Redstone Advisors

Economic and Market Review

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"This is the way that opinions obtain currency with us. Fifty ignorant people repeat in chorus something spiteful and absurd, put forward by one more ignorant than themselves, and if it happens to have the least connection with the fashionable opinions or the passions of the hour, it is at once received as an axiom."

Frédéric Bastiat

"Truth is tough. It will not break, like a bubble at a touch. Nay, you may kick it about all day, and it will be round and full at evening."

Oliver Wendell Holmes, Sr.

In his excellent essay, 'Two Systems of Morals', French economist and libertarian Frédéric Bastiat wrote; *"Tell me what modern diplomacy has accomplished, and I will describe the moral condition of the nations."* What has *modern diplomacy* wrought? In a sentence, an unassailable conviction on the part of the governed in the **omnipotence of government**. As we enter the new year, we continue to witness an unprecedented expansion of intervention as government's all around the world desperately seek to employ every means at their disposal, fair or foul, in a futile attempt to return their respective economies to the path of prosperity. Perhaps the only thing more unprecedented than the scope of the intervention is the fervor of the cry of the governed for *somebody to just do something*. Alas the debate begun long ago between Jefferson's ideal of a limited federal government and Hamilton's ideal of an all-powerful one, is over -- Hamilton has won. Quoting Joseph Addison; *"Economic distress is leading the people to be more amenable to authority as representing the only hope of salvation from the present state of affairs."*

As for the ensuing *moral condition of the nations*, **spoilation** is now advanced over work as the preferred means to secure ones' economic ends. For while it is true that in the sweat of his brow man must eat his bread, it is, as Bastiat observed, equally true that *everyone wants as much bread and as little sweat as possible*. As such men may obtain their means of existence in only one of two ways -- by *producing* them, or by *stealing* them. Spoilation is simply Bastiat's eighteenth century term for the satisfaction of wants through the toil of others -- theft. As government has no resources of its own, the only way government can "give" money to one person is to first "take" it from another person. And more to the point, there can be nothing to "take" if someone, somewhere did not first produce. We do not insist that every act of taking by government through representative taxation is illegitimate, far from it, although we do hold that Congressional appropriation and the budget process is the only effective constraint on the expansion of the Leviathan state. Nevertheless we do hold that the intentional debasement of the currency through the perpetual production of money and credit, properly called inflation, *is* theft of the most insidious kind and as such, is immoral, both for governments as well as individuals. Ironically it was Lord Keynes, the father of modern day inflationism, who in his book 'The Economic Consequences of Peace', written some 13 years prior to his Malthusian conversion to inflationism, most poignantly describes the reprehensible nature of this crime by government; *"By a continuing process of inflation, governments can **confiscate**, secretly and unobserved, an important part of the wealth of their citizens."* And such theft, when "legitimized" by social compact, is the great purpose to which modern government has been subverted.

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Yet this outcome was not always so assured. For from the founding of our nation, the principle to be established at the core of our government was to be liberty, and it was for this reason that a new form of government was conceived, a republic built on immutable laws that would protect and preserve the rights of individuals. Individualism, in contrast to collectivism and all other forms of totalitarianism, is based on respect for the individual man and the belief that it is desirable that men should be free to develop their own individual gifts and abilities, despite the innate difference in natural endowments. As such a fundamental principle of liberty is that in establishing governments for the ordering of our affairs, we should make as much use as possible of the spontaneous forces of society, and resort as little as possible to coercion. Freedom as conceived by men such as Cobden, Hume and Locke, and enshrined by Jefferson in the incomparable words of our Declaration of Independence, had originally meant freedom from coercion and from the arbitrary power of other men.

Ultimately it was liberty's success that ultimately secured its' demise. An increase in the standard of living that remains unequaled in the history of modern civilization. As author Ernest Lefever observed; *"it is the irony of virtue that virtue untamed by facts or undisciplined by a sober understanding of man and history can lead to foolish policies and dire consequences."* Socialism, a working definition of which might be *"virtue untamed"* or at least *"uninformed"*, and whose ultimate goal is the subordination of the individual to the state, albeit ostensibly for altruistic reasons, co-opted and redefined freedom so that it need no longer mean *freedom from coercion*, but rather ***freedom from want***. Owing to the very universality of the success achieved, "we" [read "the State"] refused to tolerate the *"inequality"* that remained. And while we have on previous occasions, traced the history of the ascendancy of the welfare state, suffice it to say a tectonic shift took place under the extreme duress of the Great Depression, wherein Garet Garrett's *revolution within the form* took place, resulting in a massive abrogation of executive power and the transformation of societal attitudes favorable to the new omnipotent state. That revolution was fully and firmly codified in the Employment Act of 1946 which declared that *"it is the policy and **responsibility** of the Federal Government to promote maximum employment, production and purchasing power."*

Today, in the shadow of such sweeping hubris, we take continuing economic progress for granted but we no longer attribute progress to the spontaneous activity of a free society and individual achievement, rather we attribute it to the omnipotence of the state, exercised through collective action. Perhaps you will recall the words of President Obama in Roanoke, VA on July 13, 2012; *"Look, if you've been successful, you didn't get there on your own. If you've got a business -- you didn't build that. Somebody else made that happen."* The transformation whereby *"individualism has been harnessed to the car of collectivism"* has been described by writer and senior Cato Fellow Brink Lindsey, as a process whereby initially, periods of prosperity and economic growth are attributed by the *intelligentsia* to the interventionist activities of the stabilizers. Perhaps the most recent example is the myth of the 'Great Moderation' whereby a diminution in the volatility of GDP during the 90s and early 00s was *hailed* as both desirable and beneficial (a fallacy we have previously refuted). Credit for this dubious achievement has been attributed solely to the intervention of the stabilizers, resulting in the coronation of Chairman Alan Greenspan as the *Maestro*. Subsequently, during periods of crisis, the interventionist system is re-characterized as a free-market economy, with the crisis attributed wholly to the *failure of capitalism* and market elements, ignoring the primary role played by the actions of the stabilizers in the development of the crisis. Finally, Lindsey contends, the crisis becomes a "bully pulpit" from which to agitate for the further expansion of power and control by government for *"superintending the industry of private people."*

In the end, the solution to any crisis, real or imagined, is no longer looked for in private initiative, but through increased intervention by the state. Abusing a quote by G.K. Chesterton originally made regarding Christianity; *"The problem with **capitalism** is not that it has been tried and found wanting; but rather it has been found difficult and left untried."*

As the intractable global crisis, now in its sixth year reminds us, the statist promise of ***"freedom from want"*** which originated with Roosevelt's "New Deal" revolution grounded in the Fabian philosophy of democratic socialism, is beginning to wear thin, for in it we see Hayek's dilemma of authority, the ***pretence of knowledge***. Man does not and cannot know everything, and when he acts as if he does, disaster is sure to follow. Adam Smith warned of the consequence of this **'fatal conceit'** in 'The Wealth of Nations; *"In the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might chuse to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder."*

We have for years agitated against both the **injustice** as well as the **disutility** of the continuing policies of **intervention** and **inflation**, the results of which have been a massive *degree of disorder* in both the financial markets as well as the economy. The critical role played by prices in a market economy with respect to the allocation of resources and the efficacy of the underlying structure of production cannot be overstated. In the unhampered market, prices are the guides and regulators of production. Goods are produced whenever they can be produced at a profit and not produced when production results in a loss. Profitable industries tend to expand while unprofitable ones shrink or disappear. Through their buying and nonbuying, consumer preferences impact prices which in turn, determines what should be produced and how much should be produced. And when combined with competition, acts as the ***invisible hand*** that channels the profit motive toward the optimal productive structure. By contrast, governments as planners act as a ***dead hand*** upon production by usurping or subverting the critical role played by prices. This interference with the formation and resultant structure of prices, leads to malinvestments and the misallocation of productive resources and labor. It is for this reason that we have continued to insist that the massive increase in intervention and money production is not only futile, but is in fact exacerbating the crisis by preventing prices of both commodities and labor from adjusting to market clearing levels and allowing resources to be redirected from unprofitable and uneconomic pursuits through Schumpeter's process of *creative destruction.* In short, the ***solution remains the problem***.

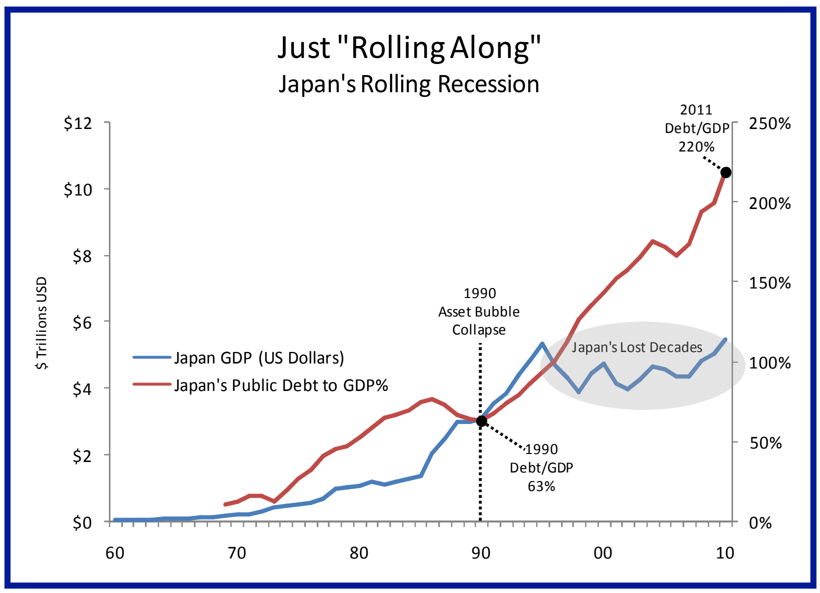
The current economic malaise facing both the US and most western developed economies, which we have characterized as a ***rolling recession*** consisting of persistent below-potential economic growth, intractable unemployment, exponential growth in unproductive debt, chronic sovereign deficits, and a massive famine of income, is **structural** not cyclical. It represents the distortive impact of the culmination of over 40 years of increasing intervention and monetary inflation. During this period, the US economy has been transformed from a market economy to a mixed economy. And while a mixed economy does create wealth, it does so, not by virtue of autonomously rewarding individual achievement, but through a system of privilege and restraint, under which the *planners* pick "winners", and by non-selection, "losers", thus conferring an unjust advantage on one party over another. The result of which is an economy whose wealth creation is limited and whose wealth distribution is skewed in favor of the *vital few* over the *trivial many* (Pareto). However the forced transfer of wealth (spoilation) will always result in the loss of a portion of the wealth in the transfer. *"Owing to the Law of Providence,"* says Bastiat, *"a moment comes when the destruction of wealth is such, that the despoiler is poorer than he would have been if he had remained honest."*

Without contradiction, when it comes to the modern advancement of spoilation as the economic means *par excellence* by which government should secure for its collectives the chimera of a permanent prosperity, Lord Keynes brooks no equal. However the brilliance of Keynes is not to be found in his collection of contradictory economic sophisms, but rather in his masterful sense of the epochal and his timely articulation of what his intellectual nemesis Friedrich Hayek called the **'fatal idea'**, the idea that unemployment is predominately due to an insufficiency of aggregate demand. Hayek described the process by which this previously discredited theory of Thomas Malthus gained acceptance; *"The fact that the 'fatal idea' which became Keynesian theory provided the politicians with tempting opportunities was probably even more important than the fashionable prejudices concerning scientific method that made it attractive to professional economists. It offered not only a cheap and quick method of removing a major source of real human suffering, but also a release from the most confining restrictions that had impeded their striving for popularity. Spending money and having budget deficits were suddenly represented as virtues. It was even argued persuasively that increased government expenditure was wholly meritorious, since it led to the utilization of hitherto unused resources, thus costing the community nothing and bringing it a net gain."* And so it is, as Bastiat suggested, that *such opinions gain currency with us*, and the heterodoxy of *'something for nothing'* became orthodoxy. This doctrine, inaugurated during the distress of the Great Depression, led to the gradual removal of all effective barriers to the expansion of the welfare state and the increase in the production of money.

One of the most damning fallacies of Keynesian economics is it's myopic focus on the short-term effects of policy actions while relegating the long-run effects of those policies to benign neglect. After all, why consider the long-run in the sphere of economic calculation when *“in the long run we are all dead.”* Keynes held that the long-run is a misleading guide to current affairs. Yet what is the long-run if it is not a compilation of the short-run. Artificially lowering the market rate of interest (the price of money), offering to be credibly irresponsible as a lender of last resort (moral hazard), and engaging in massive deficit spending to promote “dissaving”, *can*, in the short-run, temporarily exacerbate the misdirection of resources, resulting in a "statistical" increase in GDP. However, since in each instance the underlying cause of the crisis, the intentional mispricing of credit, is not fully dealt with, some portion of the malinvestments and dislocations remain. Across time these residual dislocations accumulate and manifest themselves in a distorted productive structure of the economy. In short, non-productive and wealth destroying activities become subsidized, showing up as chronic below-potential economic growth, structural unemployment, stagnant or falling real income, and an increasing polarization of wealth. For this reason we have long criticized the exclusive focus on a short-run evaluation of the stabilizers long-running Sisyphean-like policy of money production as being worse than futile, it is ultimately destructive. The continuing emission of paper money has acted to increase the volume of money and credit claims outstanding without a commensurate increase in the overall standard of living.

Honest credit, when fully backed by real savings, can be an agent for economic growth and capital formation. However *money printing* leads to an increase in **money claims** against existing wealth resulting in impoverishment due to the destruction of wealth through increased consumption, speculation, malinvestments and the diversion of wealth in the form of debt service to the holders of the new fiat money. Thus the expansion of **nonproductive debt** destroys wealth and burdens the economy with rising interest and amortization obligations, directing a growing proportion of economic resources away from productive investment to debt service. Not unlike the medieval practice of bloodletting, this dynamic of a ***"death by a thousand cuts"*** is at the core of the process we have termed the **financialization** of the economy. Financialization brings about the perpetual impoverishment of the economy by eviscerating long-term economic growth potential below "stall speed", while at the same time increasing the **instability** of the asset bubble supporting it. In sharp contrast to **industrial capitalism** which adds to the existing stock of capital through the return of real profits on production, financialization siphons off resources, not by employing labor to make useful things for sale at a profit (wealth creation), but by enticing labor and industry into a form of **"debt peonage."** By a process of gradualism, the cumulative errors of intervention and inflation, *a **planned economy** and **managed money***, have fastened onto the economy, draining its vitality, leading to the perpetual malaise of exploding sovereign debt levels and rolling recessions, *a la* **Japan**. Referring to **Figure 1**, we can see that since the collapse of Japan's asset bubble in 1990, Japan's GDP has been mired in a relentless rolling recession often referred to as **Japan's Lost Decades**. At the same time, the unprecedented level of fiscal and monetary stimulus expended in an attempt to revive economic growth, has driven Japan's public debt to GDP ratio from a manageable **63 percent** in 1990 to an unsustainable **220 percent** as of 2011, the highest in the developed world. In our opinion, it would be well for the stabilizers to study **Figure 1** and reflect on the most elemental law regarding the survival of a parasite; **Don't kill the host**.

Figure 1



As we stated last quarter, *"by following the Keynesian prescription of perpetually increasing purchasing power through the production of money (inflation) in order to fight the mythical monster of **underconsumption** (lack of demand), the stabilizers have, after over forty years of faithful adherence, brought about a **real demand problem**. But it is not the one predicted by Keynes, but rather the one that Austrian theory predicted would be **caused** by Keynes. A state of **perpetual imbalance** that is pulling the US economy into the morass of a long, slow decline into mediocrity."* It is not simply that through a perpetual policy of postponement, the US and much of the developed world have engaged in a massive campaign of borrowing from the future to fund today's *underconsumption*, leaving large and growing burdens for the next generation. It is rather, that by continually *kicking the can down the road*, we have **permanently diminished the capacity for future economic growth**, thus greatly hampering the next generations ability to deal with this legacy.

This decline is clearly illustrated in **Figure's 2** and **3** which present data based on real US GDP per-capita, both of which were created by Doug Short of Advisor Perspetives. In **Figure 2**, the history of real US GDP per-capita since 1960 is presented using a logarithmic scale so that the recessions, as highlighted by the gray vertical areas on the chart, reflect the same relative scale. Further, the red line in **Figure 2** is an exponential regression of the entire period, and as such, it represents the long-term trend in per-capita GDP growth. What stands out is the **marked deviation** of per-capita GDP from its' long-term trend and slope since the *Great Recession*. In fact, according to Mr. Short's calculations, current real US GDP per-capita is fully **10.2% below** its' long-term trend line with a **slope,** or projected trend that is visibly **flatter** than its' pre-recession trajectory.

Figure 2

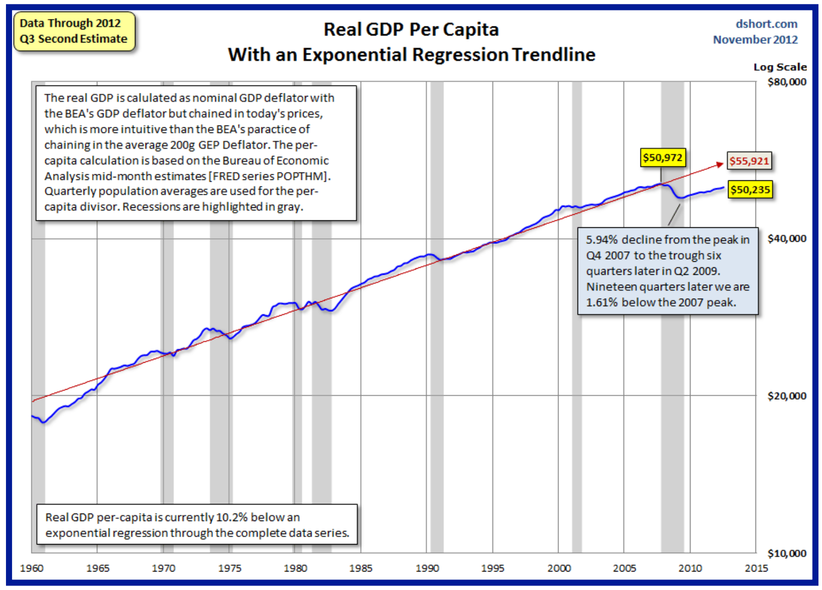
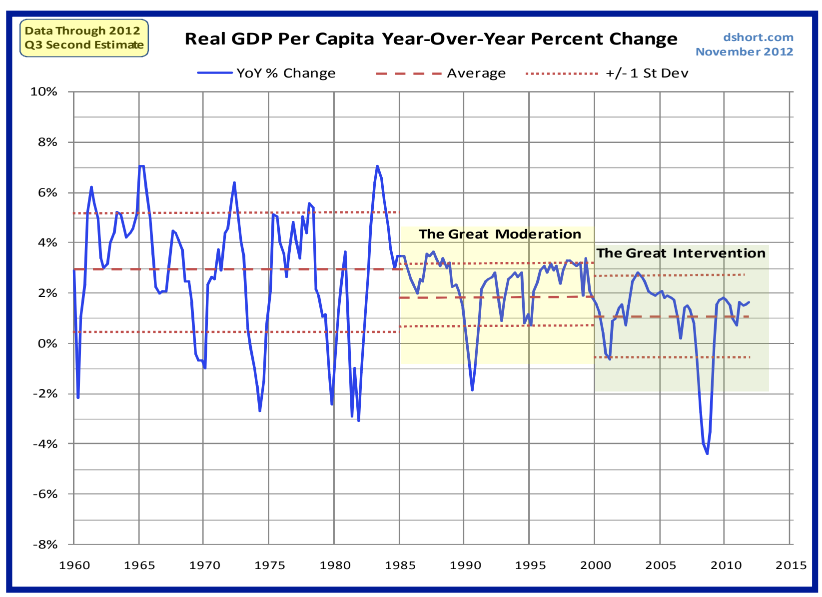


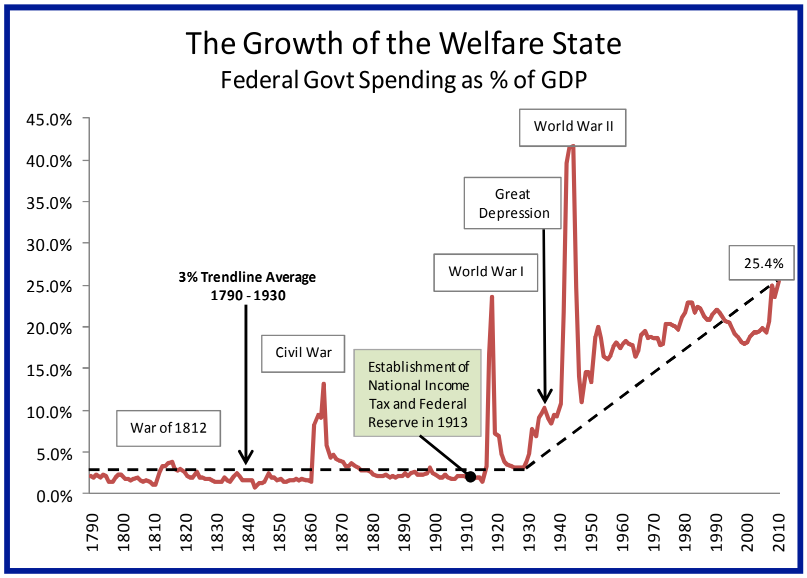
Figure 3 illustrates the year-over-year (YoY) percentage change in real US GDP per-capita since 1960. The dashed red lines denote the average percentage change while the dotted red lines denote the volatility of the YoY change in per-capita GDP at plus or minus one standard deviation from the average. What is again glaringly apparent is that the average YoY change in per-capita GDP has **declined markedly** from 2.9% prior to the orchestration of the economy, first by the **Maestro** during the **Great Moderation** where the growth rate fell to 1.9%, and subsequently by **Helicopter Ben** during the **Great Intervention** where it has collapsed to 1.2%. And while the stabilizeres have achieved a measureable diminution in the volatility of per-capita GDP, the **long-term impact** of a perpetual **short-term policy** of intervention and inflation is acting to **permanently reduce potential growth.**

Figure 3



We, however, have not been alone in our criticism of this *path-of-least-resistance* policy of money production to underwrite the growth of the welfare state. **(Figure 4)** Others have written extensively about the detrimental impact that these policies have had on economic growth and income creation. We have previously discussed the study published by economists Carmen Reinhart, Vincent Reinhart and Kenneth Rogoff entitled 'Debt Overhangs: Past and Present', in which the authors conclude that *"extremely high levels of indebtedness lead **directly** to diminished economic growth."* In another paper entitled 'Unprecedented Global Government Intervention', author Dr. Peter Linneman states unequivocally *"there is no free lunch . . . increased government spending means less private spending"* and as such, *"economic growth declines with increased government spending."* In yet another research paper entitled 'The Scope of Government', authors James Gwartney, Randall Holcombe, and Robert Lawson unambiguously state, *"The findings of this paper show a strong and persistent negative relationship between government expenditures and growth of GDP. . . . . All evidence points in the same direction: Larger government means slower economic growth."* And in an essay by Daniel Stelter entitled 'Ending the Era of Ponzi Finance', the author concludes that *"the developed world has borrowed significantly from future wealth to fund today's consumption"* and as a result they have *"reduced the potential for future economic growth."* In a recent Wall Street Journal Editorial entitled 'The Wages of Unemplyment', author and economics professor Richard Vedder notes that *"from the mid-17th century to the late 20th century, the American economy grew roughly 3.5% a year. That growth rate has since declined significantly.* And what accounts for the slowdown? According to Mr. Vedder; *"Americans aren't working as much today."* And why are Americans working less? Mr. Vedder; *"While there are a number of factors, the phenomenon is due mainly to a variety of public policies that have reduced incentives to be employed."* In other words, according to Mr. Vedder, **soaring government benefits** are the primary reason why millions of Americans are permanently abandoning the work force. Finally, even well-known geopolitical strategists George Friedman, founder of Stratfor, recently penned a piece entitled 'The Crisis of the Middle Class and American Power' in which Mr. Friedman warns, *"The threat to the United States is the persistent decline in the middle class standard of living, a problem that is reshaping the social order that has been in place since World War II and that, if it continues, poses a threat to American power."* And while this small sampling is not meant to be definitive, it does suggest that there are other *Cassandra's* who share our long-held opinion regarding the causal relationship between the current economic crisis and the preeminent role of the central planners. For of a certainty, as Bastiat reminds us, the wages of spoilation are ultimately impoverishment, as it is through the fiction of government that *"everybody endeavors to live and prosper at the expense of everybody else."*

Figure 4

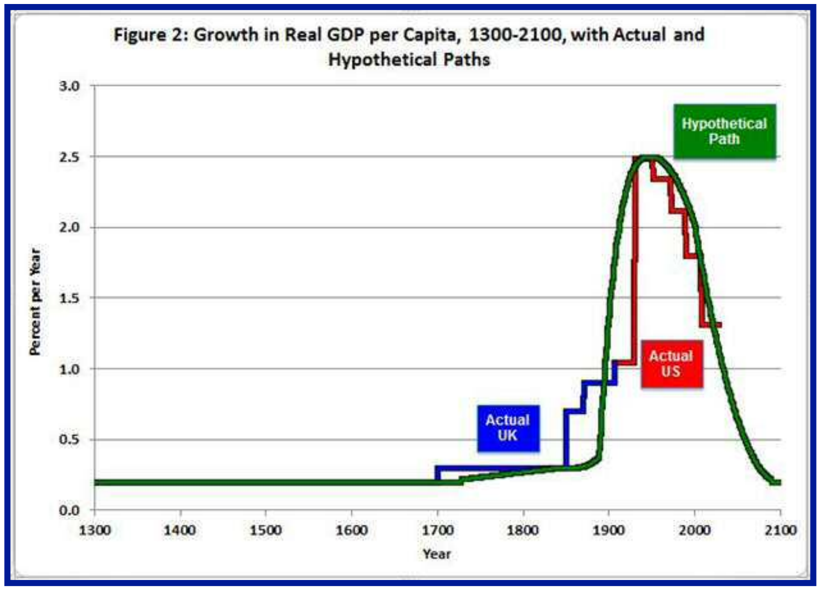


That the current crisis is secular in nature and is the outcome of the cumulative impact of a long-running policy of *extend and pretend* guided entirely by short-run considerations, is in our opinion, incontrovertible. There is, however, another peril in focusing solely on the short-run, and that is the implicit assumption that *"all things continue as they were from the beginning."* In a NBER research paper entitled 'Is US Economic Growth Over? Faltering Innovation Confronts The Six Headwinds', author Robert Gordon reviews the very long-term history of the growth in per-capita real GDP in the US and in a thought-provoking paper, challenges the notion that economic growth is a continuous process that will persist forever. In this we are reminded that one of the morals of the parable of the prodigal son was the underlying presumption that tomorrow would be like today. *"Now when he had spent everything, **a severe famine occurred in that country**, and he began to be impoverished."*

As discussed last quarter, the phenomenon that we have consistently referred to as a **"famine of income"** is both a large and growing secular trend, and is the direct outcome of the discoordinating influence of the stabilizers long-running policy of monetary inflation on wealth and income production. We also suggested that it would be naive to presume that the inexorable trend decline in income growth must follow a *"gentle downward sloping glide path."* In his paper, Mr. Gordon challenges the nearly universal assumption that ever-increasing economic growth in the US is our *"birthright"*. In his paper, Gordon makes a compelling case that not only has GDP per capita been slowing since the middle of the twentieth century, but citing **diminishing returns from innovation** as the primary cause, he argues that *"the rapid progress made over the last 250 years could well turn out to be a unique episode in human history."* Gordon admits that his self-imposed overlay of the history of innovation, is *stylized*, and may only be *"a useful organizing principle to understand the pace of growth."* However, it is not his contention that much of the rapid increase in historical per capita GDP may have been attributable to an *"innovation revolution"*, whose *"improvements could only happen once"* that we find most compelling. But rather the **"headwinds"** that he identifies which are confronting a nation whose per capita income growth is already in a **sharp secular decline**.

We have reproduced one of the charts created by Mr. Gordon as **Figure 5**. In this chart, we can see both the **"actual"** (stepped blue and red line), as well as a **"hypothetical"** growth path (smoothly curved green line) of real GDP per capita for the period 1300 to 2100. First a couple of qualifications. Although Gordon's paper focuses exclusively on the US, he utilizes data from the UK from 1300 through 1906 to *bootstrap* the long-term actual trend in per capita growth, utilizing US data from 1906 onward. Second, although the actual trend in per capita GDP has been in a **significant decline** since the mid-1960s, the hypothetical path is merely a projection serving as a "visual prop" to underscore his contention that owing to the many secular headwinds facing the US, the assumption of increasing growth in the future is not assured. In fact, many of the headwinds that Gordon identifies are the very same secular forces we have discussed for years. One such headwind is **demographics**, specifically those secular factors now conspiring to shrink the work force, reducing hours worked and ultimately economic output. Key among those factors is the coming retirement of baby-boomers and declining birth rates now below replacement levels. Another headwind identified by Gordon is **rising inequality** which Gordon states is *"the most important headwind, quantitatively, in holding down the growth of our future income."* We have devoted considerable time and space to both the cause and the effects of the extreme income polarization which has been occurring in the US and its debilitating impact on income generation. Yet another headwind identified by Gordon is **globalization** and the deleterious impact of **outsourcing** and **imports** on nations with the highest wage levels. And finally, Mr. Gordon calls out the **massive overhang of unproductive debt** and the unsustainable growth of unfunded liabilities, the combination of which augurs for a permanently lower growth rate in disposable income. In our opinion, several of these so-called "headwinds" are merely the cumulative "effects" of the long-term trend of increasing intervention and inflation. As such, we think the take-away from Mr. Gordon's challenge to Solow's assumption that *"economic growth is a process that will persist forever"* should be a call to policy makers to *forethink and repent* of the preferred policy of postponement. Recently Jean-Claude Juncker, Prime minister of Luxembourg and President of the Euro Group, tacitly acknowledged as much when he said; *"We all know what to do, we just don't know how to get re-elected after we have done it."*

Figure 5



To provoke investors to consider the possibility that *tomorrow may not be like today*, the SEC mandates that all performance advertisements come with a disclaimer alerting the reader that *past performance is not a guarantee of future results.* Yet despite this warning, the experts and pundits doggedly maintain there is no value in bonds, insisting that *what has been is what will be*. Noting that nominal Treasury yields are at or near their all-time lows and the omnipotent stabilizers, having committed themselves to the money printing policy equivalent of *no employee left behind*, will be able to reflate the economy and so overcome the niggardly monster of underconsumption, soon-to-be spiking bond yields are held to be axiomatic. Why must they rise, we ask them? Because they always have in the past.

In fact our entire first quarter Market Review was devoted to the question of whether there was any value in bonds, and in it we noted that the experts have always been bearish on bonds, noting that the consensus has predicted interest rates would rise **97 percent of the time** over the past 10-years. For years the pundits have insisted that bonds will implode. For years bonds have outperformed stocks. And the longer this pattern has persisted, the more virulent the call for rising interest rates has become. But as we argued in our first quarter Market Review, the primary reason that the expert opinion of **"no value"** in bonds has been so wrong has been due to a failure to understand those secular forces that we have outlined in this Review that are acting on the economy and as such, the reasons why the actions of the stabilizers have been so impotent in reviving both the economy and by extension, bond yields. As we have stated previously, *this ain't your daddy's bond market anymore*. There are no "real" investors in Treasury bonds. Quoting Jim Bianco of Bianco Research, *"the only buyers of Treasury bonds are those that speak Chinese, those that speak Japanese and those that print money."* Citing again the research paper 'Debt Overhangs: Past and Present' by Reinhart and Rogoff, not only did the authors find that *"extremely high levels of indebtedness lead **directly** to diminished economic growth"*, but in the same study they found that in nearly 50 percent of the episodes under review, ***real interest rates remained***

low as well due to a policy of **"financial repression"**. Financial repression is the academic term for the stabilizers policy of intentionally keeping sovereign interest rates low for an extended period of time in order to reduce the governments' interest expense and force savers to invest in risky assets. This policy of spoilation is a hidden tax which transfers wealth from savers to sovereigns and it is a policy to which the stabilizers remain committed for an extended period of time.

As we have oft repeated, economics is simply the science of human choice. And human choice, which is driven by self-interest, is that intentional, purposeful activity that is pursued to bring about a desired end. The choices of the *inconvenient individual* are fraught with irreducible complexity and as such, simply cannot be evaluated quantitatively, no matter how sophisticated the algorithm or model. Herein lies the great blind spot of all scientific economics, what Hayek referred to as the **"pretence of knowledge."** The illusion that we can accurately describe and predict this phenomena of *organized complexity* which is human action, through the expedient use mathematical models. In fact the theory that has been guiding the policy of monetary inflation for the past 40-plus years consists in the assertion that there is a simple positive statistical correlation between total employment and aggregate demand. Such a belief leads inexorably to the fallacy that we can permanently assure full employment by printing money to maintain demand. It was Einstein who observed; *"Not everything that counts can be counted, and not everything that can be counted, counts."* By focusing solely on what could be counted, and disregarding what could not, we have pursued a policy which has made matters worse. The law of unintended consequences is what happens when a simple system tries to regulate a complex system. Speaking directly to this issue, Nobel Laureate Friedrich Hayek said; *"I confess I prefer true but imperfect knowledge, even if it leaves much indetermined and unpredictable, to a pretence of exact knowledge that is likely to be false."*