

## Signals Breakdown of the Social Contract Philippa Malmgren

An independent view by a widely experienced and perceptive analyst. Flawed by bad editing and fact checking

This is a wide ranging book by a woman who has an amazing breadth of experience herself. Raised in a government family in Washington DC, she has been exposed to politics and economics all of her life. She has read extremely widely and cites an impressive number of very good sources in this book.

It is not obvious to me, not having encountered Malmgren before, that she could be immediately pigeonholed as a neocon or libertarian, and certainly not a progressive, statist or person of the left. She is an independent thinker and these are her own opinions.

A major concern is the way in which the global growth of governments, and central banks in particular, is changing society. There is simply too much debt and it will be difficult to discharge without breaking the social contract. That would be the core message of the book.

The book has somewhat of a shortcoming in that it is poorly edited. There are usages that should not have slipped through. More significant are errors in fact that simply should not occur. For instance, she has Einstein playing with vacuum-tube radios in his youth. It should be evident to somebody with some knowledge of history that radios were not invented until Einstein's early adulthood. Other similar problems of fact crop up throughout the book. They do not detract from her thesis, but they do impact her credibility.

That is the end of a short review. Long review follows.

Malmgren has had a very privileged vantage from which to see the world and form broad opinions. She grew up in Washington DC, the daughter of an advisor to Presidents of the Kennedy through the Reagan eras. She has a background in economics and a lifelong exposure to politics.

The book addresses several interconnected themes. One of the major ones is the role of central banks in every modern nation. She talks about the power shift from the private sector, including private banks, to the central banks over the course of the last several decades. She observes that power shifts to those who are able to take it. Whether or not the Federal Reserve is in any position to "steer the economy," as Janet Yellen would claim, is open to debate. The Federal Reserve did have the ability to wrest power from the banks and the private sector, and they did so. The chair of the Federal Reserve appears to be unhappy with the dissent sometimes voiced by the regional chairs, and Malmgren describes the measures now being taken by Yellen, previously by Bernanke, to get them in line. She talks about the media who are captive to the governmental process. In this case it is Jon Hilsenrath of the Wall Street Journal who appears to be the media mouthpiece for the Federal Reserve. He made the tradeoff that journalists are forced to make, giving up their independence in exchange for access. It is how the system works.

She goes on at great length about inflation and deflation. Central banks want inflation. Inflation pushes people into higher tax brackets, creates artificial capital gains that can be taxed, and decreases the value of public debt. In the long run she says that inflation is the only tolerably attractive way out of excessive government debt. A government such as the United States cannot default on its debt - it would be unthinkable. They cannot even ask creditors to take a haircut, as Greece and Cyprus have done. On the other hand, it is patently clear they can never pay it back. Therefore the only option is to inflate the debt away.

However, with inflation come higher interest rates. All central banks in the world are dedicated to holding interest rates at close to zero, in order to force money into other sectors of the economy such as the stock market and housing. They have been successful in this. The stock market and housing are at record highs: many say they are in a bubble. So the government also has an interest in deflation - keeping prices stable to keep inflation low. How do they manage this balancing act?

So far, Malmgren notes, lying has been fairly successful. Governments publish inflation statistics that are quite out of sync with everyday experience. We see beef prices, college tuitions and medical services rising as much as 25 percent per year, but the published consumer price index rose at only two percent. One of the strengths of the book is the sources that Malmgren sites, in this case John Williams' highly respected Shadow Government Statistics. Malmgren

expresses concern about the damage done to the social contract when the government lies increasingly, and about more and more things. People lose faith.

"Signals," the title of her book, puts forth the proposition that we are all surrounded by signals from the marketplace every day of our lives. One of her more colorful signals was a Bloomingdale's display of Halloween themed crockery in 2007. She asked the question, "Who can afford a special set of crockery to use once a year? Who has a house big enough to store it? How much does it cost to heat and air condition that house? Other signals she claims to have seen in 2007 include the proliferation of vastly expensive handbags, something that men definitely never look at, rather than women's shoes, which might sometimes draw a glance. These subtle signals told her it was getting close to a market top. She acted on the signals, selling her house at the right time. She goes on at length about how she was unable to convince her mother to do the same, and how her mother's house wound up underwater. The moral of the story: read the signals.

Other signals are apparent in other markets. The rising cost of food signaled Arab unrest which led to the Arab Spring. Similar signals have been evident in Greece and the southern European countries for some time. The rise of the right-wing parties in Western Europe - she doesn't name them but they include France's National Front, Britain's United Kingdom independent party, Hungary's Jobbik, Greece's Golden Dawn just to name four - indicate popular unrest.

What kind of unrest? The words that she uses are a breakdown of the social contract. It is the implicit agreement between the government and the governed to assure a relatively fair distribution of goods. What has happened over and over is that the government and the banks have taken a disproportionate share of the national wealth. The poor people are caught between the jaws of a vice.

Malmgren seems not to be aligned with any particular political group. This gives her a great deal of freedom, which she employs to express some rather unconventional views of the world. Although it would appear she is more sympathetic to the conservative/libertarian side than the statist/progressive side, it would be a mistake to crudely paint her with any label.

Her independence comes with its costs. This book was not staffed through a legion of supporters, such as Hillary Clinton's and Pat Buchanan's recent books. There are some editorial errors - sometimes you read a paragraph and ask, what did that mean? Or, I think what she means is this... Some quibbles would simply amount to disagreement. She characterizes the private schools in Washington DC as being places that government employees cannot afford. I was a parent and a longtime treasurer of the private school right across Whitehaven Parkway from Mount Vernon College, her alma mater, in the heart of her Ward 3 of Washington. We had lots of children of senior government officials.

When talking about Saudi Arabia, she says that their cost of production is so high that the recent drop in prices is going to crush them. The preceding sentences had been talking about oil, and I was curious. How can that be? Everybody knows that Saudi Arabia has the lowest oil lifting costs in the world. The next few sentences talk about chickens. Oh! That's what she meant. Saudi Arabia had been nurturing uneconomical chicken farms to provide protein for the Muslims who don't eat pork and the Indians who don't eat beef. When they went out of business it caused something of a local crisis in chicken prices.

There are more serious errors of fact. She says that Einstein demonstrated his brilliance at an early age by tinkering with radios. That cannot be - Einstein was an adult by the time Marconi invented the radio. She must have been thinking of Richard Feynmann. She says that the Lomonosov ridge lies 14,000 feet beneath the Arctic Ocean. Wrong! The ridge rises from an ocean bottom with a maximum depth about that great.

She lumps Germany, Hungary, Poland, and Ukraine together as former dependencies of the Soviet Union. There are two vast differences. The first is that Ukraine was an integral part of the Soviet Union, whereas the others were nominally independent satellites that had their own governments. More importantly, Ukraine had been under Russian domination more or less continuously since the 17th century, whereas the others fell under Soviet control only after World War II. The 43 year postwar experience of the satellites does not compare with the centuries of suffering Ukraine experienced under the Russians. Ukraine carried, and still carries, a much greater burden of corruption and misgovernment.

She goes on at length about Ukraine, where I live, making a number of errors in fact. She states that the capital of Moldova is Odessa. Wrong! Odessa is the major seaport on Ukraine's southern coast. Chisinau is the capital of Moldova. She says that Russia coveted Crimea for its food production capability. Wrong again! It is a rather barren peninsula. Such agriculture as they have was supported by water imported from mainland Ukraine. She says that the Russians in Crimea and southeastern Ukraine welcomed being reunited with Russia. Wrong again. They were rather like Mexicans in Los Angeles, Francophones in Québec, or Haitians in Miami. They felt some strong cultural ties with their ancestral homeland, but there was never any noticeable political movement to be reunited with Russia. I spoke with the people during the several times we vacationed in Crimea and spent time in Donetsk and Mariupol. I certainly never sensed any great desire to leave Ukraine. Putin fanned these sentiments to a fever pitch with television propaganda about the time of Maidan, and he certainly convinced some people. There are others who find it quite prudent at the moment to appear to be happy with Russia. Several of my friends here in Kiev are from Crimea, and they all have cautionary stories to tell about people who remain there and have not spouted the party line when asked whether or not they love Russia. They have been abused, locked up and their businesses have been confiscated. Of course they love Russia!

She says that Ukraine had a vast debt problem during the Yanukovich years. Wrong! Per capita debt was only about US\$3,000. Nobody would loan them any more money. Their problem was not debt, but the tax base. The oligarchs, in active cahoots with the Russians in many cases, held incomes to such a low level that there was not enough governmental income to support any more debt. The oligarchs were masters at moving their profits offshore to avoid paying Ukrainian taxes. Government could not borrow much to build infrastructure, and the money that was borrowed from various IMF facilities was stolen by the oligarchs, chief among whom was Yanukovich himself. Ukraine's problem was the legacy of corruption they inherited from the Soviet Union and the Czars more than any debt burden.

Malmgren credits a lot of what governments are doing in the world today with acting in the interests of their people. In particular she says that the Chinese are working to secure energy and food resources for their people. She posits that Putin may be invading Ukraine in order to secure food for his people.

Elsewhere in the book she gets closer to the truth. Politicians everywhere work in their own self-interest. Upon certain happy occasions, the self-interest of the politician is served by taking care of their people. If the people are hungry, they are likely to riot unless they get bread. This is, however, the exception. Generally the politicians can peacefully line their own pockets.

This certainly appears to be the case with Russia. It's incursion into Ukraine has nothing to do with farmland. Crimea has no farmland worth talking about. It was the vacation paradise of the Soviet Union, a rough coastline more or less like California's Mendocino coast. Except that since Crimea is the best they have - there is no Santa Barbara - people actually swim in Crimea's cold waters and sunbathe on its rocky beaches. The tourists had been mostly Ukrainian, and business in 2014 was a disaster. The Donbass, which Russia is currently in the process of attempting to take over, is more industrial, although there is farming. Russia, the biggest country in the world by far, has farmland enough. The reason to invade Ukraine has vastly more to do with domestic Russian politics, and Putin's ambition, than with taking care of the Russian people. It certainly does not have anything to do with taking care of the Russian speaking people in Eastern Ukraine. The economies of Crimea and the Donbass are wrecks since the invasion. There is no conceivable way that the invasion will have made financial sense for Russia, or the inhabitants of that area, and certainly not for Ukraine.

Returning to the social contract idea, Malmgren does not talk about social class or the problems of the underclass in the United States and Europe. She thus ignores a significant part of the problem. The present underclass exists in large part because its members are generally not capable of performing any useful work in the society. This problem is being exacerbated by the very factors that she looks to as a solution - those involving technology.

Jobs in the United States are increasingly going toward those who have an ability to work with information, and most especially, those who have an ability to work with computers. These are not necessarily computer programmers, but the people who are able to make use of computerized information systems. They use them in video editing, petroleum exploration, as she cites in one of her examples, and automated production of news stories, in agriculture and many other spheres. The common denominator is that it takes intelligence to use the computerized systems just as it takes intelligence to program them in the first place. A job seeker must have used his intelligence to acquire skills with written language, math, and generally some knowledge of history and society as well as computers.

It takes fewer and fewer smarter and smarter people to get the job done. But the demographics are headed exactly the opposite direction. Per almost all intelligence researchers (I review books by Nyborg, Murray, Lynn, Vanhanen and Hunt) we are getting more and more less and less intelligent people in society. One cannot fault Malmgren for this oversight - bringing it up could well have prevented the book from getting published. Therefore she, like almost everybody with a prescription for how to fix our ailments, puts on a happy face and overlooks this fact. If one admits it, there is no solution.

Another phenomenon that Malmgren does not address is what is happening to the family. In traditional societies, America included, a family was not simply the product of a mother and father in the nuclear family, but of an extended family of aunts uncles and cousins - an entire clan. More than that, it was that the child was the product of a neighborhood that included the church, schools, Boy Scouts and other institutions. All of these went into socializing a child and making him a member of the community first, and then larger political organizations such as a city, county, state and finally nation. The blossoming citizen's exposure, however, was mostly to local organizations.

Malmgren could note, among her signals, the fact that the federal government has been crowding out all other levels of civic organization. It has done this by taking over the charity work that used to be done by others. It has done this by imposing standards, most recently common core, on education. It has done this by mandating integration, which as Robert Putnam of Harvard says, tends to break down and divide neighborhoods. See Charles Murray's coming apart for a description of how this worked in Fishtown, Philadelphia. It fits her model perfectly. It is not clear that the federal government can do a better job of these tasks than local organizations, but they have the political power, and so they take them over. In doing so they destroy organizations that contributed to the cohesiveness of communities and socialization of children. It is a loud signal to any young person that they have to get on the side of the federal government, and to prospective parents that they are alone in the role of parenthood except for intrusive minions of the nanny state who may give them money but will certainly offer unwanted oversight.

Malmgren presents the somewhat obligatory optimistic chapter on ways that the world can grow out of this situation. Hers is almost egregiously throw away. She cites innovations such as Uber car sharing and the like and suggests that these might enable us to grow our way out of the problem.

She says that the workers of the Third World are demanding higher wages. That they are threatening to unionize. That in some cases such as Australia they are indeed effective at getting more money. This flies in the face of the free market philosophies she espouses elsewhere in the work. People offer their labor in a labor market. She says that it costs \$45 to hire an Australian bartender. I cannot believe that such a price could be sustained in a free marketplace if the money is going to the bartender himself. If most of it is going to taxes that is another story. This leads to another suspect statistic. She says that pizza costs \$30 in Sao Paulo. Nah. I googled Dominos in California and Brazil. Just a bit higher in Brazil. Moreover, in my experience in Brazil, admittedly ten years back, the abundant local dishes such as churrasco were far cheaper and tastier than chain restaurant fare.

She talks very briefly about children, a delightful aside which most economists would not even bother with. She does not talk about the economics of raising children, but she does observe, very accurately and usefully, that societies that have quite a few children are preparing themselves for the future better than those that don't. Postwar America, spawning the baby boom, was, and had reason to be optimistic. Those children would be able to support the elderly. Conversely, the overly mature societies of Japan, Western Europe and the United States do not have enough children to replace the current generation of workers.

She does not talk about the types of people among her demographics. It is well documented that even among Americans of European descent it is the less talented, the less well-educated who have the most children. This same phenomenon is true throughout the world. Overall there are smaller families, and among the more capable people there are fewer children. Intelligence, health and even character being quite heritable, this does not bode well for these societies. An absolutely forbidden topic would be the relative talents of those of European and North Asian descent, who are having fewer children, and others who are having children. Suffice it to say that her rosy optimism about innovation is probably misplaced.

Malmgren touches very briefly on education, noting that it is becoming more expensive and the quality is declining. She is absolutely right, and I would elaborate that the problem is exacerbated by the declining talent of the students themselves. A teacher has to work with the raw material that comes their way, and the problems in the schools are in

some large measure a reflection of the deficiencies in the students themselves. It is death even to mention this. Excuse me for doing so.

That is a long review. My reviews are my reading notes - I will want to remember Malmgren in two years time and will have this to turn back to. Overall it is a four-star effort. Definitely five stars for ambition and breadth, five stars for independence and innovation. However, the weak editing and fact checking detract significantly from its overall credibility.