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Options for a mercurial boss

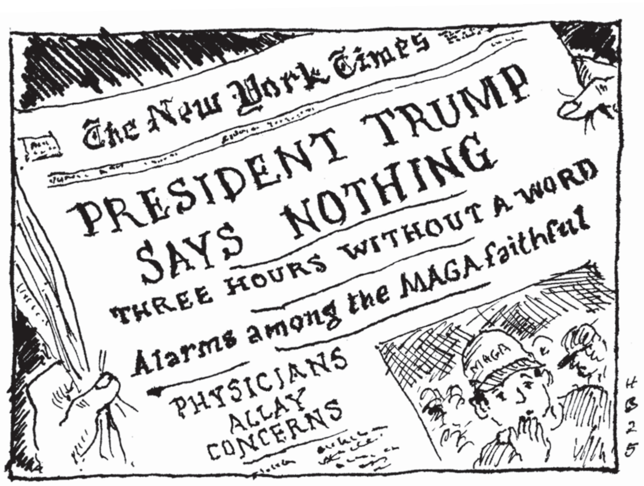
The dollar is too strong, the trade deficit is too deep and interest rates are too high, laments Donald J. Trump. To put things right, the president and his top advisers want to boost tariffs, weaken the dollar, reduce the 10-year Treasury yield and monetize the asset side of the government's balance sheet. They want a sovereign wealth fund, too. "We may be on the cusp of generational change in the international trade and financial systems," speculates Stephen Miran. Prepare for a grand monetary reshuffling—a "Mar-a-Lago Accord," as the economist puts it—on some near tomorrow.

Miran is not just anybody. Pending Senate approval, he will chair the president's Council of Economic Advisers. He's laid out his plans for the new administration in a 40-page essay entitled "A User's Guide to Restructuring the Global Trading System."

Reading between the lines, *Grant's* detects the dubious influence of John Law (1671–1729) and, yes, John Maynard Keynes (1883–1946) along with the intellectual fathers of protectionism and national economic self-sufficiency. Missing are the constructive strains of, for example, Wilhelm Röpke (1899–1966), German economist and author of the cautionary 1942 volume *International Economic Disintegration*, and Daniel Webster (1782–1852), American politician and orator. It was Webster who, almost exactly two centuries ago, spoke against a pending tariff bill in the U.S. House of Representatives with these heartening words: "In this day of knowledge and of peace, there can be no commerce between nations but that which shall benefit all who are parties to it."

Has the "day of knowledge" come and gone? "The word 'tariff' is my favorite word in the dictionary," President Trump told his raucous fans at the Conservative Political Action Conference last Saturday. "You know," he said,

> we were the richest, relatively, from 1870 to 1913, because we collected tariffs from foreign countries that came in and took our jobs and took our money, took our everything, but they charged tariffs, and we had so much money, they set up the 1887—think of that long-ago time—the 1887 Tariff Commission. It was a commission of very important people to determine where we should spend all of the tremendous, vast wealth that we had. We had so much wealth. Wouldn't it be nice today? Of course, now we give it away to transgender this, transgender that, everybody gets a transgender operation. Just wonderful.



Or, as a certain Sir Thomas Smith put it in a distant age of error: "We must always take heed that we buy no more from strangers than we sell them, for so should we impoverish ourselves and enrich them." Smith, an Elizabethan polymath, wrote 476 years ago.

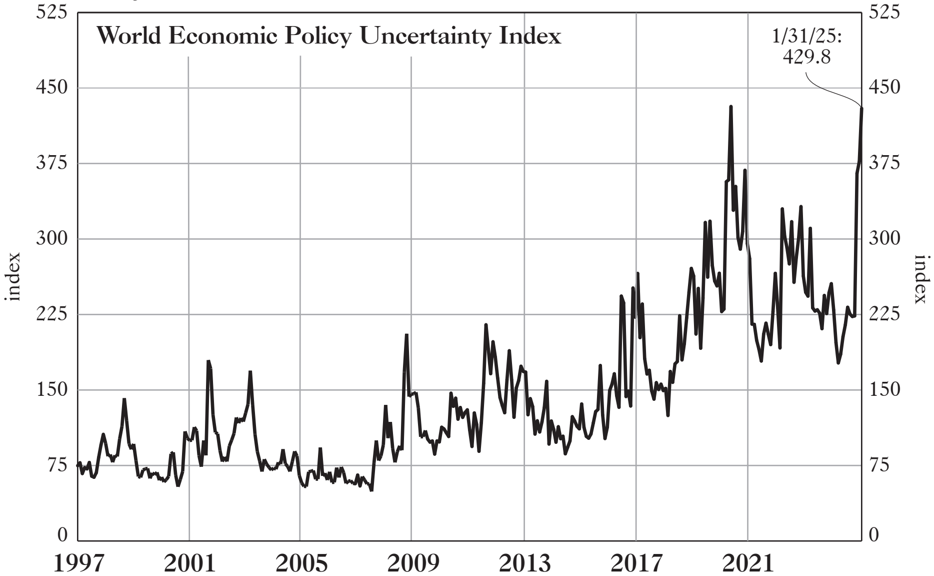
We write to remind the president's advisers about the risks they run with the options they present. Their advisee is a master politician. He is undoubtedly resilient, brave and tireless, but no one would call him reflective. On the evidence of a long career in business and politics, he will say anything and do many things.

Miran, one of whose proposals is a forced international debt exchange, may be inadvertently handing the commander-in-chief a loaded economic-policy pistol. Treasury Secretary Scott Bessent, with his broad hints of a gimmicky debt-for-equity swap, is similarly tempting a president who has a demonstrated weakness for magical thinking.

Yes, just as the advisers say, the "international economy" is in need of reform. The United States has been a chronic debtor on current account since 1982 (with a single time-out during the first Gulf War in the early 1990s). Perhaps, as Miran contends, the dollar is overvalued on a trade-weighted basis. And, no doubt, dollar-denominated interest rates are uncomfortably high for a variety of debtors, including the U.S. government itself.

However, the global trading system is as complex as it is imperfect. According to the Alliance

We just don't know



sources: Baker, Bloom and Davis (2012); National Bureau of Economic Research

of Automobile Manufacturers, any given auto part can cross the U.S. border seven or eight times before being integrated in the final assembly of an "American-made" vehicle. A moderate rise in tariffs may not inflict great harm, but there's no predicting the unintended consequences of a perceived hostile action on erstwhile friends (and confirmed adversaries). Neither Sen. Reed Smoot nor Rep. Willis C. Hawley intended to wreck the world economy, or contribute to that project, in 1930 with the aggressive tariff bill that made their names infamous. The world has changed, to be sure, but who can predict the dynamics of a trade war?

Miran acknowledges that some of his ideas might backfire—"many of these policies are untried at scale, or haven't been used in almost half a century"—but his audience of one is no close reader. A little like Trump, Miran denies that trade is necessarily a positive-sum game. Like Bessent and the former real-estate-promoter-in-chief, he wants to lower interest rates. The bond yield, like the exchange rate, is too high, he says. The remote cause of the problem is the dollar's reserve-currency privilege, he argues. It has worked to lift the trade-weighted dollar to heights that do America no good.

Standard doctrine has it that the reserve-currency franchise is a gift, not a burden. It dates back to the dawn of the Bretton Woods era at the close of World War II. However, the mid-20th-century-model dollar owed its worldwide stardom to something besides American power and might (and to the strength of the physically undamaged U.S. economy). Unique among the currencies of the world, the U.S. unit was convertible into gold at a fixed rate: $35 an ounce. Only sovereign holders enjoyed the conversion privilege, which President Richard Nixon summarily ended in 1971, but the golden anchor provided a measure of stability to the system, and luster to the dollar, for as long as the system lasted.

A half-century into the worldwide paper-money experiment, the greenback remains the world's first choice for invoicing and transacting in securities and merchandise alike. To Miran, this is a distinction without a benefit. Indeed, it has become a millstone, and he wants the rest of the world to help bear its weight.

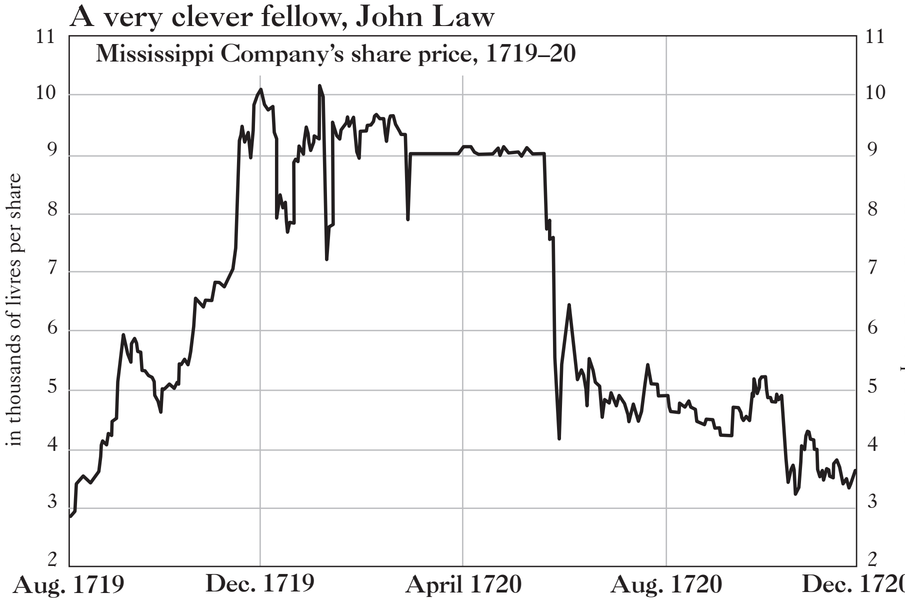
"From a trade perspective," the economist says, "the dollar is persistently overvalued, in large part because dollar assets function as the world's reserve currency. The overvaluation has weighed heavily on the American manufacturing sector while benefiting financialized sectors of the economy in manners that benefit wealthy Americans."

The confounding thing, Miran goes on, is that the demand for dollars is unshakable—"inelastic with respect to investment fundamentals"—on account of the reserve-currency privilege. In so many words, there is no alternative. His paper can be read as a how-to guide to devalue the dollar without acknowledging the intention to devalue it. Delicate work, indeed.

Miran does not forget President Trump's panegyrics of that very same reserve-currency status and his threats against any country, or bloc of countries, that dared to knock the dollar off its pedestal. The trick, then, is to square the circle: to discourage foreign central banks from holding the dollar; to discourage imports (or, at least, to tax them); to encourage exports; to push interest rates lower; and to reduce inflation, all without antagonizing the boss.

One could call an international monetary conference to engage America's allies and partners in the constructive

A very clever fellow, John Law



source: Prof. Steve H. Hanke, The Johns Hopkins University work of monetary burden-sharing. Alternatively—and this appears to be Miran's preference—the United States could take unilateral steps to the same end.

Then, Miran suggests, tax the coupon income of foreign holders of U.S. government securities. Call that tax a "user fee," so as not to fall afoul of international tax treaties. And dun the coupon income of America's adversaries more heavily than that of our remaining friends.

In step with the president, Miran supports the linkage of national security policy with a new kind of international monetary strategy, and he approvingly quotes the consulting economist Zoltan Pozsar:

> 1) Security zones are a public good, and countries on the inside must fund it by buying Treasurys;
>
> 2) Security zones are a capital good; they are best funded by century bonds, not short-term bills;
>
> 3) Security zones have barbed wires; unless you swap your bills for bonds, tariffs will keep you out.

So, 100-year bonds priced to yield not much and denominated in a dollar designed to lose 2% of its purchasing power every year. Who would buy them? Only a nation state eager to share America's security umbrella, which the Trump administration is fast folding.

Put yourself in the position of a recipient of the hypothetical Trump ultimatum. You see Pozsar's logic. But the concept of buying America's protection, or—a crucial distinction—the not entirely dependable promise of America's protection, sits badly. All things considered, might it not be cheaper, and less humiliating, to create one's own security zone or to seek cover under, say, China's or Russia's or maybe even Europe's?

Judy Shelton, the thoughtful almost-Federal Reserve governor, has long proposed issuing long-dated Treasurys bearing a gold-conversion feature. Taking up that still-worthy idea, Treasury Secretary Bessent could be sure of a livelier sale of the hypothetical century debt. John Law, not entirely in character, in his 1704 "Essay on a Land Bank," had this to say about fair dealing in sovereign debt operations: "There are ways now that may be effected without wronging the moneyed man or any other part of the people."

In America, today's new-new idea is economic nationalism. It was similarly fashionable in 1942, when the aforementioned Röpke issued his blast against it. World War II was in its early innings, and markets, borders, currencies, citizens—everything—were under rigid wartime control. How much better, Röpke reflected, was the internationalist system in place only a quarter-century earlier.

The pre-1914 world was "interdependent and intercommunicating," Röpke wrote. "There was a very close (horizontal and vertical) correlation of national markets which made the world market *virtually* a unit." You could almost say, the economist proceeded, "that the essential condition of economic integration, viz., unhampered 'arbitrage' (buying in the cheapest and selling in the dearest market), was practically fulfilled.... Customs duties, like transportation costs, were merely data in the otherwise free transactions which connected the national markets to 'world markets' and reduced national price disparities to a minimum.'"

Is this long-ago world beyond reclaiming? The reflex answer is no. Miran fails to mention the gold standard, the beating heart of the pre-1914 era, and there is indeed something undeniably anachronistic about a time-tested, universally acceptable, tangible monetary asset that cannot be nicked from a cold wallet by the beady-eyed coders of a hostile foreign power (see page 9). Certainly, John Law decided that he had discovered a more suitable monetary asset than gold or silver. Land was his big idea, a resource vastly more abundant than either precious metal. The credit of a land bank, he reasoned, unlike the credit derived from silver, "may be extended to the whole lands in the nation."

You'll recall Law as the too-clever-by-half pioneer in QE and financial repression who blew up the French economy in 1720 by monetizing the asset side of the balance sheet of the overleveraged French state. The debt-for-equity swap he organized proved irresistible to the holders of low-yielding French sovereign securities, and the resulting bubble in the equity interests of the Mississippi Co. made Law, for a giddy moment, the richest man on Earth.

At an Oval Office signing ceremony on Feb. 3 to mark the executive order allowing the creation of a U.S. sovereign wealth fund, Bessent waxed lyrical about the administration's plans to "monetize the asset side of the U.S. balance sheet for the American people. We are going to put the assets to work, and it's going to be very exciting.... It will be a combination of liquid assets, assets we have in this country as we work to bring them out for the American people."

Gold is the liquid asset par excellence, but "assets we have in this country" could easily be read as encompassing land. Of Law's favorite banking collateral, the federal government owns some 30%, or 650 million American acres. If we conjecture correctly, a Law-style land bank, and, perhaps a securitized land-for-debt swap, is in America's near future. A president who would annex Canada and the beautiful beaches of Gaza would hardly scruple at monetizing Yellowstone National Park. Careful, therefore, presidential advisers: What you propose might just happen. As for the investment implications of the above, let us be frank: Who the heck knows?

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