Venezuela's history is a textbook case of economic mismanagement in which two themes emerge: dictatorship and oil. Both have played important roles in turning a once-rich nation into a failed state.

If it is ever to recover, Venezuela needs at least to start producing oil at the levels it once did. But doing so will require foreign capital. And getting foreign capital will require Venezuela to come to terms with its creditors. Venezuela’s defaulted bonds, currently trading at 10/11, seem too cheap.

David Graeber has a clear talent for tantalising book titles, his most recent Bullshit Jobs being a case in point. Nevertheless, I haven’t read Bullshit Jobs, nor do I expect to. Because his more famous Debt: The First 5,000 Years (with its equally catchy title) is a rambling, incoherent and intellectually disingenuous excuse for scholarship.

I started to read it partly because I was hoodwinked by the fascinating title, and partly because it had such rave reviews. But I finished it, not because my usual instinct of cutting losses early deserted me, but because its empirical contortions and twisted logic became strangely perverse fascinations in their own right. I’ve reviewed this book in the hope that it might save anyone thinking of reading Debt the 15-20 or so hours of their life they will irrevocably lose if they do.
Venezuela's contemporary economic history has two intertwined themes: oil and dictatorship. From discovering its first barrels in 1922, and mainly staying out of WW2, its people entered the second half of the 20th Century standing proudly as the fourth richest in the world. They also trembled under the yoke of one of the continent's most repressive military regimes. The country has never managed to ween itself off its dual dependencies and successive regimes have progressively mismanaged the country's oil wealth so outrageously, that Venezuela today is a failed state.

The pricing of the Bolivarian Republic's defaulted sovereign USD bonds reflects this, currently trading at around 11% (offered). And for context, just before Kim Jong-Il died in late 2011 North Korea's bonds traded at 15%, rising to 18% a few days after he died. I think Venezuela's bonds look extremely attractive.

The decline and decline of an oil superpower

The real problems started for Venezuela during the '70s oil boom, which it rode euphorically and greedily, nationalising its oil resources (ie creating the national oil company, Petróleos de Venezuela SA, or PDVSA) so that 'the people' could reap its riches, rather than the gringos from Standard Oil, Mobil and Shell. The Government spent heavily on public health, education and welfare programmes. Times were good.

But when prices crashed during the inevitable glut that ensued, Venezuela found itself unable to keep the promises it had made when times had been better. In 1982 it explicitly defaulted on the loan agreements it had entered into with American banks. The default on its own people however was implicit. The printing presses were used to maintain its social programmes so that by 1988, annual inflation approached triple digits.

It was in that year that Carlos Andrés Pérez, running for the presidency on a populist, anti-neoliberal ticket famously compared the IMF to a neutron bomb, “killing all the people but leaving the buildings standing.” Economists at the World Bank were “genocide workers in the pay of economic totalitarianism.” So deeply did this resonate with the public, appalled at the “Washington Consensus” then being imposed across the continent by the gringo money men, that Pérez won a landslide.

So one can imagine the sense of outrage and betrayal across the nation when only weeks after his victory, the new President accepted a $4.5bn bailout from the IMF, conditioned on the usual bitter medicine of austerity and market liberalisation, including the Apertura (opening up) of still quite recently nationalised oil company PDVSA.

At that time, despite the nationalisation, PDVSA remained independently run. The staff and expertise inherited from the multinational oil companies were largely kept in place, even if cooperation with multinational corporations was forbidden. The IMF-imposed liberalisation saw a repeal of those protective laws, and from 1992 extraction rights were permitted to be split with various multinational oil companies. Oil output increased, as did the efficiency and profitability of production.

But the other reforms were botched. Financial liberalisation, for example, saw reckless (and fraudulent) credit growth which led to a banking crisis in 1993, a recession and an enormous government bail out costing around

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2 See “North Korea Bonds? Now Could be the Time” WSJ, 23 Dec 2011
75% of government revenue. Oil prices settled after the first Iraq War at a lower equilibrium too, draining the public purse and triggering the printing presses once more. Inflation returned to near-triple digits.

The IMF were called in again in 1996, by then-president Caldera and the resulting austerity imposed on a crisis-weary nation proved ill-timed. The Asian Crisis was about to devastate the global economy, and send oil prices below $10 per barrel. Venezuelan per capita GDP was one third lower than its 1978 peak and poverty rates had doubled, reaching over 60%. Venezuelans were exhausted, angry, and they blamed the free-market neo-liberalism of the gringos.

So by the time Chávez was making his bid for the presidency in 1998, during which he promised to end austerity and reduce inequality, he was pushing on an open door. He was elected with 56% of the vote, taking office early in 1999.

We’ll stop the history here to emphasise two things. The first is that oil has driven Venezuela’s fortunes since the beginning of the 20th Century. For generations, successive governments have used temporary oil windfalls to make permanent promises. The second is that when the oil price eventually reverses and those promises are broken, Venezuelans don’t seem to see through what had always been empty promises, or blame the political dishonesty of tying everyone’s fortunes to a volatile commodity price. They blame capitalists and gringos.

To extend this last point, it should be understood that Hugo Chávez, who single-handedly turned a weak country into today’s failed state, was repeatedly voted in. Between 1998 and his death in 2003, he won four presidential terms and a referendum to determine whether he should be recalled from office, even as his authoritarian tendencies emerged, constitutional checks and balances were brazenly eroded, power was centralised in his hands, family members and cronies promoted to positions of power and an increasingly arbitrary campaign of private property confiscation was waged against the country’s business class.

He did it all in the name of a Bolivarian Revolution aimed at restoring the dignity of the poor and putting ‘the workers’ in charge. And the Venezuelans voted for it all.

| The current crisis |

I’ve been referring to Venezuela as a failed state. It’s not hyperbole.

GDP is currently declining by around 20% per year. But the easiest place to see how wrong things have gone is with the chart of the Venezuelan CPI. Note that this data stops in 2016. The IMF currently estimate that it is likely to reach 10,000,000% (ten million percent!) by the end of this year.

Most indicators have stopped being collected, and those which are have lost their relevance, given the collapse in the currency. But the following non-financial indicators tell a powerful story.
Nevertheless, centrist rival Juan Guaidó in January 2019 proclaimed himself acting President, following what he and his supporters say (probably correctly) that the election was illegitimate. He is recognised by over fifty foreign countries including the US and Canada, most of Europe and Latin America. It is conceivable that there is a civil war, though the most likely next stage is a military dictatorship.

It would be easy to draw a straight line between Chávez's utopian socialist policies and the mess that followed, but the reality is more nuanced. Under Chávez the flimsy institutional checks and balances which did exist were systematically removed, so that in the end, all government policy was driven by the whims of one man and his vision.

Thus, for example, when he deemed that the prices of rice and corn, electricity and water, or cement and steel were too high for ordinary people, Chávez accused businesses of profiteering and proceeded to impose a maximum price on these goods.

When production declined in consequence, (since at the new state-imposed price, companies would be making a loss), or if affected goods were exported to world markets where they might attract a market determined price, the companies were publicly shamed as traitors to the Bolivarian cause, and then nationalised. Foreign owned businesses were given compensation. Domestically owned business were not.

Chávez’s nationalisation spree focused initially on ‘strategic’ industries, for which national ownership was ‘in the national interest’. After that, it simply hoovered up anything that was left. For example, construction suddenly ground to a halt in 2010 when Chávez announced on live TV that the local construction companies were “urban vultures” building homes “only for the middle class and then squeezing them. We have decided to act.”

Local building firms found they no longer owned their businesses. Anyone who had made a downpayment for a property found themselves with a half built house, which they weren’t even sure they still had a claim on.

According to the Heritage Foundation, Venezuela had the weakest property rights in the world, scoring only 5 out of 100 with expropriation without compensation common. Today there is virtually no private sector to speak of.

So far, so Latin. But to really get to the bottom of the mess today, it has to be understood that virtually all government revenue comes from oil production (ie from PDVSA).

It’s not easy to track down good historic data about Venezuela. More recent numbers don’t mean much either because they are so distorted by the hyperinflation. But in the chart below I’ve pieced together data from PDVSA’s financial statements, or from various sources citing PDVSA’s financial statements.
The dark blue line shows the total oil revenue (composed of income and production taxes, dividends and royalties). The orange line shows total government revenue.\textsuperscript{3}

By 2008 the price was nearly $150. So although we can’t see the numbers for the first few years of his presidency, we can imagine that revenues would have been around $3-5bn. A few years later, and that number is around $30bn, hard currency. He must have felt like a kid in a sweet shop, with no social programme he couldn’t fund.

The second observation, the collapse in revenue, is also worth reflecting on because it turns out this isn’t entirely driven by weaker oil prices. From a peak of just under 3.4mbpd in 2006, Venezuela was only producing 1.5mbpd at the end of 2018. This hasn’t been the result of any fundamental shortage of oil (on the contrary, reserves seem to have been increasing). It is because the oil assets have been so grotesquely mismanaged.

Although the Venezuelan oil industry was nationalised (and subsumed under the newly created PDVSA) in the 1970s, the expertise was retained. The geologists and engineers who had been trained and educated by the international oil companies stayed on, in effect just switching the name of their employer in their contracts. For over two decades, PDVSA was run independently.

Two things stand out: the first is that revenue from PDVSA taxes are around 90% of total revenue (90%!!)\textsuperscript{4}; the second is that revenue collapsed between 2013 and 2015 (ie during the ‘Shale Gale’). With the recovery in oil prices since, current tax revenue is likely at a $11-$12bn run rate.

In other words, Chávez’s Bolivarian socialist revolution - with its multiple Bolivarian Missions (including dozens of social welfare programmes), its nationalisations, its subsidised oil sales to ideologically aligned countries - was funded in its entirety by a single oil company, PDVSA. That’s an awful lot of heavy lifting for one company, even if it does own the biggest oil reserves in the world.

It’s also incredibly risky. When Chávez came to power in early 1999 a barrel of oil sold for $20.

\textsuperscript{3} As the hyperinflation gathers momentum the conversion of PDVSA's USD revenues into Venezuelan Bolivars becomes more volatile, hence what looks to be higher PDVSA tax payments than total revenue.

\textsuperscript{4} In fact, the actual money transferred by the oil company to the state was greater than that shown in the chart because since 2003 it has had to make “social transfers” from pre-tax profits, though these are sent to the central bank and are officially off budget.
Chávez changed that, making it an explicit organ of the state and as we have seen, using it to fund his socialist revolution. In 2002/03 supporters of the opposition who worked for PDVSA shut down oil production in an attempt to force a general election. Chávez ended up firing 19,000 of them and replacing them with staff loyal to him. Venezuelan oil is heavy and requires deep expertise to extract it properly, so Chávez invited in the international oil companies to help him keep the oil flowing.

This they did, until 2007 when Chávez got greedy and unilaterally changed the terms of the concessions. Some of the oil majors went along with this (BP Statoil, Total, Chevron) but some didn’t (Exxon, ConocoPhilips). This reduced expertise, plus PDVSA’s declining maintenance investment during the boom years contributed to the situation today, in which the oil money just isn’t there.

But the welfare programs are. And so is the printing press. And that is why we are where we are.

The risk, and the opportunity

As already stated, defaulted USD bonds currently trade 10/11, which is lower than North Korea’s bonds on the eve of Kim Jong-Il’s death. Clearly the Venezuelan situation is desperate and the future highly lacking in any real visibility.

Importantly, Venezuela is also sanctioned. This is an important factor explaining the bonds’ attractive valuation. Pre-sanctions the bonds fetched around 35%. But the sanctions prevent the hedge funds who would normally participate in such a situation from doing so. So for now, there isn’t much of a bid.

According to Moody’s the average recovery rate on sovereign defaults since 1998 has been 65% on an issuer-weighted basis (st dev of 22%), and 46% on a value-weighted basis. The latter is lower due to the poor recovery rates for some of the largest recent defaults - including Argentina in 2001(recovered 30%), Greece in 2012 (recovered 29% and 40%) and Russia in 1998 (recovered 50%). The return to purchasing the bonds at current prices in any of those recovery scenarios would be an attractive one for the risk assumed and work required.

Of course, there clearly is a lot of risk. Firstly, there is no guarantee that the situation will resolve itself any time soon. China has a claim on Venezuela’s oil too and recently extended its upfront payment for around 500mbpd. They could well provide the financial lifeline Maduro (or whoever follows) so desperately needs to string things out. Here, the recent precedent set by Argentina might ultimately be applied to the potentially significant detriment of recovery rates. US law only allows for three years to claim interest, and ten to claim principal. In the past, these rights have been waived by the defaulter, but Argentina applied their rights, leading to a significantly lower recovery rate.
Secondly, and less probable but worth thinking about nonetheless, is the risk that the US uses its executive power to lower the recovery rate. Iraq’s defaulted Sadam-era bonds only recovered around 10% (ie a 90% haircut) because the Federal Government immunised any Iraqi assets based in the US from any claims by holders of such debt (including any attachments to oil of cash proceeds from the sale of oil).

Admittedly, this was a special case. A UN resolution was passed specifying the immunity on the grounds that it was in the international community’s interest to have Iraq on its feet as quickly as possible.

Could the same thing happen to Venezuela? It is, after all, a large exporter of crude. It’s also causing a refugee crisis in neighbouring countries. And the international community clearly think it’s geopolitically important (or it wouldn’t have sanctioned Venezuela in the first place). It’s possible that in the event of a regime change deemed desirable by the US Government that the same arguments that were made about Iraq could be made about Venezuela.

But it’s probably quite unlikely. Iraq was a special case even compared to Venezuela. Precedent has been set though, and it’s worth keeping an eye on.

Other risks are more obvious. The bonds are highly illiquid. And Venezuela’s history suggests it is only a matter of time before another Chávez is in power: its institutions are weak and electorate suspicious of free-markets and prone to populist seduction.

But Venezuela’s history also suggests that the hyperinflation will eventually be stabilised. Whoever takes over from Maduro - or even Maduro himself should he manage to limp on - knows that the only way to get the country even close to being back on its feet is to harness the potential of its oil fields. They need the foreign expertise, they need the foreign capital. They will eventually need the gringos to be able to sell their hydrocarbons.

Currently, Venezuela is exporting less than 1mbpd and producing less than 1.5mbpd, which is probably bringing in tax revenues of around $11-$12bn per year. If, as a first step, it were to reach its prior peak production of closer to 4mbpd, that number would be closer to $50bn per year, enough to comfortably service a more sustainable debt load (eg a 50% haircut would lower its USD debt to $50bn, implying around $3-4bn per year in servicing costs). The Government could then invest in turning around its economy and finally switch off its printing presses. Everyone would benefit. It just needs to settle with its creditors first.

**Sharing is caring**

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The ongoing debate around the pros and cons of Modern Monetary Theory (MMT) is a strange one. On one level, it feels like the kind of distraction you get when the squabbling between macroeconomists over which faction has the best untestable hypothesis bursts out of the lecture theatre and into the public arena. It’s mildly entertaining, like when brawling drunks spill out of the bar and onto the street, but not particularly enlightening.

On another level though, MMT has clearly sparked something in the collective imagination. I think this is much more interesting.

Although MMT policy prescriptions are probably too radical to be adopted in their entirety, I think MMT’s central tenets will become increasingly influential among the coming generation of voters and investors.

It’s important to understand that financial markets weren’t the only thing that crashed in 2008. The reputation of economists took a hit too. The years preceding the Great Financial Crash were those of the ‘rock-star’ central banker. This was unforgettably captured by the famous and timelessly brilliant 1999 Onion article, “Greenspan, entourage destroy hotel room” (which mock-reported that Greenspan had “once again found himself in legal trouble” after he and Deputy Treasury Secretary Larry Summers had pushed a vending machine off their Beverly Hills penthouse suite balcony onto the swimming pool area below.)

But the years since the GFC have been less kind to central bankers. They’ve been accused of having been asleep at the wheel as the crisis unfolded, of impotency in the face of ongoing deflationary pressures since and of stoking inequality by pumping up asset prices. Detractors argue that thanks to Quantitative Easing the rich got a stock market boom, while the poor got lumped with austerity.

Unsurprisingly, there’s a growing demand for a new kind of economics. In the same way that there was a demand for an economic theory which could fix the depression in the 1930s (Keynesianism) or one which could fix the runaway inflation of the 1970s (Monetarism), there is now demand for one which can stop deflation, end austerity and benefit ‘the many not the few’.

This is the context in which I am taking MMT seriously and trying to imagine its potential implications.

For what its worth, I’m no fan of MMT and certainly not advocating it. Intellectually I find it breaks no new ground, and as a theory it seems little more than a caricature of existing theories, replete with the same flaws which make theoretical macroeconomics the unscientific embarrassment that it is today.

But what I think doesn't matter. What the public, and therefore the policy makers think, does. And here, MMT is delivering the message people want to hear. So my feeling is that this is an idea whose time has come, and that this in turn has allocation implications. It has the potential to drive a change in the macro regime, from an economic-deflation / financial-inflation regime to an economic-inflation / financial-deflation one.

What we talk about when we talk about MMT

MMT seems to mean different things to different people, even its luminaries. For example, Stephanie Kelton, one of MMT’s intellectual architects and ‘co-founder’ thinks that Japan has been conducting MMT for some time. But Randy Wray, another intellectual architect and ‘co-founder’ has said that it has not. I don’t want to get embroiled in this specific debate. Instead I want to talk about MMT as I perceive it. In particular, when I refer to MMT, or of MMT-influenced policy, I will be referring to what I see as its central idea, namely that the notion of currency-issuing governments going bankrupt is plain wrong.
Because unlike private sector actors such as households or businesses or even other governments which borrow in foreign currency, the MMTers point out, such sovereigns with their own currency can always print the money they need.

If you follow the premise of the argument you end up with some of the other key ideas of MMT, namely that macroeconomic policy should be managed through fiscal rather than monetary policy and that the Government should run a Jobs Guarantee programme.

But these other variants flow from this central idea, which is that raising taxes and issuing debt are not necessary from any kind of revenue or solvency imperative because a currency-issuing sovereign can print the ‘revenue’ it needs (Yes, MMTers would say, taxation and bond issuance are important levers for aggregate demand management, and taxation is necessary anyway to guarantee an end demand for the currency printed by the Government, but they are not needed for any traditional ‘housekeeping’ sense).

The Government can print as much (or as little) money as it needs so long as inflation doesn’t pick up. Therefore, government spending is not constrained by any kind of budget constraint, like that which constrains the private sector. Inflation is the constraint.

So for me, MMT, or MMT-influenced policy, is any policy idea which is based on the argument that “government can afford it since it's non-inflationary.”

And here is the first problem MMTers run into. Saying “governments can’t go broke because they can always print money” naturally conjures images of wheelbarrows in Weimar in the mind’s eye.

And here is also where one of the MMTers’ main frustrations with non-MMTers rests. Although they readily admit that the insight is not a new one, they feel the full power and potential of it has not been fully understood by mainstream economists, or realised by policy makers.

Therefore the whole debate around, for example, the cost of Bernie Sanders’ “Medicare for all” plan in the US, and whether it is affordable misses the point - from an MMT perspective, it’s all affordable so long as paying for it doesn’t trigger inflation.

Of course, the application of this logic is endless - the Green New Deal, the rebuilding of roads, new schools, new hospitals, all or any of the above. And the way current discussions around these policy ideas are framed - in terms of it not being affordable because debt/GDP is already “dangerously high”, or the deficit already unsustainably big - is all wrong according to the MMTers. The correct question is whether or not there is the capacity in the economy to produce those things. If there is, there will be no inflation. And if there is no inflation, there is no problem. The current low and falling rates of inflation across the world economy is a strong signal to MMTers that governments should be pumping money into the economy.

| The soft-money zeitgeist |

To repeat, I really don't like this and find it a terrible idea on many, many levels. Primarily, I don't buy the premise that we are all better off because central bankers and government officials have some clever way of ‘managing’ the macroeconomy. To me prosperity, wealth, job creation are micro, not macro phenomena.

But bad ideas can still become policy (eg imperialism, eugenics, socialism). And if I was a host to the macroeconomic meme, and I believed that my judicious interventions could make the world a more prosperous and harmonious place, I’d be looking at MMT’s idea that government spending should only be constrained by the economy’s inflation speed limit, and I’d be excited. I’d be thinking, “Globally inflation is low and falling. Economists have been warning about the dangers of deflation for years now, and we’re getting closer. Surely, that can only mean … we’re not spending enough money fiscally!”

Alternatively, if I were a megalomaniac politician living for votes and seeing myself as some kind of wise benevolent dictator, I’d be rubbing my hands and salivating.

If I was on the right, I could finance enormous tax cuts. If I was on the left, I could fund New Deals, more doctors and nurses, more teachers, rail system upgrades, affordable housing, a shorter work week, etc etc.
And that is one of the reasons why I think it’s going to happen. People believe what they want to believe in proportion to how desperate they are. During the next downturn the idea that only old-fashioned thinking about fiscal responsibility is preventing us from building a better, fairer economy will have strong appeal.

There’s another powerful reason which I think will see MMT inspired ideas gain traction in the coming years too. It is that central banks suffer all too obviously from Charlie Munger’s “man with a hammer” syndrome (every problem is a nail.) There is no problem a central banker sees that cannot be fixed with an adjustment in interest rates.

But rates are at zero, and QE “hasn’t worked”. The hammer box is empty. So how are they going to continue doing the only thing they know? Answer: with a new hammer. The next downturn will see us move into a more serious discussion about the ‘need’ for additional policy levers.

So that’s how I think we’ll get politicians and central banks on the same page, and that’s how MMT-inspired policy will happen. We may not see MMT in its purest manifestation, with public Job Guarantees, near-abandonment of government bond issuance and MMT’s influence might not even be acknowledged. But for better or worse (worse in my view, but what do I know?) the next generation of stimulus designs will have the fingerprints of Wray and Mitchell all over them.

| An MMT regime is coming |

During the last UK election, Jeremy Corbyn proposed a “People’s QE”, in which printed money would be used to invest in housing and public transport. Since then Oxford Economist Simon Wren-Lewis and macro hedge fund manager Eric Lonergan have publicly urged the Government to adopt the same policy. Francis Coppola has published a clearly articulated and succinct book outlining a detailed rationale for a similar policy. Across the political divide, there is a strong demand for new types of stimulus. The idea is not going to go away.

It might seem too radical right now, but ‘crazy’ things do happen. Monetary regimes change. The idea that the gold standard would ever be abandoned must have seemed pretty radical to anyone who was contemplating it in the early 20th Century. But by the 1920s, following the disaster of WW1, the idea was gaining ground. By the 1930s it had happened.

Similarly, the idea that currency would be unbacked by anything real would have seemed ludicrous after WW2, which is why the Bretton Woods regime was built in the first place. But by the 1970s, that ‘preposterous’ policy had become normal. Indeed, today the idea that we’d go back to a gold standard is seen as loony by most.

And not too long ago, the idea that the central banks of the world would be printing money to buy government bonds, corporate bonds, equities and/or ETFs would have been laughable!

So how radical is MMT, really? True, the theory might offend the sensibilities of certain theoretical economists. But economists are notoriously thin-skinned and are always offended by the theories of anyone outside their faction. Do politicians and voters care about the hurt feelings of such notorious squabblers?

| What to do differently, and when? |

So I think we are drifting into a new policy regime. Does that mean we’re moving into a new market regime too?

The end of the gold standard certainly ushered in a new financial market structure, reflecting the era’s new inflationary environment. Real assets were in, basically, while nominal assets were out.


What did the era of QE bring in? Not much really. In financial market terms it was more of the same, and everything has continued to go up since. So policy regime changes don’t necessarily bring in changes to financial market regimes.
Ultimately, I do believe a shift to an MMT inspired policy regime will change the market regime. I think everything which has done well in the prior regime (bonds, credit, public and private equity) will do badly in the next one.

But I don’t think there’s much to do differently right now because this all remains too distant. The ‘People’s QE’, or some variant thereof probably won’t be a story until the next recession, during which there isn’t likely to be a whole lot of inflation.

But ultimately, the ‘good old-fashioned’ CPI inflation will come. The key MMT idea that government spending will be limited not by some maximum deficit, but by inflation implies that someone somewhere in one of these government departments is able to precisely and reliably forecast inflation. I don’t think that person exists.

Therefore, the new target for central banks will effectively become sharply rising inflation. Inflation will become volatile. Policy responses will be clumsy, unpredictable and difficult to time. This will be reflected in higher risk premiums in asset markets.

And, if MMT, even by stealth, is ultimately CPI inflationary in a way that QE was not, MMT will be market deflationary in a way that QE was not.

Here is an example of some of the asset classes I’m exploring in preparation for this regime change:

1) **Gold**, which is an obvious one, the problem being that it’s difficult to model. For example, if the expected return of a bond, or an equity is some variant of its yield, then a decline in prices implies an increase in yield, and therefore a higher expected return, all else equal. But gold has no yield. So how should we think about expected returns? If we say expected returns are the rate of expected inflation, which I think isn’t a dumb way to approach the question, we still have no way to know how to link that to a movement in the gold price. So what happens when the gold price doubles over a few months or years when inflation expectations have remained unchanged? What is our expected return now? Still the rate of expected inflation? If so, it means that the current price has no relation to the expected return, which can’t be right.

2) **Inflation linked securities.** Again, obvious.

3) **Real estate**, also obvious, though less straightforward. As inflation accelerates, the replacement cost of real estate rises too. Since most rental agreements are indexed to inflation, real estate has various layers of inflation protection built in (indeed, I believe the data shows real estate actually did OK in the 1970s). On the flip side is that real estate is typically a levered asset, and as higher inflation pushes up rates, the more extended borrowers are shaken out, becoming forced sellers and depressing prices as the process plays out.

4) **Asset backed structures.** Less obvious because they are clearly nominal assets, but related to the above because a big category of ABS are real estate backed securities. They’re typically floating rate, and are collateralised by real assets. So as inflation picks up, your coupon will be increasing while your credit risk will be decreasing (since collateral values will be pushed up by the inflation). The negative is that your principal is non-indexed, and in a steeply rising rate environment, you might still suffer defaults (although the extent of this exposure depends on which tranche of the structure you’re in).
Debt: The First 5,000 Years
David Graeber's book is the worst I've ever read

How I got sucked in

Over the last few years this book regularly cropped up in conversations. When I mentioned that I'd given up after only 50 pages I was told repeatedly that I should have stuck with it. “It get's really interesting”. “It’s a must read”.

On more than one occasion during discussions with other armchair monetary-theorists, both crypto-anarchists (bizarrely) and MMTers, the conversation would stop the moment they found out that I hadn't 'read my Graeber.' Until I'd done so, I was told, I had no right to an opinion.

Actually, a small part of me feels forever guilty when I don't finish a book, and these rebukes had the unpleasant effect of aggravating the wound. The only way I'd get closure was to finish the damn thing.

The thing is, I remember how eager I was to read it when I first bought it in 2012. I love history, and have a particular fascination for financial history. A book about 5,000 years' history of debt - all my Christmases had come at once!

That it was written by an anthropologist only added to the intrigue. “Point of view is worth 80 IQ points”, according to computer-science pioneer Alan Curtis Kay. And one of my favourite books ever is Guns, Germs and Steel by Jared Diamond, whose background in anthropology and geography illuminated world economic history in a way no economist ever could have.

So I convinced myself that I must have missed something first time round and resolved to give it another go. So that's why I read it.

Why am I now writing about it? Well, we only have so many books we'll be able to read in our lifetimes. So imagine you had a bookshelf with one space for each of those possible books, and that each time you read one, the book shelf shrank by one space. The moment you die would be the moment the bookshelf shrinks to a solid block of wood, with no empty spaces left.

The spaces on that imaginary shelf should be sacred, with only the most joyful, enlightening and uplifting books allowed. So what I want to do here is save anyone who might have been tempted to use up one of their sacred spaces on Graeber's garbled rambling tome of nonsense.

It's too late for me, but if I can save any of you, it might just be worth it after all …

Graeber's bullshit theory

OK, so the best place to start is with an outline of Graeber's thesis. So this, as far as I could disentangle one, is roughly it:

- Before there was money, there was credit. The idea that we simply bartered with one another before we had coins is a demonstrable myth propagated by economists.

- Markets are created by government. They didn't emerge spontaneously, as economists have led us to believe, but were in fact the result of some kind of deliberate 'policy action' by governments, designed to facilitate military expansion.

- As a kind of state-sanctioned military technology, markets are fundamentally borne of violence. They have always required violence to perpetuate their existence, and still do to this very day.
- Violence is required to impose the cold calculus of prices on all dimensions of human life, facilitating not only the comparison of things in the material sphere (which is OK), but in the moral sphere too (which isn’t). The debtor-creditor relationship is a natural one, and intrinsic to social organisation as can be seen in primitive economies. But money has somehow corrupted it, criminalising debtors and allowing creditors, typically the most powerful members of society, to enforce their claims with the use of violence (the EU's treatment of Greece being the most recent brutal example).

- We are at our ecological and social limits, and capitalism is unlikely to last another generation. Midway through the first millennium was the last time “money died” and it saw catastrophes unfold across Eurasia. The same thing is likely to happen again, and governments have been spending the last thirty years in preparation, building a “vast bureaucratic apparatus for the creation and maintenance of hopelessness, a giant machine designed first and foremost to destroy any sense of possible alternative futures” but that there is an alternative way to organise ourselves.

- Our only possible salvation is to reimagine ourselves and form protest movements to let others know that another way is possible.

- A biblical debt jubilee is inevitable.

Got that?

OK, so if you’re still reading, you’re probably thinking that this guy sounds like a loon. And I think that too. But I didn’t fully appreciate how much of a loon until I finished the book, read my notes, rechecked them against the book, read a few interviews with him, and then read a couple of his academic papers. That’s when I managed to cobble together the above narrative (although, to be clear, I’m still genuinely unsure how accurately I’ve portrayed his thesis, if you can even call it that).

“Hang on a minute Grice”, you might be thinking. “Admittedly, the ideas as you’ve outlined them seem quite controversial and it’s clear you disagree with them. But you just called him a loon. Surely him believing in something you happen to disagree with doesn’t make him a loon?”

Well I’m glad you mentioned that, hypothetical reader. But to be clear, I’m not referring to Graeber as a loon because I disagree with his thesis. Those two things have no bearing on one another. I’m referring to him as a loon because I think he is one, not in the sense that he’s short of cognitive horsepower, but in the sense that he’s not intellectually honest, not good at careful, logical thought, and not good at rigorously testing his arguments. He’s not someone you’d want in your research team.

Here is some evidence that Graeber is a bullshit peddler.

| Exhibit 1: The myth of barter |

A key building block to Graeber’s ‘thesis’ is that economists have indoctrinated the world to “see money as the highest form of human freedom” by perpetuating the lie that before money was invented, humans bartered. In fact, as Graeber falls over himself to explain, the evidence firmly shows that long before there were coins there were systems of credit: a consumer of wine might run a tab at the local tavern; a neighbour might stitch a tunic for a neighbour in the expectation that this favour would be returned later. And what’s more, these systems of credit were important precursors to money. So debt came before money, not barter. And the historical records are very clear on this. There never was a ‘barter economy’. So far so good.

Except that in pointing this out (and high-fiving himself during the course of the rest of the book for it), Graeber seems to see himself as somehow sticking a pin in the economists’ over-inflated balloon of self-opinion, and dealing a death-blow to the entire discipline.

The irony is that I would like nothing better than to see someone finally prick that very same balloon. But he’s got the wrong myth. The intellectual edifice of crap which is
modern macroeconomic theory isn’t built on the presumption of barter at all. It’s built on the presumption of representative agents/linear scaling rational agents, closed-system equilibria, etc. So Graeber’s ‘killer punch’ is actually nothing of the sort.

Also, I had always assumed it common knowledge among economists that credit predated coin. For example, in *A History of Money* (first published in 1994, nearly two decades before Graeber), Glyn Davies writes that “the one thing experts on primitive money all agree on … backed up by overwhelming tangible evidence … [is that] barter was not the main factor in the origins and earliest development of money.”

Davies then goes on to detail the banking systems of Mesopotamia and ancient Egypt in the third and second millennia BC. Quite remarkably, these societies had deposit-taking institutions whose business was lending out those deposits, much as commercial banks do today, even though there was no ‘currency’ in existence (now that is an interesting book for those interested in the history of money and debt).

So why Graeber’s gloating triumphalism? Presumably because he thought he’d made some kind of groundbreaking insight. But how did the idea that civilization has never really bartered lead to the conclusion that “governments create markets”? I couldn’t quite figure out that particular leap. But it’s something he presents over and over during the rest of the book, as if he’d proved the statement simply by repeating it. You would have thought a scholar would know that asserting a theory is not the same as demonstrating its validity. But, there is far far worse intellectual malpractice to come.

**Exhibit 2: the “famous” example of Apple**

In Chapter 5, Graeber is enjoying himself, foppishly reflecting on one of “the great scandals of capitalism, which is that most capitalist firms, internally, operate communistically … [and that] the greater the need to improvise, the more democratic the cooperation tends to be … Inventors have always understood this, start-up capitalists frequently figure it out, and computer engineers have recently rediscovered the principle.”

OK, so far, so typical. A good example of one of the ‘controversial’ little Graeber-theories you find scattered on every page. They’re supposed to be provocative, and usually sound far fetched, but since I don’t really know the subject matter he’s citing, and I’m not going to dig into his references (just yet), I roll my eyes and continue … until I reach the following supporting evidence, which I’m going to quote in full because it’s so hilariously appalling:

“Apple Computers is a famous example: it was founded by (mostly Republican) computer engineers who broke from IBM in Silicon Valley in the 1980s, forming little democratic circles of twenty to forty people with their laptops in each other’s garages.”

The thing is, although I don’t know much about the obscure African or Polynesian primitive tribes that anthropologists have studied, I do know something about the history of Apple Computers, as will most of you. And what is as clear as it is remarkable is that every single ‘fact’ in the sentence above is wrong: Apple wasn’t founded by computer engineers plural, there being only one in the founding three (only Wozniak was an engineer, Jobs and Wayne weren’t); they never had anything to do with IBM (which is based in NY anyway, not Silicon Valley.); there weren’t 20-40 founders, just three; laptops didn’t exist in the early 80s; and anyway, Apple was founded in 1976 (not the early 1980s), when there definitely weren’t any laptops.

Maybe they were Republicans (I have no idea, and am not sure how that’s relevant anyway). But what struck me about this passage wasn’t just that it was evidently made up, it was the brazen matter-of-fact confidence with which it was rattled off (Apple is a “famous example”).

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2 Chapter 1, page 23

3 Chapter 5, Kindle location 1946

4 Chapter 5, Kindle location 1954
Exhibit 3: The Lele didn’t have markets

Following the embarrassment that was the “famous example of Apple”, I couldn’t help but wonder what else Graeber was making up. So I found myself reading the primary source on one of the anthropological examples he leans on quite heavily as he builds his thesis on how violence is necessary to usher in money (it was at about this time I admitted to myself I was spending too much time on the book … but “in for a penny”, as they say).

The Lele of Kasai were an African tribe first studied by the pioneering anthropologist Mary Douglas who lived with them, observed them and published her findings in what is now a classic study.5

I won’t go into the detail of how the tribe organised itself, but the key point here is that this was a very primitive community. Money wasn’t typically used to allocate output (status was); households were largely self-sufficient, making everything they needed (only meat and wine were shared around at the village level).

The role of raffia cloth was central to the functioning of Lele society. The tribes would make it themselves and it was used to discharge social obligations, rather than to pay for ‘goods’. For example, if you offended a neighbour, you could buy forgiveness with a certain number of raffia cloths; if you committed adultery, you could smooth things over with some raffia cloths; when you wanted to marry, you had to pay the father (and mother) of the bride some raffia cloths too. For joining a cult, visiting the witchdoctor, or attaining a certain age, a certain amount of raffia cloth would be handed over. According to Graeber, what you couldn’t buy with the cloths was anything ‘real’ for “there were no markets, and, as Mary Douglas discovered to her great inconvenience, within a village one couldn’t use it to acquire food, tools, tableware, or really much of anything”.6

Except, when you read the original piece, that’s not quite what Mary Douglas said. What she actually said is that she, “… had great difficulty trying to buy ordinary domestic objects with francs. For raffia cloth they would have sold willingly, but … I couldn’t buy raffia cloth for francs.”6 In other words, the Lele did have raffia prices for their ‘things'. They just didn’t want her Congo francs for the cloth.

Earlier in the same passage, Douglas explicitly states that raffia cloths were used as currency for internal trade within the village and that for an admittedly limited range of goods, there were raffia prices: “Raffia has a real monetary role, as a medium of exchange, for the seller accepts it in order to use it as payment for other exchanges … skilled craftsmen sometimes gain a great reputation for carving, and may supply drums, bellows, or drinking-cups to strangers from afar off. They will charge as much as 50 raffia cloths for a big item. These charges are real prices, to be distinguished from the gifts made to a craftsman who furnishes objects to kinsmen.”7

And just to be crystal clear, the Lele were at the centre of a regional trading hub in which raffia was used as a medium of exchange. They specialised in making the cloth, and would trade it for arrow heads, knives, pottery and fish. And perhaps even more revealingly “… the Cokwe hunters accept it in payment for game, though they do not wear it, and intend to sell it.”

In other words, in Graeber’s flagship example of a pre-money primitive tribe with no money and “no markets” we find very clear evidence of both. Yes the tribe was primitive, and yes each village operated more as a collective than a bunch of specialised individuals trading each others’ skills. Yet there were (admittedly limited) internal markets for the sought-after produce of skilled craftsmen, and there was international trade. Critically however, there were neither the governments deemed so necessary in the creation of these markets nor the use of violence to sustain and enforce them.

6 Douglas, page 115
7 Douglas, page 115
So while Graeber could maybe be forgiven for colossally screwing up the Apple example on the grounds that it was outside his comfort zone (he later blamed it on a research assistant), it’s difficult to make that defence for the Lele of Kasai. Indeed, it’s hard to avoid the conclusion that he’s deliberately misrepresenting the work of others, selectively fitting data into his own pre-decided narrative. Very simply, this isn’t honest enquiry, let alone deserving of the word scholarship.

Why do people listen to David Graeber?

There are so many other examples of factual inaccuracies or self-contradictions that it’s laughable. For example, Graeber states his favourite assertion, that there were “no markets” until the Axial age (from about 800BC), when governments created them with the help of coinage to facilitate military development. Yet later in the book, he quotes the ancient Sumerian story of Enkidu in the Epic of Gilgamesh, which was written sometime between 1300BC and 1000BC (ie well before the Axial age). When Enkidu is sentenced to death by the Gods, he curses the courtesan he blames for his woes, wishing upon her a life of prostitution among the vomiting drunks in the taverns. In other words, at the time of Gilgamesh there were markets in the oldest products of all: sin (ale and sex). But according to Graeber there were no markets during this time.

I could go on, like when he tried to explain the US banking system but gets assets and liabilities mixed up (Ch 12); or when he says that gold is an IOU (Ch 3); or when he says the Iraq War was about maintaining the dollar’s reserve status (Ch 12).

But you get the idea. And now I hope you see that I’m not calling Graeber an idiot because I disagree with him but because he is one. Simply put, the guy’s a phoney.

Perhaps more interestingly though, he’s also enormously influential.

The average book review for Debt on Amazon is four stars (across nearly 400 reviews for various versions of the book and on various Amazon geographical sites.) People love this book. And his more recent book, Bullshit Jobs garnered plenty of attention and has been selling well.

He’s a professor at the LSE, one of the foremost institutions for the study of social sciences in the world (the same LSE once graced by Karl Popper and Friedrich Hayek, who I imagine are spinning in their graves). He’s a radio documentary writer for the BBC, a leader of the Occupy movement, and has been referred to as “the best anthropological theorist of his generation”.

So maybe the bigger question is what does it say about us, as a species so enamoured by our capacity for rational thought that a man so demonstrably unskilled at logical thinking as David Graeber, is widely seen as a ‘thinker’? He is widely acknowledged and esteemed as an ‘intellectual’. Why?
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