

RESEÑA DE *CRASH PROOF: HOW TO PROFIT FROM THE COMING ECONOMIC COLLAPSE*

DAVID HOWDEN*
ANTONIO ZANELLA*

It proves instructional for academic and professional economists to glance into each others' realms from time to time to see what new lessons can be gleaned. Peter Schiff's new book, *Crash Proof: How to Profit from the Coming Economic Collapse*, provides one such opportune foray. In fact, by outlining the source of the current crisis with solid economic theory Schiff is able to elucidate where the effective solution to the malaise should properly stem from.

The book is divided into three broad sections. The first concerns the international sphere, and demonstrates that real fundamentals have been slowly eroding within the American economy placing it at a structural disadvantage with its trading partners. The second focuses on the domestic situation of the American economy, specifically the numerous bubbles in financial assets that have falsely benefited, and now plague, the American investor. The last, and arguably the least imperative section, looks to the future and specific avenues investors can pursue to maximize their wealth and financial well-being.

Schiff's pessimistic tone (earning him the nickname *Dr. Doom* among CNBC pundits) has proven to be extremely prescient over the months since the book originally debuted. By demonstrating that financial analysis rooted in sound economic theory can boast accurate predictions, hope has been given to economists who have been plagued by much shoddier results of late, by much more academically esteemed colleagues than Mr. Schiff would normally be considered. This book may do much to change that.

* Universidad Rey Juan Carlos.

I

A REVERSAL OF FORTUNE?

Schiff dispels the much-ballyhooed myth that America's shift from a net creditor to a net debtor nation has been due to strengthening competitiveness in the international arena, and that it is a signal of future prosperity. Much of the first section of the book (roughly chapters one through four) concerns itself with effects manifesting in the real economy placing American industry at a disadvantage to its foreign peers. Two points stand out above all others.

Schiff first tackles inflation, demonstrating that it is harmful to view solely as rising prices. Instead, this is the result of an increase in a more fundamental root – the money supply. As the money supply has been inflated over the past century, unintended consequences have resulted. The price increases in the more commonly used CPI and PPI do not reflect extreme valuation increases now evident in the stock and real estate markets. Schiff effectively builds off Machlup ([1940] 2007) by pinpointing the assets that this fresh monetary injection can settle in may breed detrimental long-term effects.¹ Next, implicitly using Menger's (1871) imputation theory of value, Schiff aims to dispel some of the more prevalent myths concerning inflation's causes – cost-push, demand-pull, or the wage-price spiral as examples. He pinpoints with clarity that these are particular effects of a much more fundamental problem given by an increasing money supply. In a pertinent piece of history-revisionism, Schiff shows that the inflation of the 1970s was not caused by increasing input prices as is commonly assumed, but that these were rather the consequence of an expansionary monetary policy under the Nixon administration. If one can fault Mr. Schiff on any point in this analysis, it is his persistence in using the now discontinued M3 as a proper metric for the monetary expansion. Rothbard (1978), Salerno (1987) and Shostak (2000) have done much work to replace this measure with the more relevant *Austrian Money Supply* (AMS) as a gauge of true monetary expansion.

Second, implicitly using Austrian Business Cycle Theory (ABCT), the particular causes of the current recession are identified.² Money, acting as a Hayekian (1941, p. 408) loose-joint, has allowed an artificially

¹ See also Bagus (2008, p. 292) to the effect that *where* fresh fiduciary media settle is as pertinent to the boom as their *mere* existence in the first place.

² On Austrian Business Cycle Theory (ABCT) see: Bagus and Howden (2009), Garrison (1994; 2001), Hayek (1931), Huerta de Soto (2006), Hülsmann (1998), Howden (2008), Mises (1998), and Rothbard (1975; 1993). For the connection between ABCT and asset price bubbles see Bagus (2007; 2008).

induced demand to embrace the market and create an illusion of prosperity via an inflating asset price bubble. The *artificialness* of this demand is key however, as goods are produced with reduced heed to the true fundamental causes of the fresh demand; the end result can only be the general elevation in the price level. Once the true state of affairs is seen behind the guise of the inflationary expansion, entrepreneurs and consumers are able to see that resources were never available to sustain the previous levels of production/consumption. A *healthy* recession sets in which corrects the imbalances bred from the previous expansionary period. Mr Schiff correctly identifies that the current quagmire serves a necessary market-clearing role in removing the previous excesses, and correcting the real imbalances that were caused by the boom.

The combination of these two factors creates uneasiness about the US economy. However, Mr. Schiff would do well to see the trees through the forest, and take a comparative approach to his analysis. Concluding that the American economy is on shaky structural grounds can be taken as absolute, but the dollar predicament he foresees must be viewed relative to other competing global currencies. The rate of growth (the main issue reared against the dollar) of the greenback has remained quite consistent, *if not conservative*, relative to other major global currencies.³ We find the dollar's past not so different from other currencies; perhaps the outlook on its future should be reassessed accordingly.

II

LET SLEEPING BEAR MARKETS LIE

Section two (roughly corresponding to chapters five through seven) concerns the domestic investment bubbles that have since collapsed in the American economy. Writing primarily about the recently popped real-estate bubble it is shown how effects in the analysis detailed previously have caused unsustainable valuations to arise in the domestic markets.

Paired with the monetary inflation has been a decline in lending standards leading to further leveraging, and hence inflation, in the housing market. Specifically, the maturity mismatching promoted through adjustable-rate mortgages (ARMs) has been aided by the inflationary

³ Although differences in central bank measures and reporting lead to questionable accuracy, the following most recently posted growth rates should serve as approximate proxies: British Pound M4: 13%, Euro M2: 9.3%, Canadian dollar M2++: 8.5%, US dollar M2: 7.4%.

environment to create an unsustainable situation which otherwise would not occur, a point recently raised in Bagus and Howden (2009). The danger of ARMs is now quite well known. Schiff, writing before the popping of the bubble, was able to foresee their complication and disentangle the mess, a performance in analysis still unparalleled concerning the housing bubble. Previous (unfortunately current with some analysts) justifications for the housing boom are dealt with speedily. Demographics as a necessity for rising valuations, for instance, are proven to rest on shaky theoretical ground. Much of the increased demand has not been through a demographic shift, as so many would lead us to believe, but through a decline in the occupants per household. This is a product of affluence through *perceived* wealth, not real underlying fundamental wealth growth. As this perception could, and indeed is, changing presently, we see that the temporary nature of this demand become apparent. None could sum the situation better than Schiff himself: «[T]he heart of the real estate bubble has been speculation, pure and simple, caused by all the factors we have been discussing, which can be collected under the rubric of monetary mismanagement» (p. 133).

In a general sense, popped bubbles do not reflate again when left to their own devices. Any effort to reflate the recently popped housing bubble will culminate with unintended consequences; likely the inflation of a bubble elsewhere. Schiff, relying on conclusions drawn from his application of ABCT to this specific case, leads him to protest further attempts to keep this bubble alive. In fact, this part is where Schiff clearly differentiates himself from other recent books looking at the current crisis (i.e., Shiller 2008). Not only is Mr. Schiff's prescription out of this turmoil superior to others', his analysis of the problem is deeper as well. For instance, ancillary issues to the housing bubble are analyzed (i.e., the rental market) which are ominously absent in Shiller's recent work. Unlike Shiller, Schiff does not bifurcate by advocating solutions to the problem that have previously been identified as the source of the problem (see Bagus and Howden, forthcoming). Instead, a logical consistency is maintained throughout the work that yields impressive results and clear solutions to the passing crisis, and emerging boondoggle.

III

WILL THE MARKET REMAIN RATIONAL LONG ENOUGH FOR MR. SCHIFF'S SOLVENCY?

Our main fault lies with the final section which prescribes actions for investors to take to weather the storm. Mr. Schiff's insistence on a flight to foreign assets has proven a poor option over the past year if it were

followed strictly. Time will tell if he will emerge victorious, but the question remains: Will the market return to rationality in time for Mr. Schiff to remain solvent? It is no doubt that the recent action in the currency markets has occurred contra to what readers of *Crash Proof* would expect. However, as Schiff himself readily admits on several occasions, this book is not about timing, it is about a result which *must* obtain. Many sympathizers with his viewpoints will draw a similar conclusion concerning the fate of all expansionary fiat currencies. Time will tell if they will be vindicated or eliminated from the market.

IV CONCLUSION

Although arguably of greater importance to the reader prior to the current turmoil's onslaught, *Crash Proof* still provides the standard in analyzing the current market environment and is rich in fodder for all. Business professionals will do well to listen to Schiff's analysis, both unbiased in its approach and clear in its delivery. Oft confused concepts are disentangled providing an excellent road map of the exceedingly complex financial situation. Academics will benefit by seeing what research is being used by market professionals to successfully weather the financial storm. The true test of theory is its ability to accurately and easily further understanding of the world we seek to describe. While we cannot agree with every angle Mr. Schiff has taken on the current situation, we happily greet the clarity with which this market professional has applied pure theory to navigate the current turbulence. If only others could take note and proceed accordingly.

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