Myrmikan Research

February 15, 2024

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Failing Imperium

Trade is the core of civilized life. As Sir William Ridgeway noted in 1892: “Amongst the lowest races of savages such as the aborigines of Australia, even barter is almost unknown. Each man makes his own stone implements from the greenstone which is everywhere in abundance, his own clubs and boomerangs, whilst Nature supplies all his other wants.” Members of civilized society, by contrast, are *not* self-sufficient, participating instead in the division of labor and then trading their productions.

Despite its importance, the first comprehensive and coherent theory of trade was not developed until as late as 1871. Ancient philosophers such as Aristotle thought value was an objective attribute of each object. If one person made money trading, it meant by definition that someone else had lost money; profits from trading, therefore, were little different from theft.

William Stanley Jevons overturned that view by developing the theory of declining marginal utility. The marginal orange has almost no value to the orange farmer whereas the first apple has great value; the apple farmer is in the opposite position, and so trade between the farmers improves the wellbeing of both, and neither is a scoundrel, nor is the trader who executes the transaction and keeps a fee for himself.

Anthropology suggests that trade began not between individuals but among tribes. One tribe lives on an island with plentiful coconuts, the other on one with a surplus of fish, and when they are not fighting each other they will trade.

Civilization did not emerge until the advent of institutions that allowed the individual to hold and to trade his own capital, to form his own decisions about how best to enhance productivity, to choose for himself the trade at which he excels. The innovation that allowed individual ownership of capital was writing.

Written records emerged in Mesopotamia ten thousand years ago in the form of simple tokens that represented agricultural commodities being transacted in the market. The tokens were portable, allowing decentralized trade among various individuals within the society. Decentralized trade enabled spontaneous division of labor, which allowed for organized agriculture.

The first cities arose four thousand years later. Simple tokens were joined by complex tokens that represented manufactured goods and enabled the high degree of specialization that cities require. Cities do not pre-date complex tokens, nor do complex tokens pre-date cities: they are interdependent.

The money market began as various tokens that represented various goods and commodities, but competition soon drove the market to a standard. Carl Menger described the process:

> When any one has brought goods not highly saleable to market, the idea uppermost in his mind is to exchange them, not only for such as he happens to be in need of [i.e., through barter], but, if this cannot be effected directly, for other goods also, which, while he did not want them himself, were nevertheless more saleable than his own. By so doing he certainly does not attain at once the final object of his trafficking, to wit, the acquisition of goods needful to himself. Yet he draws nearer to that object. By the devious way of a mediate exchange, he gains the prospect of accomplishing his purpose more surely and economically than if he had confined himself to direct exchange.

Given only the assumption that actors in the market seek their own profit, they will naturally and necessarily gravitate to those commodities for use in mediate exchange that entail the least transaction costs—in other words, the ones that have the greatest liquidity, which then become known as money.

There is a record of this exact process occurring in economist R. A. Radford's personal account of a World War II prison camp:

> Starting with simple direct barter, such as a non-smoker giving a smoker friend his cigarette issue in exchange for a chocolate ration, more complex exchanges soon became an accepted custom.… By the end of a month, when we reached our permanent camp, there was a lively trade in all commodities and their relative values were well known, and expressed not in terms of one another—one didn't quote bully in terms of sugar—but in terms of cigarettes.… [E]veryone, including non-smokers, was willing to sell for cigarettes, using them to buy at another time and place. Cigarettes became the normal currency, though, of course, barter was never extinguished.…
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> Although cigarettes as currency exhibited certain peculiarities, they performed all the functions of a metallic currency as a unit of account, as a measure of value and as a store of value, and shared most of its characteristics. They were homogeneous, reasonably durable, and of convenient size for the smallest or, in packets, for the largest transactions.

He added: "The essential interest lies in the universality and the spontaneity of this economic life; it [money] came into existence not by conscious imitation but as a response to the immediate needs and circumstances."

Silver and gold have the greatest levels of liquidity, which is why every unfettered market that has sufficient supplies has gravitated towards them as money. But it is liquidity, not metal, that traders always seek. Cigarettes can be the most liquid commodity in a prison, or sea shells amongst Indians, or fiat currency when the use of metals is suppressed by law and regulation.

Once a market establishes standard money, it draws neighboring economies to it as well. Writing in the fifth century BC, Herodotus describes what is known as "silent trade":

> The Carthaginians also relate the following: There is a country in Libya, and a nation, beyond the Pillars of Hercules, which they are wont to visit,

> where they no sooner arrive but forthwith they unlade their wares, and, having disposed them after an orderly fashion along the beach, leave them, and, returning aboard their ships, raise a great smoke. The natives, when they see the smoke, come down to the shore, and, laying out to view so much gold as they think the worth of the wares, withdraw to a distance. The Carthaginians upon this come ashore and look. If they think the gold enough, they take it and go their way; but if it does not seem to them sufficient, they go aboard ship once more, and wait patiently. Then the others approach and add to their gold, till the Carthaginians are content. Neither party deals unfairly by the other: for they themselves never touch the gold till it comes up to the worth of their goods, nor do the natives ever carry off the goods till the gold is taken away.

Note that there is no state power specifying the monetary medium, setting prices, or even protecting the parties—the Carthaginians could have slaughtered the natives, taken the gold, and retained their chattels, but that would have ended the flow of trade from which both parties benefited. Adam Smith's unseen hand shielded the Libyans from assault, and market forces prompted them to begin specializing in gold mining in order to obtain goods that they could not themselves produce, drawing them into international commerce.

As peripheral economies develop, central economies begin to export capital as well as goods. David Hume described the process in 1752:

> There seems to be a happy concurrence of causes in human affairs, which checks the growth of trade and riches, and hinders them from being confined entirely to one people; as might naturally at first be dreaded from the advantages of an established commerce. Where one nation has gotten the start of another in trade, it is very difficult for the latter to regain the ground it has lost; because of the superior industry and skill of the former, and the greater stocks, of which its merchants are possessed, and which enable them to trade on so much smaller profits. But these advantages are compensated, in some measure, by the low price of labour in every nation which has not an extensive commerce, and does not much abound in gold and silver. Manufactures, therefore gradually shift their places, leaving those countries and provinces which they have already enriched, and flying to others, whither they are allured by the cheapness of provisions and labour; till they have enriched these also, and are again banished by the same causes.

The happy, virtual cycle of trade and capital development enriching the globe depends on safe transportation. In the ancient world, traders traveled by caravan over land and by fleets over water for mutual protection. In 75 BC, even the young Julius Caesar was kidnapped by pirates. Friends paid the ransom (which he himself demanded be increased, insulted that the original figure was so low). He immediately raised a fleet, caught the pirates, and had them crucified. A decade later, Pompey was granted full authority over the navy and within three months had cleared the seas of pirates, making travel safe for merchants. A Greek author would record in the second century AD:

> Today, it is possible for Greeks and barbarians, with or without baggage, to go easily wherever they want to go, exactly as if they were going from homeland to homeland. No fear in the face of the Gates of Cilicia or of

> the narrow, sandy passages leading through Arabia to Egypt, nor when confronted by mountains difficult to access, vast rivers, or the fierce races of barbarians.

Widespread piracy resumed in the Mediterranean Sea in the fifth century AD following the fall of Rome. Domestic decay prevented Rome from policing the trade routes, which dramatically raised the cost of imports, which further impaired the economy, the reverse of the virtuous cycle that had brought prosperity. This self-reinforcing process led to a rapid fall in living conditions.

The scourge of piracy in the Mediterranean continued through most of European history. Records suggest that the insurance premium for Venetian ships around the year 1600 rose to 50% of the value of the goods insured. The nineteenth century saw the rise of the nation state with the power to suppress threats to trade, as related by J.L. Anderson in his 1995 article: "Piracy and World History":

> Northern navies were more powerful and therefore more threatening, while their expansion provided employment for restless seamen who in earlier centuries might have "gone on the account" and even "turned Turk" to do so. Further, in the global wars between European nations in the eighteenth century, in which navies were important instruments, the alliance or at least respectful neutrality of the North African states was a useful strategic asset, confirmed by the regular payment of tribute.
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> These comfortable arrangements were disrupted in the early nineteenth century by the nascent power of the newly independent United States. That country had come into conflict with Tripoli over a dispute concerning tribute payments. Action by U.S. naval forces and marines obliged the pasha of Tripoli to undertake to refrain from interfering with American ships and from demanding tribute. Corsair attacks continued, however, and a further naval expedition to Algiers, Tunis, and again Tripoli in 1815 temporarily restrained (but failed to subdue) the rulers of those cities.
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> Almost immediately after the American action, the power of the Maghribi states was further challenged by Britain, but again with limited effect. The Royal Navy, acting on earlier precedents and with Dutch support, in 1816 bombarded Algiers into accepting peace and the abolition of the slave trade. As on many previous occasions, however, punitive actions and naval demonstrations by one or two nations brought only a temporary respite from interference with seaborne commerce—naturally so, as predation had long been intrinsic to the structure and functioning of the maritime states of North Africa. The threat that their corsairs posed for the safe passage of ships on the Mediterranean Sea was all but eliminated a few years later, not through occasional naval action but through a novel cooperation between the major European maritime powers, at that time Britain and France. About a decade later, France occupied Algeria as part of the nineteenth-century movement of European colonial expansion.

Unlike the Roman period, when a single power developed the strength to protect international trade routes, the modern international order was the product of competitive nation states abandoning the theory of zero-sum mercantilism, Aristotle's view of trade, and realizing that voluntary trade makes all parties richer.

The destruction of Europe in the twentieth century wars and the rise of America as the economic and financial colossus shifted the burden of maintaining open seas solely to the United States. The U.S. requires military alliances for political purposes only.

So we see that the progression of trade—that phenomenon that allows man to escape the swamp—progresses as tribal, individual within a nation, then as an international batch process, finally as an international continual process enabled by imperial might.

A unipolar world is more stable than a multi-polar world but is also more fragile. As the U.S. sinks under the weight of taxes, bureaucracy and regulation, debasement, and unrestrained immigration—the same pathologies that doomed Rome—its ability to project power declines. We see this currently in the Red Sea.

The Red Sea is adjacent to the Suez Canal, through which 15% of global shipping passes. Since mid-November an Iranian-backed Yemeni rebel group called the Houthis (which controls a large portion of Yemen) has been hijacking and firing missiles at ships transiting the Red Sea.

Upholding its hegemonic role, the U.S. navy began accompanying ships transiting the Red Sea. In other words, maritime trade retreated from the open seas of imperial eras to the convoys of antiquity. And the convoys do not even work: on January 24, the U.S. government announced that a U.S. destroyer had intercepted two missiles aimed at a merchant ship "while another landed in the water." The press release did not mention that the one in the water narrowly missed the merchant ship (in other words, it got through the missile defense system), that the ship abandoned its transit, and that the ships owner, Maersk, one of the largest shipping companies in the world, announced that all of its ships would now travel around the horn of Africa instead of through the Red Sea.

Freightos reports that container rates from China to the U.S. East Coast have increased 174% since October; Asia to Northern Europe is up 333%. The Houthis are targeting only Western-aligned ships. Chinese ships may traverse the canal and the Red Sea unmolested, which greatly favors Chinese economic interests and demonstrates the neo-mercantilist nature of Chinese economic and political strategy: China is competitive with the West, not collaborative.

Turmoil in the Red Sea is a direct challenge to American interests in the Middle East. Local actors sense that the hegemon is weak after Biden's humiliating surrender in Afghanistan and the embarrassing defeat of American weaponry and tactics in the Ukraine. American bases are under constant attack, and American bombing campaigns have had little effect.

With America's military increasingly tied down in regional conflicts, other actors may become emboldened to challenge the Western order. *The Wall Street Journal* reports that Venezuela is "moving light tanks, missile-equipped patrol boats and armored carriers" to its border with Guyana, a small county with vast oil reserves that has attracted billions in U.S. investment. France can no longer control commodity-rich West Africa, and the U.S. must decide whether or not to expend resources opposing growing Russian influence. China is facing the overdue collapse of its financial system and may well choose to channel domestic fury into a conflict over Taiwan.

American power faces another threat beyond its decreasing ability to project power because of domestic decline: the navy is using missiles that cost $2 million each to shoot down Houthi drones that cost a few thousand dollars each. Similarly, $10+ million tanks in Ukraine are being destroyed by $3,000 Chinese drones.

This radical asymmetry in costs may bring profound changes to the foundations of the global political structure. It was the cannonball that enabled the nation state;

before that invention the city wall enabled a small number of defenders to hold up a large army, which inhibited the amalgamation of dukedoms and principalities into nations.

If swarms of $3,000 drones can overwhelm the enormously expensive fixed capital of the U.S. military, such as tanks and naval ships, the technological ability of the imperial force to maintain order comes into question. This story is not yet written—perhaps drone warfare will develop in such a way such that the ability to outlay large amounts of capital will still be decisive, bolstering a world order in which one or a few powers dominate; yet the Ukrainian adventure has demonstrated that a relatively weak Russia is more able than the West to concentrate its economic production towards an effective military without damaging its civilian economy.

Whether because of military technology or Western cultural decay, it is clear that the stability of trade routes enforced by American imperium is waning. Trading costs will increase and the global economy will suffer; less wealth will detract further from the ability to maintain trade routes, which will further detract from wealth. Meanwhile, China and Russia are expanding the trade routes under their influence through large investments in infrastructure and in their militaries.

America is in a relatively good position to withstand the ebb of globalism, being an enormous market with plentiful natural resources (though only if businesses are allowed to access them). But America is not self-sufficient. Commodities and goods that it now imports cheaply will cost a lot more, either because of much higher transaction costs or the added cost of domestic production. The virtuous cycle described by Hume begins to go into reverse.

As costs increase, the administration will turn increasingly to price controls. Biden tweeted on the eve of the Super Bowl: "While you were Super Bowl shopping, did you notice smaller-than-usual products where the price stays the same? Folks are calling it Shrinkflation and it means companies are giving you less for every dollar you spend. I'm calling on the big consumer brands to put a stop to it." He also told oil companies "we will not tolerate … profiteering or price gouging" after he cut Russian supply from the market. These are just threats for the moment, but the administration or the next will follow the examples of Obama, Carter, Nixon, FDR, Robespierre, and Diocletian when the second wave of inflation hits. We know this because price controls are one of the most pervasive features of government, as related in Bob Schuettinger's marvelous book *Forty Centuries of Wage and Price Controls*.

Prices, which Hayek called "a mechanism for communicating information," broadcast the precise balance of scarcity and marginal demand. The more static that is added to that information, the less traders can make rational decisions. The diminution of international trade thus leads to conditions that undermine individual trade, leaving society barely above tribal forms. Tribal societies organize wealth by identity, not merit, so it should be no surprise to see this primitive form of social organization reestablishing itself.

The retreat of American geopolitical dominance does not mean by itself that the dollar will lose its position as the reserve currency. The Byzantine nomisma, as an example, was the preferred currency in Europe after the fall of Rome even though the Byzantine Empire had little economic influence and no political or religious authority. A sixth-century AD trader noted: "Every nation conducts its commerce with their nomisma, which is acceptable in every place from one end of the earth to the other. . . . In no other nation does such a thing exist."

But the nomisma was a gold coin minted to a standard that remained fixed for seven hundred years. It had solid economic value. The dollar began as a modern nomisma—in 1940, gold formed 85% of the Federal Reserve's assets—but it is now a unit of liability of an insolvent central bank. Its value is political, not economic. Its massive overvaluation compared to its true worth allows America to acquire foreign goods and commodities at much reduced cost, the "exorbitant privilege" that Jacques Rueff complained about. The world was willing to subsidize American purchases because of the enormous profits gleaned from the free flow of capital and goods that the American imperium provided. If the U.S. retreats from its role, the burden of supporting the dollar will bring less benefit and make countries question why they are paying the subsidy.

Instead of resisting the decline of the political project known as the dollar, the incompetent Biden administration is exacerbating it. When America was strong, even its enemies wanted to hold dollars, cementing U.S. power: In a strange twist of history, the Eurodollar market (which gives the dollar its international strength) began in the 1950s when the Soviet Union wanted to hold U.S. dollars outside of U.S. banks, and the European banks obliged, creating offshore dollar deposits and then debt. When the Biden administration froze and then proposed to confiscate Russian reserves, it undermined the dollar's political value. Putin was entirely correct when he told Tucker Carlson:

> The dollar is the cornerstone of the United States' power. I think everyone understands very well that, no matter how many dollars are printed, they are quickly dispersed all over the world. Inflation in the United States is minimal. It is about 3 or 3.4 per cent, which is, I think, totally acceptable for the U.S. But they won't stop printing. What does the debt of US$33 trillion tell us about? It is about the issuance.
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> Nevertheless, it is the main weapon used by the United States to maintain its power across the world. As soon as the political leadership decided to use the U.S. dollar as a political instrument, a blow was dealt to this American power. I don't want to use any unliterary expressions, but this is stupidity and a huge mistake.
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> Look at what is going on in the world. Even the United States' allies are now downsizing their dollar reserves. Seeing this, everyone starts looking for ways to protect themselves. But the fact that the United States applies restrictive measures to certain countries, such as placing restrictions on transactions, freezing assets, etc., causes grave concern and sends a signal to the whole world.
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> What did we have here? Until 2022, about 80 per cent of Russia's foreign trade transactions were made in U.S. dollars and euros. US dollars accounted for approximately 50 per cent of our transactions with third countries, while currently it is down to 13 per cent. It was not us who banned the use of the U.S. dollar, we had no such intention. It was the decision of the United States to restrict our transactions in U.S. dollars. I think it is a complete foolishness from the point of view of the interests of the United States itself and its taxpayers, as it damages the U.S. economy, undermines the power of the United States across the world.

> By the way, our transactions in yuan accounted for about 3 per cent. Today, 34 per cent of our transactions are made in rubles, and about as much, a little over 34 per cent, in yuan.
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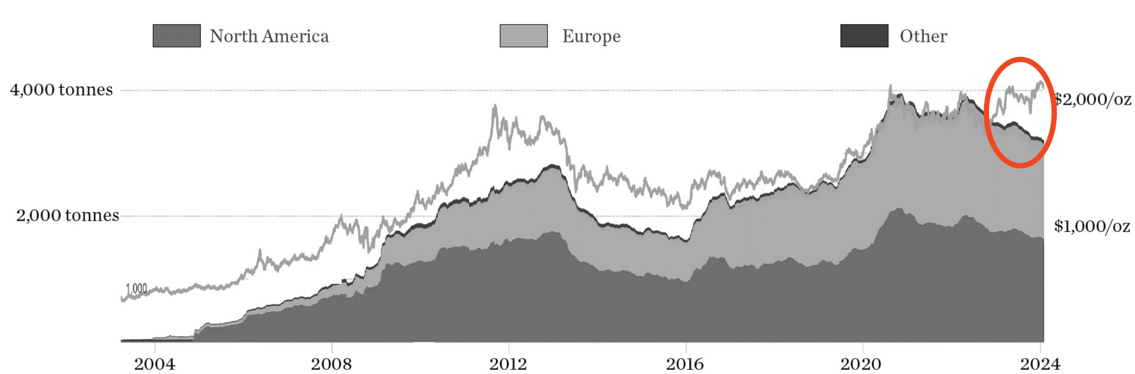
> Why did the United States do this? My only guess is self-conceit. They probably thought it would lead to a full collapse, but nothing collapsed. Moreover, other countries, including oil producers, are thinking of and already accepting payments for oil in yuan. Do you even realize what is going on or not? Does anyone in the United States realize this? What are you doing? You are cutting yourself off… all experts say this. Ask any intelligent and thinking person in the United States what the dollar means for the U.S.? You are killing it with your own hands.

The embryonic movement away from the U.S. dollar can be seen not only in Russia's ability to sell oil in non-dollar terms and increasing international yuan-based debt (5.8% of global finance in September up from 3.9% a year earlier, a 49% increase in just twelve months), but also in the divergence of the gold price from Western speculation.

For many years, bank analysts argued that higher nominal rates send the gold price lower since gold has no income and higher rates increase the opportunity cost of holding it. This theory, though wrong, fit the data since 1980. As Myrmikan has pointed out many times, in the 1970s nominal rates correlated with gold because as rates increased, the interest rate-sensitive assets that the Fed holds lost value, and so the dollar (its liability) must lose value as well against gold, which is free-market money. What changed starting in the 1980s was the enormous increase in off-shore U.S. dollar debt via the Eurodollar market, which meant that increasing rates required non-U.S. borrowers to demand more dollars to meet interest payments. Myrmikan has long argued that when that relationship reverts, when rising interest rates cause the market more concern about the Fed's asset value than the financing needs of foreign borrowers, the dollar's value will rapidly decline to its economic value. Gold will need to trade up to $10,000/oz at least to balance the Fed's balance sheet.

The chart below shows that the gold price in U.S. dollars has more or less tracked Western ETF flows, until a dramatic divergence began in 2022. Western investors are dishoarding gold with higher rates, yet the dollar price keeps increasing because of non-Western buying.

GOLD ETF HOLDINGS



Barter is preferable to the use of money in that traders get the thing that they want immediately. But barter's inefficiency limits its use to primitive economies. Money is therefore used out of necessity. The U.S. dollar became the global standard as the gold-backed currency of a rising power because it had the most liquidity. The Biden administration is undermining the three main pillars of the dollar's value: enormous deficits detract from the dollar's economic value; the decreasing ability of America's military to maintain the safety of trade routes makes countries reluctant to subsidize the U.S. empire by buying its Treasury bonds, which decreases its political value; and Russian asset seizures increase the risk-adjusted costs of holding dollars, decreasing its liquidity.

"There is a great deal of ruin in a nation," Adam Smith advised. The still dominant position of the U.S. dollar across the enormity of the global economy may lull many into the comforting expectation that the effects of U.S. policy will be felt only over the long term. Note, however, that necessity allowed Russia to shift its economy from dollars to yuan and rubles in only a year. If Russia and China treat foreign traders fairly, and offer better protection for trade, large portions of the globe will shift their allegiances "to protect themselves." The uninformed will be shocked by the suddenness of the change when it manifests, even though the ruin of the U.S has been accelerating for decades. Gold is the only geopolitically neutral financial asset. It is the only sure safe haven for Western investors. How ironic that they are selling it fast when they need it most.