Bizantine Capital

# The Macroeconomy

Where We Are, and Where We're Going

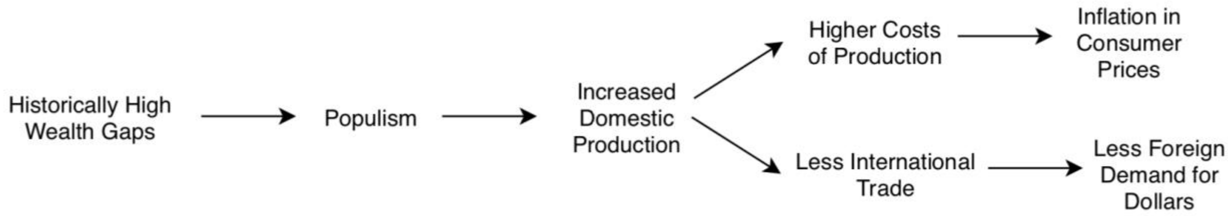
**The Current Regime**

In the past ten years, a decade primarily of open, globalized trade, Europe, China, and emerging countries combined to double their outstanding dollar debt from $30trn to $60trn [1] (Total outstanding global debt is approaching $260trn, for reference.). These countries grew their dependence on the dollar because, put simply, it was the optimal decision for both parties in the debt transaction process: buyers of debt (dollar exporters) sought to denominate their returns in the most liquid, stable currency, while sellers of debt (dollar importers) preferred to receive loans in dollars because A) the dollar has the most liquidity when they trade abroad and the second most liquidity (to their domestic currency) when they trade locally, and B) these countries and corporations held trade surpluses with the US, thus rendering the belief that they would acquire plenty of dollars to pay back their dollar-denominated debt (European and Asian countries run the largest trade surpluses globally, while the US runs the largest trade deficit.).

However, in times of crises, as we are in now, the demand for USD rises significantly because A) global trade collapses, consequently eliminating these countries' USD trade surpluses, and B) countries/corporations with outstanding USD debt require USD to avoid defaulting. These countries experience the downside of their dollar dependence, as their ability to maintain solvency rests on the decisions of a foreign entity with incentives different from their own, the US's central bank (the Federal Reserve, herein referred to as 'The Fed'). The Fed has the privilege of playing god in this scenario, deciding which companies domestically and which countries abroad to save from the bankruptcy restructuring process. The Fed issues the corporations it wants to save generous loans and the countries it wants to save generous swap lines.

As Charlie Munger famously said, "Show me the incentives and I'll show you the outcome." The Fed is incentivized to always take care of its own corporations/people first, and its allies second, and then, if at all, its enemies third. Thus far, the Fed has decided to help every American company under the sun, Europe, Brazil, South Korea, Mexico, and other allies, while neglecting India, Indonesia, Turkey, South Africa, Thailand, and nearly all non-G20 countries, the countries that will need the most help. Being the reserve currency is the greatest strength for any country: in times of stress, you can't fail; in fact, you strengthen relative to the other countries, as you both get to pull the lever that stimulates the global economy *and* decide who gets that stimulus.

The Fed and their friends win. The Fed's enemies lose. The difference between the rich and the poor widens, both between rich Americans and poor Americans (due to domestic corporate bailouts) and rich countries and poor countries (due to which foreign central banks qualify for swap lines). Even before the Coronavirus, America was nearing historically high wealth gaps; the Fed's actions will take us to historically high wealth gaps [2]. As discussed more later, historically high wealth gaps will play a prominent role in the dollar's decline, by leading to populist policies that both generate inflationary pressures domestically and decrease foreign demand for dollars.




**A Rising Power**

While American populism is an adequate course of action for the American working class, it further neglects the countries that the Fed has neglected in this most recent round of quantitative easing. However, the world will not end for these countries that the Fed does not assist; these countries will instead find a helping hand in China. China has enough current economic power and enough projected economic growth to challenge America's dominance: the country is extremely well-positioned for the future, due to its large cash reserves, relatively low debt to GDP ratio (~50%, while the US's exceeds 100%), competent government (as exhibited by its handling of the Coronavirus; their economy has already reopened), and high growth projections (as exhibited by its prime interest rate, ~4%, significantly higher than those in the West). All projections point to China's GDP exceeding the US's GDP at some point this decade [3].

China's goal to challenge the dollar is no unkept secret, and neither is the intelligence and competence of their government, the CPC. A substantial portion of the loans that the CPC will issue to distressed countries (that the Fed ignores) will need to be converted into dollars, thus diminishing the value of the RMB in the short-term. However, the CPC will be willing to devalue its currency in the short-term for its long-term benefits, as they've done in the past to increase the country's trade exports; only this time, they will be devaluing their currency to increase the country's capital exports. The CPC's long-term bet/agreement with these countries will be that these countries increasingly issue debt/capital products denominated in RMB, further elevating the RMB's status as a reserve currency.

A helping hand in a time of need is the best way to build trust, and China's greatest problem in its quest to become a reserve currency has been outsider trust in its insider-heavy central government. While the CPC has already begun to build with the Belt and Road Initiative, China can build significantly more trust with the countries the US neglects by being there for them now. The rise of China and its desire to supersede the dollar will give the countries that the US ignored a viable option out of the dollar system [4].

Thus, it is likely that hyper-dollarization continues in 'Western countries', but that hyper-RMBization begins in 'Eastern countries' [5]. The transition from hyper-dollarization as exists globally today to a world divided in two, with two currency Pareto distributions, will not be smooth. It will create immense inefficiencies, manifested in what will be known as the World Trade War. However, these inefficiencies are not without cause; in fact, along with populism, they are desired by the middle and working class.

**A War with a Cause**

The 2020s appear eerily similar to the late 1930s/early 1940s: 1) interest rates sit near 0 across reserve currencies [6], 2) nearly all countries' debt to GDP ratio is at an all time high [7], 3) domestic wealth inequality is at historical highs, and 4) there exists a rising global force determined to challenge the world order (Germany then, China now). As in the 1930s, global sentiment is shifting from globalization to populism. History doesn't repeat; it rhymes.

There are two forms of populism: hyper-populism and select-populism. Hyper-populism entails the manufacturing of all essential goods domestically; select-populism entails producing a meaningful fraction of essential goods domestically and the rest from select allies via trade agreements. Hyper-populism is a fully-planned domestic economy, while select-populism is a fully-planned international economy.

In the World Trade War, hyper-populism is an unlikely outcome. Both hyper-populism and select-populism require large upfront national investment via the incentivization of building of new factories, as well as developing new energy infrastructure to power these factories and new transportation infrastructure to optimize the movement of the goods from these factories. However, hyper-populism would require significantly more investment than select-populism, and thus governments will be unwilling to commit to hyper-populism from the outset. Additionally, select-populism, while still producing inflation, helps contain hyper-inflation, as allies can turn to each other for products that each has a competitive advantage in. It should be noted, however, that the ability to perfectly control inflation will be very difficult in a volatile environment, which a paradigm shift from international to domestic manufacturing would create.

Select-populism (aka The World Trade War), the most likely outcome both in in the West and East, will proceed as follows:

- Trades with allies will follow a semi-free-market approach, with allies buying goods from each other without tariffs; there will be some degree of planning between allies, to best optimize this new world order.
- Each side of the War will have their own reserve currency, the dollar and the RMB.
  - While the allies of each side would prefer to have their currencies as reserve currencies, Pareto distributions are the optimal outcome due to their reduced friction in transacting [8].
  - Because the US and China are far wealthier than their allies, their allies and their allies' corporations will have the ability to issue debt in dollars and RMB. This has the benefits of attracting capital from public and private institutions in the US and China, thus allowing for the necessary localized infrastructure development to happen globally.
- Trade with enemies could be allowed, but with negative repercussions for the importer and positive ones for the exporter: automated market makers (link to first article) will

facilitate cross enemy-line trade, with the exporter programmatically selling the importer's currency for their own currency or their ally group's reserve currency. The weakening of one side's currency as well as likely tariffs will heavily disincentivize trading with the enemy side. However, there may be some resources or goods that simply cannot be found anywhere else, and so these transactions may still happen on occasion.

America has optimized for efficiency via technology and globalization, but introducing inefficiencies via a large-scale trade war will be America's only way to grow out of its economic standstill (deflation, unprecedented debt, a historically high wealth gap) while also combating the rise of the greatest threat to America's global dominance in modern history (China). America's allies are in similar positions. In fact, they are in even worse positions; however, because America sits at the top of the totem pole, it is its decisions that ultimately determine 'the West's' course of action [9].

**Inefficiencies**

A World Trade War has significant negative effects for corporate shareholders (those whose profits will be substantially cut), as well as the wealthy more broadly (as inflation reduces the real value of the debt they are owed via bond products). Due to the American wealthy's current symbiotic relationship with American politicians, is there an alternative option to be pursued by those in power?

**An Alternative**

The wealthy's theoretical best option is to further increase corporate profitability via further optimized globalization and technology (thus eliminating the potential of significant inflation caused by populism) and to instead tax personal and corporate income more significantly [10], directing those funds to citizens directly through universal basic income (UBI) or large-scale government healthcare and education programs (bottom-up UBI would be a better option, as then families could choose how to spend their cash as opposed to the government deciding for them.).

However, this outcome is less likely. America's corporate profitability to GDP ratio is already significantly higher than its historical average and the processes required to raise it higher, namely automation and/or additional outsourcing of jobs, would require further restructuring in American employment and thus require even larger social programs (meaning the gains in profits would be offset by costs of those profits on the American population). Additionally, it will be extremely difficult for corporations to generate profit growth in a deflationary environment: even if corporations can further optimize their supply chains via automation and globalization, the demand side must be met by consumers who have money; with 60% of Americans living paycheck to paycheck, along with the recent realization that their paychecks could disappear overnight, it is unlikely that demand returns to normal any time soon (expect the middle class to focus more on essential purchases, savings, and paying down debt).

The counter-argument would be that corporate profits grow large enough to pay for social programs/UBI that allow consumers to meet demand. Due to how expensive these programs would need to be for this to be the case (at least $5trn per year in additional government spending per year, likely more), it is pretty much impossible for corporate profits to pay for these programs and make any meaningful dent on the unprecedented levels of both public and private sector debt [11].

Thus, it appears that the World Trade War is the best option for America: it solves the problems at home and mitigates China's rapid growth. Taxes will still need to be raised significantly, as the bill for the War will be steep due to the infrastructure development required and the debt needed to be repaid. The combination of taxes and inflation to both pay back and devalue debt will be preferred over the extremes of either 1940 levels of taxation or hyper-inflation [12].

**How It Ends**

All wars end; the World Trade War will too. Debts will be paid back (or forgiven, in some form of beautiful deleveraging); domestic wealth gaps will be reduced; interest rates will be lifted. The two sides will come together, knowing that the benefits of free trade, in good times, are too great to live separately. China's GDP will be higher than the US's (India's may be too), but the West will not be willing to submit to a new reserve currency controlled by an authoritarian regime, and the difference in GDPs won't be enough for China to force the West to submit, as the West will tout their fully functioning economy that no longer needs the East. Instead, the two sides will reach the Nash equilibrium, a solution where neither side loses, a non-sovereign reserve currency, a fully digital, fully programmatic neo-gold standard, the Ether standard.

**Endnotes**

[1] Some estimates suggest these numbers are at half these levels. It's extremely difficult to give perfectly precise numbers because a significant portion of foreign dollar (Eurodollar) debt is held by shadow banks. If only there was a universal ledger where all of this data could be completely transparent!

[2] The further increase of an already historic domestic wealth gap in America is triggered by mass unemployment and, simultaneously, mass corporate bailouts that benefit executives and managers.

[3] It won't be all bright and sunny for China. The country will face a substantial decline in its trade exports (and exports make up over a third of China's GDP), a core feature of the populism trend outlined above. However, because China will financially help the countries that the US neglects, their capital exports, via RMB-denominated loans, will increase dramatically.

[4] If not for the rise of China, hyper-dollarization might be have been the most likely outcome of free market AMMs, as these countries would have no other options (The Euro, the second most liquid reserve currency today, is getting stretched to the breaking point and will likely lose significant market share to the USD and RMB in the coming years. The only other competitors to China's RMB, the British Pound and Japanese Yen, rely on economies too small to challenge the dollar; they only lead today because of greater trust in their central governments and the Lindy effect.).

[5] The East here is a broad term for simplicity's sake, encompassing Russia, India, other parts of Asia such as the Middle East, and large portions of Africa.

[6] The only one not near 0 is China's, but the RMB is hardly a reserve currency yet.

[7] Although China's debt:GDP ratio is significantly lower than the US's and Europe's.

[8] Pareto distributions are optimal in any market where network effects are prominent; in the case of foreign exchange and reserve currencies, liquidity begets liquidity, even with the advent of automated market makers.

[9] Because the West is significantly more wealthy than the East, it will be the West that ultimately decides whether this war happens.

[10] Significantly higher tax rates would need to be exercised for a significant amount of time (likely multiple decades). This is extremely unlikely, as, put simply, Americans of all incomes don't like paying taxes, as exhibited by the e multi-decade trend of decreasing corporate and individual tax rates.

[11] Corporate profits in 2019 were just under $9trn.

[12] The Coronavirus has been more destructive to the economy than World War II. Consumer demand was vibrant throughout the duration of World War II, while it has declined rapidly for the duration of the Coronavirus. Tax rates during the 1940s were over 2x higher than they are today.