THE FREE MARKET

THE MONTHLY PUBLICATION OF THE MISES INSTITUTE

# The New Skyscraper Curse

## An Interview with Mark Thornton

*From CNN to* Barron's *to* Le Monde*, Mark Thornton has been featured as an authority on how record-setting skyscrapers signal impending economic downturns. Last month, Dr. Thornton spoke with us about the Skyscraper Index and the Skyscraper Curse.*

***Mises Institute:*** The Skyscraper Index, which shows a correlation between the construction of the world's tallest buildings and economic busts, was created by economist Andrew Lawrence in 1999. In 2007, you used the index with Austrian business cycle theory to identify the economic downturn that followed. How does Austrian business cycle theory explain the index?

***Mark Thornton:*** Record-setting skyscrapers are a prominent example of how distortions in interest rates (i.e., actual rates below "natural" rates) alter the economy's structure of production in an unsustainable

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manner, but obviously it is not the building of a very tall building that *causes* an economic crisis. The most general impact on the economy is that the structure of production is reoriented toward longer run and more roundabout production processes. Record-setting skyscrapers usually require a multitude of new technological processes and systems all of which have to have their own production, distribution, installation, and maintenance systems. This is symptomatic of the entire economy in an artificial boom.

Another general impact on the economy is an increase in the amount of investment and consumption, and a decrease in saving. This means that balance sheets of businesses become relatively more leveraged and thus firms become more susceptible to failure. With skyscrapers and related markets there is a large increase in capacity, namely, the amount of office space and related services means that expected future prices are unlikely to be achieved and therefore expected profits will not be achieved and losses will increase. Once boom has turned to bust, the existing capacity to produce new extremely-tall skyscrapers will greatly exceed demand for producing skyscrapers, and profit margins will be squeezed tight for the construction and materials firms that survive the bust.

***MI:*** So how can we know if a tall building is a sign of an economy-wide problem?

***MT:*** My first detailed article on the Skyscraper Index was published in 2005 and, the first major test was the housing bubble in the United States and elsewhere. In 2007, I identified the record-setting new skyscraper in the United Arab Emirates (now known as the Burj Khalifa Tower) as a possible skyscraper *crisis signal*.

Skyscraper *Alerts* are given when "ground breakings" occur on construction projects that are projected to break world, continental, and national records. In contrast, skyscraper crisis signals are given when construction actually exceeds the previous record. The distinction between the two recognizes that not all such projects will be completed as planned.

It was at this same time that the U.S. stock market reached its peak and began to roll over. The housing market which had been strong for many years finally stalled and then began to turn negative in terms of housing starts, housing sales, and housing prices. Mortgage financing companies began to falter and fail. Employment in the construction industry began to decline quickly. I even found that illegal immigrants from Mexico had started to return home because of a lack of jobs. A nascent recovery or correction from the boom had begun in earnest by the end of the year.

However, by January of 2008 the Federal Reserve had begun to take actions beyond the traditional scope of Fed policy. They went beyond the typical policy moves of cutting the federal funds rate and discount rate and embarked on a long series of unprecedented policy moves designed to bail out the large banks, supposedly with the purpose of preventing contagion effects in the broader economy. The U.S. Treasury was also very active in attempting to bail out the economy in a rather unorthodox approach.

***MI:*** So it doesn't look like record-setting skyscraper construction has stopped.

***MT:*** In 2009, Dubai began to experience financial trouble and had to delay payment on its debt to finance the Burj Khalifa Tower. When the Tower officially opened in January of 2010 the sovereign fund of the United Arab Emirates, which built the skyscraper was broke and had to be bailed out by the sheikh of Abu Dhabi for $10 billion.

CNN reporter Kevin Voigt took note of my research on this in 2010, and reported that I had predicted "tough times" for the emirate in 2008.

The next major Skyscraper Signal was of the regional or continental variety. When the Shard building in London

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# How Carl Menger Put Consumers at the Center of Economic Science

CHRISTOPHER WESTLEY

One of my favorite economists in the history of economic thought is the great Austrian, Carl Menger (1840–1921). While the mainstream of the economics profession acknowledges Menger's place due to his contribution to the Marginalist Revolution in the 1870s, it otherwise ignores him because his theoretical framework does not lend itself to policy prescriptions. In an era in which the economics profession largely views itself as a shadow branch of government which is itself charged with managing the economy, thinkers like Menger (and those who work in his tradition) are not going to be extolled or studied in the same way that thinkers like Irving Fisher, John Maynard Keynes, Milton Friedman, or Paul Krugman have been.

This is true if only because the government tends not to fund academics or economic schools of thought that do not promote its central role in the economy or provide economic justifications for its interventions in market forces. Absent this connection, the study of Chicago-School Monetarism or Ivy-League Keynesianism would have much less prominence in economic science today.

Menger's theoretical framework differs from so many of the modern interpretations of economics because he represented the culmination of a pre-Progressive Era development of economic thinking that had occurred over centuries, mostly in continental Europe by scholastic thinkers in the Middle Ages as well as French liberals such as Turgot, Cantillon, and Say. Such people may have studied economics as a form of what was known as the Moral Sciences in the nineteenth century, but their impetus for doing so was often due to the innate human desire to better understand the world and the natural laws that govern it. Their interest was in economics as economics, and not simply as a policy tool to make government appear more scientific, efficient, or benign. (Government is actually the exact opposite of these things.)

So to study economics as a science, pure and simple, especially in an era in which it seems economic confusion reigns, it is not a bad choice to start with Carl Menger.

Menger was born in Galicia, a then-Austrian region that is now in Poland, to a wealthy family with roots in Bohemia. During breaks from the study of law at the Universities of Prague and Vienna, Menger worked as a financial journalist who developed some degree of prominence for writing novels and comedies that were serialized in newspapers.

It was during his time as a journalist that Menger first noticed the significance of the discrepancies between Classical economic doctrines on market phenomenon and the actual business market that he covered over the course of his profession. Soon after receiving his law degree from the University of Krakow in August 1867, Menger embarked on the formal study of political economy in an attempt to better understand and resolve

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# Mises Scholar and Alumni Notes

CEO and Chairman **LEW ROCKWELL** was interviewed in January by Ron Paul about the future of the Mises Institute on the Ron Paul Channel.

Mises Institute President **JEFF DEIST** was interviewed and featured on the Ron Paul Channel in January; Jeff discussed his new role at the Mises Institute on *Power Trading Radio* in March; and discussed the economics of foreign policy with Alan Butler on the *Butler on Business* show in March.

PASCAL SALIN

**SENIOR FELLOW PASCAL SALIN** in January published a new book, *La tyrannie fiscale* (Tax Tyranny) and an additional short book, *Libérons-nous* ("Let Us Be Free"); in March, he published an essay on monetary policy, "Que peut-on demander à la politique monétaire?" with the Fondation pour l'innovation politique; Dr. Salin was also awarded an honorary doctoral degree from the University Alexandru Ioan Cuza of Iasi (Romania) in November 2013; he was interviewed for several French newspapers and magazines (*Le Monde, Le Figaro, L'expansion, Le Point, Le Figaro-magazine*) during early 2014; between September 2013 and March 2014, he delivered lectures in Liechtenstein, Torino, Paris, Lasi, Vilnius, London, and Moscow.

ROBERT HIGGS

**SENIOR FELLOW ROBERT HIGGS** published "State-led Humanitarian Aid: Another Case of 'Government Failure'" in the December 2013 issue of *The Review of Austrian Economics*; he published "The Salmon Trap: An Analogy for People's Entrapment by the State," in the spring issue of *The Independent Review*; he presented "Civil Liberties and the National Security State," at The Future of Freedom Foundation in Washington, D.C. on February 15; he was interviewed by Caleb Brown for the Cato Institute podcast on February 17; he was the guest for the Q & A Luncheon at the Capitalism Club at the Western Kentucky University on February 24; he was the keynote speaker at the Spring Political Philosophy Conference at Lindenwood University on March 21; he presented "Liberty, Privacy, and the Security State," at the Institute for Humane Studies on March 29.

GUIDO HüLSMANN

**SENIOR FELLOW JÖRG GUIDO HÜLSMANN** was received as an ordinary member into the European Academy of Sciences and Arts, at the Academy's annual festive plenary meeting in Salzburg, Austria on March 8.

A new and revised edition of **ASSOCIATED SCHOLAR BRENDAN BROWN**'s book *Euro Crash: How Asset Price Inflation Destroys the Wealth of Nation*s was released in February and features a new foreword by **SENIOR FELLOW JOSEPH SALERNO**. Dr. Salerno also spoke with Redmond Weissenberger on the *Better Red Than Dead* podcast, discussing monetary policy.

EDWARD STRINGHAM

**INSTITUTE FRIEND AND SUPPORTER CHRIS RUFER** produced the short film *The Conversation* featuring a discussion explaining the foundations of libertarian views of the state.

BENJAMIN POWELL

**MISES UNIVERSITY ALUMNUS PROFESSOR EDWARD STRINGHAM** will be joining the faculty at Texas Tech University and teaching Economics of Entrepreneurship at the undergraduate and doctoral levels in the fall. He will be working at Texas Tech's recently-created Free Market Institute, headed by **ASSOCIATED SCHOLAR BENJAMIN POWELL**, which welcomes doctoral students interested in advancing ideas of Mises, Hayek, Rothbard, and others.

ROBERT MULLIGAN

**ASSOCIATED SCHOLAR ROBERT MULLIGAN** co-authored two new articles forthcoming this summer: "An Empirical Examination of Minsky's Financial Instability Hypothesis: from Market Process to Austrian Business Cycle," in the *Journal des Économistes et des Études Humaines* (coauthored with Roger Lirely and David Coffee) and "Multifractality of Sectoral Price Indices: Hurst Signature Analysis of Cantillon Effects in Disequilibrium Factor Markets" in *Physica A.*

**CARL MENGER**
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these discrepancies—an effort that resulted in the 1871 publication of *Principles of Economics*.

While Menger recognized that the Classical economists had made significant contributions to the development of economic theory, he believed one of their primary shortcomings was in their analyses of the consumer, a shortcoming which was perhaps epitomized by the Classicals' emphasis on the labor theory of value and their rudimentary and even shallow price theory that explained prices as phenomena resulting mostly from the economic calculation of businessmen. Menger's primary contribution in *Principles* was to insert the primacy of the consumer in determining value and (by extension) price, not only in the marketplace but in all economic activity.

The Mengerian approach, which we today call the science of praxeology, emphasized the importance of individual human action resulting from the desire to satisfy felt needs and the relationship of those needs to the external world. Having a felt need, and the knowledge that the external world possesses some characteristics that allow the individual to satisfy it, provide the basis for logical human action and the *subjective* valuation of goods and services both within and apart from the market. Menger further noted that as our knowledge about the external world changes, so do individually-felt needs. Efforts to satisfy felt needs presuppose recognition of cause-and-effect relationships that provide the basis for all of human action.

Note how completely irrelevant such a framework is to modern adherents of the Keynesian or Chicago Schools. The major difference is that both schools view the individual person (or actor) as an object that needs to be manipulated in the name of policy success. For Chicagoans, this success is based on market outcomes that are closer to their pre-conceived ideals regarding market efficiency, while for Keynesians, this success is based on the achievement of arbitrary short-run employment levels that are achieved in practice by penalizing saving and rewarding consumption. To both schools, the human person is a cog in an economic machine that must be coerced to act in ways that make their systems work. Such a view is modern—its roots are in the Progressive Era—and contrasts with economics as it developed from Aristotle through Menger (and beyond through those who developed Menger's system).

But in the 1870s, Menger boldly applied its implications to the determination of value. He noted that since goods are external to the human person and recognized subjectively as possessing qualities that allow for need satisfaction, they could be differentiated between goods of different order. In *Principles*, he described first-order goods as being goods that we consume to satisfy needs. These are consumption goods.

Second-order goods are goods required to produce the first-order good, so that while a car may be a first-order good satisfying a felt need for transportation, the second-order goods would include the glass, rubber, chrome, and all the other inputs which make up the car. The third-order goods are all of the goods that are required to produce the second-order goods, and so on, with more complex forms of production being characterized with more distant orders of production.

Nonetheless, the values of all of the goods of whatever order are derived from the initial subjective desire on the part of the individual to satisfy a felt need, so that rubber has value not in itself or in the work effort going into its production, but because of the initial human desire for transportation, leading to a human preference for cars. This understanding of goods contrasted greatly with the Classical economist's notion that the value of economic inputs is based on their technical usefulness in production. Menger's value theory represents an expansion of Say's Law that supply creates its own demand, and is the proper theoretical response to the monetary and credit cranks (of Menger's time as well as today) who see no difference between government-created and -directed capital and privately-created and -directed capital.

In truth, government-created capital satisfies the needs of the political classes and the special interests connected to it, whereas privately-directed capital is directed at the satisfaction of consumer wants.

Absent the state's influence in the development of twentieth-century economic thought, it is likely Menger would be known today as an important Classical economist who corrected known shortcomings of the Classical School, and it would never have been deemed necessary for Classical economics to morph over time into various neoclassical schools characterized by tools appropriate for the hard sciences.

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**SKYSCRAPER CURSE CONTINUED FROM PAGE 2**

surpassed the 1,000-foot mark, it set a new skyscraper record for Europe. At the time, the Eurozone crisis had already started to be revealed in some of the smaller nations of Europe, but major European stock markets and the euro were generally considered strong. By the time the Shard building officially opened in July of 2012 the Eurozone crisis was clearly evident with the sovereign debt crisis striking the PIIIGS (Portugal, Italy, Iceland, Ireland, Greece, and Spain).

There was also a spreading concern over the future of the euro. More recently there has been the banking crisis in Cyprus and the widening uncertainty surrounding Germany's request to have some of its central bank gold reserves returned from New York. In the wake of the forthcoming bailouts, in 2012, I reported that most European stock markets and sovereign debt problems have been papered over, but overall debt levels and unemployment rates have remained dangerously high.

The next skyscraper event occurred in the U.S. when One World Trade Center reached a record height in May 2013. Strictly speaking, the record-setting status is ambiguous since the building's record height depends on the inclusion of its very large antenna. Nonetheless, we'll know in 2014 if One World Trade Center can be considered a crisis signal or not, practically speaking.

The last Skyscraper Signal occurred in 2013 in China where the Shanghai Tower became the country's tallest skyscraper. The Associated Press reported the Tower surpassed the Shanghai World Financial Center that set the national record in 2008, which itself was a Skyscraper Signal for the 2008 economic crisis in China. So far this latest national signal has been accompanied by a declining stock market and widespread concern over declining rates of economic growth and the recent change in political leadership.

Finally, the latest Skyscraper Alert was also recently issued in China. Ground breaking ceremonies recently took place on what is planned to be the world's tallest skyscraper called Sky City. This project is noteworthy because of the remarkably short construction schedule due to the company's pre-fabricated construction process. On-site construction, however, has recently been delayed until April 2014.

***MI:*** Where does this all lead?

***MT:*** The confluence of regional Skyscraper Signals in Europe, North America, and China along with a Skyscraper Alert for a world economic crisis clearly suggests the possibility of a looming world economic crisis. This pattern would be very much like previous episodes of skyscraper records including the Panic of 1907, the Great Depression, the stagflation of the 1970s, the dot-com bubble, and the housing bubble. In line with these skyscraper-based predictions, a fundamental case can be built around the notion of a looming world economic crisis. Most of the world's major economies are facing pressing economic difficulties, including the U.S., Europe, Japan, and China. Additionally, central banks have been engaged in a world currency war on a scale that has never been experienced in human history.

Mark Thornton is Senior Fellow at the Mises Institute. His publications include *The Economics of Prohibition; Tariffs, Blockades, and Inflation: The Economics of the Civil War; The Quotable Mises; The Bastiat Collection;* and *An Essay on Economic Theory.*

# In Memoriam

The cause of liberty and the Mises Institute in particular lost some very good friends in 2013. We mourn the passing, but celebrate the lives and achievements, of these great men. Their far-sighted concern for the future of freedom will always inspire us:

**Mr. Victor E Manning** passed away on November 11, 2013. Mr. Manning was a Charter Member of the Mises Institute and a tax attorney in Texas.

**Mr. Al V. Scott** of Abilene Texas, Charter Member of the Mises Institute and baseball enthusiast, passed away on October 6, 2013.

# COMING EVENTS

Register online at mises.org or by phone at 800.636.4737.

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|---|---|
| June 8–13, 2014 | ROTHBARD GRADUATE SEMINAR • Mises Institute |
| July 20–26, 2014 | MISES UNIVERSITY • Mises Institute |
| Jan. 24, 2015 | SOUTHWEST REGIONAL MISES CIRCLE IN HOUSTON |
| Mar. 12–14, 2015 | AUSTRIAN ECONOMICS RESEARCH CONFERENCE • Mises Institute |

# Thank you

to John Muller, founder of Laissez Faire Books, for providing this sketch of Ludwig von Mises which appeared on the cover of their Fall 1981 book catalog.

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