should do is target any inflation at all. The only way to compete — the right way to have free trade is to have a central bank that does not attempt to force inflation in the domestic economy, and in fact, a monetary system that would actually lead to deflation.

In other words, if nature had been allowed to take its course and not Greenspan's crowing about the wonderful achievement he made by getting inflation down to 2%, the price level since the late '80s would have gone down. Nominal wages wouldn't have gone from $9 to 22; they might have been flat. And in that environment, not nearly as many jobs would have been offshore migrated abroad, because there is still what I call the offshoring premium. There is a 12,000 mile pipeline supply chain that costs money; not just the freight, but everything that goes with it in terms of the risk of delivery, damage to merchandise, sourcing risks, and on and on. So the point is that there is an offshoring premium on wages, but when you try to deliberately inflate at 2% year after year after year, you obliterate that premium and jobs go marching abroad. So that's not a small point; it's a huge point.

The heart of what the Fed's doing — and most central banks in the developed world — is inflation targeting and insisting without a shred of evidence that 2% inflation is the magic elixir that causes economic growth and job creation. That is upside down. It actually undermines economic growth, causes massive trade deficits that aren't natural deficits, causes good jobs to be offshore, and as a result of that, I believe the problem that Trump has identified — you know 500 billion in imports from China or 60 billion from Mexico. The problem he's identified is not caused by bad trade deals, really; it's caused by horrendously bad monetary policy.

So the target of the attack ought to be the Fed and not, as I said, the USTR, the US trade representative. I'm not saying that the deals that they have on the table now amount to anything. You know, the Trans-Pacific Partnership and so forth, that's just a big corporate deal to suit their convenience, but I don't believe it's going to make that big a difference on trade volume one way or another. What we have to focus on now is getting monetary policy back into less of an anti-jobs posture, and also get a tax policy

— and I wrote about this on my blog the other day — that recognizes that we've stranded American workers at high nominal wages because of this inflation policy, and we need to find some way to offset it. You can't wind back the CPI. It's already up in the stratosphere after the 20 years where it is today.

But I think we can change the focus of tax policy to reducing the payroll tax, and therefore the wedge between what a worker takes home and what a business pays on the margin for an hour of employment. Remove that 15% wedge, and I think it would go a long way to rejuvenating job growth, because the cost wedge would be lower, and giving the worker in flyover America a break. You know, because 160 million people are paying payroll taxes. There may be 10 million people on the margin paying mostly income taxes. In theory, cut both of them, but if you can't afford to do both in this deflationary environment, in this drought-of-jobs environment, the thing to do I think is not what we did in the '80s, because that was an inflationary bracket creep environment, but what we ought to do today is eliminate the payroll tax entirely and replace it with a tax on consumption and imports.

Now, it's the same thing, but since we import such a large fraction of the goods that we use, if you were to actually exempt, say, healthcare and a few other things from the 10 trillion of consumption in the US each year and tax the balance at 15%, you would have enough revenue to replace the social insurance taxes, the payroll taxes, and the corporate tax entirely. Now, I think taking — it amounts to 1.5 trillion a year. The corporate tax is 400 billion and payroll is 1.1 trillion, so if you took 1.5 trillion worth of taxes off workers and employers and you replaced it with a tax on imports from China and elsewhere and consumption, then we would be doing the right supply side thing. I think you've got some very geriatric supply siders who are in a time warp from the 1980s and don't recognize that in the world that we have today what we need to be addressing is taxing labor and business less and taxing consumption and imports more. Supply side theory says you'll get more of the former and less of the latter, and frankly, that's what we need at this late stage because of all the ruin that's already been done by monetary policy since 1987.

WOODS: Well, I'd like to pick up on that, but I know I'm just about out of time with you. I still feel like I want people to know that your book includes 10 deals that you'd like to see a President Trump or any president make with the people that might actually begin to get us out of the mess that we're in. And one of them is a sound money deal. I just want to point out one aspect of your sound money deal. It involves abolishing the Federal Open Market Committee. So I want to emphasize, you were the Director of the Office of Management and Budget under Ronald Reagan, so you're not just some guy with a newsletter. And you're advocating abolishing — you're basically advocating the end to monetary policy itself. You would be taking away the ability of the Fed to make monetary policy and to try to target and control certain aggregates.

STOCKMAN: Yes, I call it monetary central planning, and although it sounds radical, the thing that's important about this chapter — I have a whole chapter on that — is if you go back to Carter Glass, who was the author of the Federal Reserve Act in 1913, that was exactly his vision. His vision was there would be no activist monetary policy. They didn't have any idea of targeting GDP or wages or unemployment rate or, you know, the PCE — none of that.

The whole idea was that the Fed would be 12 decentralized banks that were bankers' banks and that would be available to supply credit at the market rate of interest, with a penalty spread above it against good commercial collateral, which is to say receivables or finished inventory. They couldn't even bring to the Fed window as it was conceived by Carter Glass — government bonds. They weren't eligible for collateral. And what that meant was that the expansion and contraction of the Fed's balance sheet would not happen in Washington, but on a decentralized basis at 12 banks, and that it would be driven by the ebb and flow of industry and commerce by the business system, and not by economists or politicians or government apparatchiks in Washington. So that's actually what abolishing the FLMC means. The FLMC didn't even exist until 1917, when, in order to finance World War I, they discovered they had a printing press and they could buy government bonds and make ends meet.

So I think it's kind of the heart of the matter, and if you just talk about telling the Fed to be more restrained or doing something, you know, like — who's the Professor Taylor with his rules — Professor Taylor's rules. It's as bad as Bernanke. You know, take inflation minus this plus that and the potential GDP versus the actual GDP plus and minus. This is a lot of gobbledygook. Capitalism can operate with a crisis in the financial markets, including free interest rates, and if you're going to have a central bank at all it should be a banker's bank that operates under the very restrictive rules that Carter Glass put in place in 1913 and that we've unfortunately completely abandoned with what we have today, which is essentially Keynesian monetary central planning.

WOODS: Well, the book is *Trumped: A Nation on the Brink of Ruin and How to Bring it Back*. Linking to it at TomWoods.com/741, which is the number of today's episode. Also linking there to DavidStockmansContraCorner.co, which you are completely crazy if you are not visiting every day. David, best of luck, and if we don't manage to get you on *Contra Krugman* soon we're going to have to seek you out, bodily get you onto the show, because we've had a lot of demand for that. Thanks again.

STOCKMAN: Definitely like to do that, so we'll look forward to it.