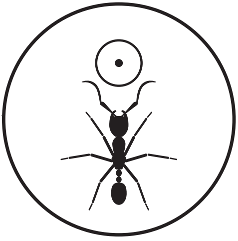

Myrmikan Research

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Welcome to the Machine

Three of Myrmikan's recent letters prompted some readers to cancel their (free) subscriptions: Leninthink, which explored the details of the soft coup against President Trump (published even before the emergence of hard evidence that the whole seditious Russia-hoax was orchestrated by the Clintons); The Fourth Revolution, which explained how a Democrat-sweep of the presidency and the Senate (which is still possible, perhaps likely) would create a permanent single-party rule in the United States and send it toward third-world status; and The Die is Cast, which detailed some of the evidences of fraud in the recent election. The farewell emails from these readers urged Myrmikan to remove political analysis from its writings on economic affairs. The problem with their advice is that gold is a political investment.

All banking system start with banks adding liquidity to specie (gold and silver) and short-term claims on specie: banks accept less liquid bullion and commercial invoices as assets and issue more liquid demand IOUs redeemable unto specie as liabilities. Indeed, banks in an unfettered market can do little else. Commerce requires a certain amount of monetary media for commerce to circulate. If a bank in a free market tries to insert too much money into commerce (by financing thirty-year mortgages, for example), the value of its IOUs (being of excessive quantity compared to commercial demand) will fall in value, no matter how solidly they are backed. Speculators will buy these devalued IOUs and demand redemption into bullion at face value, draining the bank of reserves. This tendency for the market to eject excess monetary media from circulation is called the Law of Reflux.[1]

1 As formulated by Adam Smith:

> Many people would immediately perceive that they had more of this paper than was necessary for transacting their business at home, and as they could not send it abroad, they would immediately demand payment of it from the banks. When this superfluous paper was converted into gold and silver, they could easily find a use for it by sending it abroad; but they could find none while it remained in the shape of paper. There would immediately, therefore, be a run upon the banks to the whole extent of this superfluous paper, and, if they showed any difficulty or backwardness in payment, to a much greater extent; the alarm which this would occasion necessarily increasing the run."
>
> Smith [1776] (1904, vol. 1): 283–4.

The actual term "law of reflux" was coined by John Fullarton in 1844 and expanded upon by Thomas Tooke in 1848. Both men observed that by the mid-eighteenth century, redemption into coin was the least significant way that excess notes returned to issuing banks. Other avenues of reflux included depositing the notes, which required that the issuing bank begin to pay interest on the liability (greatly increasing the bank's cost), and pre-payment of debts (which decreased the issuing bank's profit). Banks also began to accept each other's demand liabilities (notes and or checks drawn on deposit accounts) at face value and would meet at clearing houses to settle liabilities. Banks that had overissued demand liabilities that ended up at other banks would see their reserves drain under

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The world has not had a free market in money since World War I, of course, and even in the nineteenth century it was only partially free. Socialist economist Abba Lerner explained the transition to political money succinctly:

> Before the tax collectors were strong enough to earn for the state the title of creator of the money, the best the state could do was to tie its currency to gold or silver which had a stability of their own that antedated the appearance of the state.…
>
> But if the state is willing to accept the proposed [fiat] money in payment of taxes and other obligations to itself the trick is done. Everyone who has obligations to the state will be willing to accept the pieces of paper with which he can settle the obligations, and all other people will be willing to accept these pieces of paper because they know that the taxpayers, etc., will accept them in turn.

And not just fiat currency, but claims on fiat currency: checks drawn on private banks may be used to pay taxes and creditors at face value however shoddy the assets on the issuing bank's balance sheet (at least up to the moment the bank actually fails, and even then the liabilities are protected by the FDIC). Because currency and deposit holders can pay away excess money to settle their own liabilities, the excess money that banks create is not ejected from commerce but serves to push prices higher.

So we see that, at the beginning, credit inflation and currency debasement are impossible without the exertion of a political power that permits banks to do irresponsible things.

Banks that create excess credit change the structure of production: banks lend mostly against assets, which pushes asset prices higher. Higher asset prices with constant cashflows signal that discount rates have declined. Changes in discount rate disproportionately affect the net present values of capital-intense, long-term projects: falling rates stimulate especially the construction of real estate, cars, factories, base metal mines, ships, all kinds of heavy industry.

During the Civil War, for example, the U.S. government issued a fiat currency (called the greenback) and gave it legal tender status in order to finance war spending. One senator who opposed the measure pointed out that the government: "might as well lose 25 per cent. on the sale of her bonds, as to be obliged, in avoiding it, to pay 25 per cent. more for everything she buys."

Depreciation would have been better because the unintended side effect of boosting prices was the stimulation in particular of an enormous bubble in railroad construction. As a politician in the pioneer state of Nebraska observed:

> Railroads born before their time are commercial deformities—monetary monsters which first consume the substance of the people, and then turn upon their proprietors to rend and destroy them also. Physical deformities are incarnate protestations against violations of natural

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the principle of adverse clearing. All of the avenues of the Law of Reflux rely on the underlying threat that holders of bank liabilities can demand redemption into coin (a depreciating nonredeemable currency will suppress the demand for deposits and also entice debtors to delay repayment of debts). As Fullarton wrote: "It is not so much by convertibility into gold, as by the regularity of the reflux, that any redundance of the bank-note issues is rendered impossible.… [But] perfect convertibility is no doubt one essential condition of every sound and efficient system of currency. It is the only effectual protection against internal discredit, and the best preventive of any violent aberrations of the exchange with foreign countries." Fullarton, John. 1844. *On the Regulation of Currencies*. London: John Murray: 67.

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> laws; and commercial boa-constrictors in the form of railroads, through peopleless and cropless counties, are denunciations of the policy which donates into life railroads before there is anything legitimate for railroads to do.

The railroads funded themselves with debt and bank finance made cheap by the issuance of the depreciating greenbacks. In a space of only ten years, the largest railroads had reached market capitalizations that were thirty-five *times* greater than the largest antebellum corporations.

But then there arose a legal threat to the railroads' power: Salmon Chase, who as Lincoln's Treasury Secretary had issued the greenbacks, ruled as Chief Justice of the Supreme Court that their tender legal attribute was unconstitutional: "Indeed, we are not aware that it has ever been claimed that the power to issue bills or notes has any identity with the power to make them a legal tender. On the contrary, the whole history of the country refutes that notion."

Chase's opinion was joined by four of the seven justices on the court. President Grant quickly filled the two vacancies with men who had been legal counsel for and directors of railroads. Less then a year later, Grant's appointees joined with the dissenters to overrule Chase in a stunning violation of *stare decisis*. Greenbacks had concentrated capital artificially, and then the representatives of that concentration conspired to maintain their privileges. Railroad financings and share prices grew apace—and Myrmikan's critics believe that somehow the study of economics and politics may be untangled.

The bankers and railroad promoters could succeed in harnessing political power, but no man or combination may overcome economic law. Two years after the triumph of legal tender, railroad overcapacity began to pressure margins. Speculators remained unconcerned, putting their trust in government. The *New York Herald* boasted:

> True, some great event may prick the commercial bubble of the hour, and create convulsions; but while the Secretary of the Treasury plays the role of banker for the entire United States it is difficult to conceive of any condition of circumstances which he cannot control. Power has been centralized in him to an extent not enjoyed by the Governor of the Bank of England. He … [has] a greater influence than is possessed by all the banking institutions of New York.

A week later the New York Warehouse & Security Company declared itself illiquid but solvent, announcing: "This company has loaned money and its notes to railways and construction companies … some of whom are not able to respond. For the money and paper loaned, the company has what its managers consider ample security in the shape of collateral and endorsements." This was more or less what the banks argued in 2008. The Treasury Department used its $29 million of "greenback reserves" to buy bonds and prop up the market. Of course it was insufficient, and within a month the Panic of 1873 hit in full force.

Credit bubbles always serve to misallocate capital, but they also do something worse: they concentrate it. In our system, the more assets a company has, the lower its borrowing costs. According to Federal Reserve data, since 1997, the interest rate for business loans between $10,000 and $100,000 has been 2.5 percent higher, on average, than that for loans above $10 million. Large companies use their lower cost

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of capital either as a subsidy to reduce prices and drive smaller competitors out of business or to acquire them. As Amazon CEO Jeff Bezos told Congress: “There are multiple reasons that we might buy a company. Sometimes we’re trying to buy some technology or IP, sometimes it’s a talent acquisition. But the most common case is market position.”

The result has been massive industry concentration in every sector. Nearly half the restaurants in America are chains, every one striving to serve exactly the same thing. Nor do independent restaurants offer variety—*two thirds* of American restaurants are supplied by a single company: Sysco Foods, an amalgamation of over 150 different distributors (and many of the remaining restaurants are controlled by huge chains with their own distribution systems). This is why, wherever you dine, the food tastes exactly the same (except in the fancies restaurants in the fanciest cities).

Cooking at home does not help: just four companies control more than half of the U.S. food retail sector, and they demand volume and consistency from their suppliers, forcing supply chains to become concentrated. The diversity of brands on store shelves is an artifice: Perrier, Poland Spring, and San Pellegrino are all owned by Nestlé, along with more than 2,000 other brands; Klondike, Ben & Jerry’s, and Breyers are all owned by Unilever, along with more than 1,000 other brands. These conglomerates likewise demand consistency from their suppliers. Since 1950, for example, the number of chicken producers has plummeted by 98 percent. Just three firms control 87 percent of the soft drink market. Four companies control 84 percent of the beef slaughter business (up from 70 percent in 2001 and 39 percent in 1984). More than half of the seed market is controlled by just three firms, themselves the product of over 200 mergers.

It is not just the food business that banking has corrupted: six companies control 60 percent of U.S. hotel rooms, four airlines provide 80 percent of U.S. domestic flights (up from 65 percent in 1987 and 56 percent in 1978), three companies produce 92 percent of light bulbs, four companies control 90 percent of appliance manufacturing, and so on. Consumers are herded into big box retailers designed to maximize throughput, where everyday low prices reflect the value of the products on offer. Now even these monolithic firms are being crushed by Amazon, the ultimate throughput machine.

Our modern credit bubble has also created a living hell for employees (and customers). Companies that take on debt to crush their rivals cannot use the proceeds to innovate: innovative success is by its nature uncertain, so it is not possible to predict exactly when the proceeds from innovation will arrive. Meanwhile there are debt payments to be made. Debt capital, therefore, may be used only to enhance efficiency. And, as Adam Smith taught, efficiency is best pursued through enhancing the division of labor: “by reducing every man’s business to some one simple operation.” The Amazon warehouse job is efficiency’s ultimate expression: human beings, sparks of divine fire, take a trinket out of one box and place it in another, until they drop.

> To the same degree in which the division of labour increases, is the labour simplified. The special skill of the labourer becomes worthless. He becomes transformed into a simple monotonous force of production, with neither physical nor mental elasticity. His work becomes accessible to all; therefore competitors press upon him from all sides. Moreover, it must be remembered that the more simple, the more easily learned the work is, so much the less is its cost to production, the expense of

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> its acquisition, and so much the lower must the wages sink—for, like the price of any other commodity, they are determined by the cost of production. Therefore, in the same manner in which labour becomes more unsatisfactory, more repulsive, do competition increase and wages decrease.... It is evident that the small manufacturer cannot survive in a struggle in which the first condition of success is production upon an ever greater scale

Marxism may well have been the most malign influence of the past century, conditioning us to dismiss everything Marx wrote as erroneous; but where, precisely, is the fallacy in the above quotation from *Das Kapital*? Assuming legal tender laws have set an asset-based banking system in motion (in which the race to accumulate debt forces manic pursuit of efficiency), where is the error in logic? Marx merely took Adam Smith and extended his reasoning to its logical extreme:

> The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. The torpor of his mind renders him, not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgment concerning many even of the ordinary duties of private life.... His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilized society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it.

The lines above are not by Marx but are, in fact, rarely quoted lines from Adam Smith's *The Wealth of Nations*. No one who has conversed with an urban teller at Duane Reade (who are also being replaced by automated systems) can doubt the veracity of Smith's description. No wonder the national share of income to the bottom half fell from 21.6 percent to 14.5 percent from 1950 to 2016, while the top decile increased its share from 34.5 percent to 47.6 percent.

These trends create fertile soil for the modern Democratic Party. Manic increases in efficiency (at the cost of innovation and flexibility) force ever more workers into jobs that create little value and, therefore, have no ability to demand decent wages. Organized labor and state intervention seem the only way to support living standards, attracting voters.

The Party itself, however, is paid for and run by the same large corporations that voters think they are rebelling against. See, for example, former vice-president Biden's prospective appointees: The joint-chair of Biden's transition team, Jeff Zients, is a former Facebook board member (a second former Facebook board member is an advisor). His Chief of Staff will be Ron Klain, a lobbyist for Fannie Mae, ImClone (the CEO of which was convicted of fraud), AOL Time Warner, and the "Coalition for Asbestos Resolution," a front-group for a roofing-materials manufacturer.

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Tony Blinken has been tapped for Secretary of State: he lobbied for the defense industry, private equity firms, and hedge funds. He also is a parter of the private equity firm Pine Island Capital Partners, whose chairman is the odious John Thain (who spent $87,784 of shareholder money on his office rug, $68,179 on a credenza, $18,468 for a chair, and then demanded a $40 million bonus for selling Merrill Lynch at a share price two-thirds lower than it had been when he had joined the firm as CEO less than twelve months earlier).

Martha Gimbel, who runs a venture capital firm started by Google CEO Eric Schmidt, will lead Biden's Council of Economic Advisers; Tom Sullivan of Amazon is going to the State Department; Clare Gallagjer of Airbnb to the National Security Council; Arthur Plews of Stripe to the Small Business Administration; Ann Dunkin of Dell to the Environmental Protection Agency; Nicole Isaac of LinkedIn to the Treasury Department; Ted Dean of Dropbox will be U.S. Trade Representative; the Office of Management and Budget will be staffed with Mark Schwartz of Amazon, Brandon Belford of Lyft, and Divya Kumaraiah of Airbnb; Biden's intelligence community group will include Matt Olsen of Uber and two representatives from Disney.

The reason that Trump was so vilified by the establishment (and the reason they were determined to win the election at *any* cost) is that he interrupted the growth of their power. But even Trump encouraged the Federal Reserve's destructive course. The Fed/Treasury program of backstopping the corporate bond market necessarily benefited again the large corporations against their smaller competitors. Now that Biden has tapped former Fed-chair Janet Yellen to be his Treasury Secretary, there will be ever less distinction between the central bank and the government it exists to finance, an attribute of the third world.

In the time of the railroads, big industry was content with preserving its special privilege. Big corporates have now captured the entire seat of government. And, of course, the corporatists overlap with the neocon war-party and military contractors. It will be business as usual in Washington.

These political events have profound implications for investors. First, the largest companies will continue to prosper as the cost of capital (for only the largest) shrinks to zero (perhaps even beyond). The largest companies will exploit regulatory capture that will benefit them and harm their competitors. As long as the system continues, big low-cost index funds, which are capitalization weighted, will be the place to be.

But, as in 1873, economic reality lurks behind the political facade. These enormous corporations, being so inflexible, do a lousy job of responding to changes in consumer demand and the availability of resources and become brittle.

Consider H.J. Heinz as an example: everyone eats ketchup, and Heinz is the only serious brand. So Brazil's 3G Capital and Warren Buffet bought the company with enormous amounts of debt in a standard private equity transaction. With large interest payments to make, the new owners slashed costs, fired workers, scaled back advertising and product development: why advertise? everyone knows about Heinz; why innovate? the whole point is the products are staples that everyone will always buy forever.

Well, consumer tastes did change, towards salsa as the population becomes more Hispanic and toward organic as consumers become more health conscious. The new

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Heinz had no flexibility: every dollar was reserved for debt payments; and all of the product innovators had been fired. Heinz stock collapsed.

But now imagine that Heinz could call up the Fed and get free financing (not available to its competitors). Well then the company—all such private equity financed companies—could continue making its investors rich and force Americans to keep eating their harsh, vinegary product. Keep in mind that Jerome Powell, Chairman of the Federal Reserve, was formerly a partner of The Carlyle Group where he founded and led the Industrial Group within the Carlyle U.S. Buyout Fund.

Eventually, however, taxes are exhausted and the credit of the state runs out. Fed financing is ultimately borne by those who hold dollars and claims on dollars. And this is why gold lies at the end of this political process.

Both political parties are to blame for where America finds herself, but (as discussed in The Fourth Revolution) one faction now stands on the cusp of absolute power: just a little more cheating Georgia to capture the Senate or a couple of squishy GOP senators on key issues (Mr. Romney, for example) will do it.

Myrmikan's most recent letter ended on the hopeful note that if the Democrats failed to capture both Senate seats in Georgia, they would not be able to pack the senate with two new states and four new left-wing senators or the court, which would expose them to full voter fury in 2022.

Having read the Texas complaint to the Supreme Court, Myrmikan now thinks its analysis may be too optimistic. The basis of the complaint is not the thousands of sworn affidavits detailing widespread fraud in certain swing-state jurisdictions. Instead it argues the limited point that: "State officials, sometimes through pending litigation (e.g., settling "friendly" suits) and sometimes unilaterally by executive fiat, announced new rules for the conduct of the 2020 election that were inconsistent with existing state statutes defining what constitutes a lawful vote."

Particular sins committed by the renegade states include abandoning mail-in ballot signature requirements, keeping poll-watchers at a distance too far to witness the ballot counting process, accepting ballots after cutoff times, breaking chains of custody, statistical impossibilities (Pennsylvania's official data, for example, recorded 2.7 million mail-in ballots mailed to voters as of November 2, but by November 4 that number had increased to 3.1 million), wildly different mail-in ballot rejection rates compared to 2016 (in Georgia, for example, the rejection rate was 0.37% compared to 6.42% in 2016), unlawful use of unmanned drop boxes, promoting the unlawful curing of invalid ballots and only in certain jurisdictions, and so on.

All of the practices detailed in the compliant violate the Supreme Court's decision in *Bush v. Gore* that "The State legislature's power to select the manner for appointing electors is plenary." In the context of Pennsylvania, Alito has already opined that "The provisions of the Federal Constitution conferring on state legislatures, not state courts, the authority to make rules governing federal elections would be meaningless if a state court could override the rules adopted by the legislature," reasoning that applies equally to governors and secretaries of state.

In short, the Texas compliant—which has now been joined by more than a third of the states, Pennsylvania's House of Representatives, a hundred and six Congressmen, and the Trump campaign—is constitutionally unanswerable. Even absent the allegations of outright fraud, a Biden victory is plainly unconstitutional. But does

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the Court have the courage to uphold the law, to endure the firestorm of the elite, to threaten the integrity of the institutions that the establishment has reshaped, to behave in a Trumpian manner?

If the five conservative justices decide to uphold the Constitution, to preserve the American experiment, it would be one of those unlikely moments that change history, Themistocles at Salamis, Sobieski at Vienna. But such courage is nearly unimaginable in our age. And if the court lets the fraud stand, as is likely, it will have forever shifted the power of election from the state legislatures to the executives. The country will cease to be a republic. And the corporations will scale ever larger. And the tech giants will tighten their grip on expression. And consumer choice will shrink. And wealth disparity will continue to widen. And there will be no red wave in 2022, even if the GOP holds the senate because the fraudsters will be emboldened.

Concentrating political power allows the continued concentration of economic power; but a core lesson of history is that markets are stronger than politics. Investing in gold is a political statement, it is an act of resistance against the corporatism; is it also the best way to preserve capital when the final economic crisis overwhelms the corporatist state.

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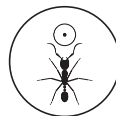

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