The "D" Word

By John F. Sase, Ph.D.

With Gerard J. Senick, Contributing Writer and Editor

"There ain't no such thing as a free lunch."

--Various Sources

In this month's column, we will explore the phrase that is referred to as one of the ten fundamental principles of economics, the concept of "No Free Lunch." In addition, we will explore its application to booms and busts in the U.S. economy over the past two centuries. We are addressing this issue because investors and their attorneys (as well as investors who are attorneys) need to read the waves of the financial sea before casting their nets. One needs to recognize the point at which an economic cycle hits its peak. Why? Approaching this apex indicates the time to bail out of the market. Of equal importance is the fact that an investor needs to read the trail markers in order to foresee the point at which the market "bounces," that moment at which a market bottoms out to its firm-foundation values and begins to rise again.

In our article of January 2011, we explored the stair-step dynamics of the Crash of 1929 that led to the Great Depression or, simply, *The* Depression. Due to its length and depth, this historic downturn has assumed a mythological quality. Many of us can recount stories of Grandma and Grandpa hiding their cash under a floorboard or burying it in a coffee can in the backyard. As a result, the "No Free Lunch" rule has come to mean the following: once a country gorges itself by living high on the hog during years of plenty, its citizens must pay the piper through lean years of biblical proportion.

Call Me What You Want. Just Don't Call Me Late for Lunch

The history of the "No Free Lunch" slogan dates from an ancient folktale in which a king convenes a meeting with all of the economists in his domain so that they may counsel him. One by one, the economists present his majesty with bad news. In response, the king lops off their heads. Finally, the last economist rises and says, "There ain't no such thing as a free lunch." This advice pleases the king so much that this sole remaining economist gets to keep his head.

In modern popular culture, the phrase seems to have its roots in the nineteenth-century practice of bars offering a "free lunch" with drinks. Ergo, the more you eat, the more you drink. As a result, the lunch is paid for from the excess profits made on alcohol sales. On the "Word Origins" Web site (www.wordorigins.org), David Wilton traces the earliest recorded incident of this marketing strategy to an advertisement for Eadie's Coffee House at 196 Fulton Street that appeared in the *New York Herald* (4 July 1848). Proprietor George Eadie offered steaks, chops, Scotch mutton, and veal pies along with brandies, wines, and liquors of the first quality—Free Lunch at 11 a.m.

During the mid-twentieth century, the catch phrase "There ain't no such thing as a free lunch" condensed to the acronym TANSTAAFL and began to appear in economic literature and popular fiction. Most notably, both the phrase and acronym played a central role in Robert Heinlein's libertarian science-fiction novel *The Moon Is a Harsh Mistress* (G.P. Putnam's Sons, 1966), which centers on the revolt against earthly rulers by a lunar colony. Also, economist Milton Friedman, a Nobel laureate, repaired the grammar and used the phrase as the title of one of his more popular books, *There's No Such Thing as a Free Lunch* (Open Court, 1977), a collection of interviews and observations about the state of economics in the 1970s.

TANSTAAFL began to show up in academic circles during the post-war 1940s. Infamous for getting a rise from the leftists, author Pierre Dos Utt describes an oligarchic political system based upon the conclusions that he drew from the principle of No Free Lunch in his monograph *TANSTAAFL: A Plan for a New Economic World Order* (Cairo Publications, Canton, OH; private printing, 1949). More pertinent to our discussion is a reference attributing the phrase to Leonard Porter Ayres, an American economist, statistician, educator, and soldier. In his column in the *New York Times,* Robert H. Fetridge tracks the professional use of the phrase to an interview with Ayres in 1946, shortly before his death ("Along the Highways and Byways of Finance, 12 November 1950). During his lifetime, Brigadier General Ayres had served as a mortality statistician for the U.S. military during both world wars, a director at the Russell Sage Foundation, and an economist for the Cleveland Trust Company. Fetridge writes, "It seems that shortly before the General's death…a group of reporters approached the general with the request that perhaps he might give them one of several immutable economic truisms that he gathered from long years of economic study…'It is an immutable fact,' said the general, 'that there is no such thing as a free lunch.'"

The Big "D"

I (Dr. Sase) reacquainted myself with the work of Leonard Ayres while rummaging through boxes of research material in my basement. I found an old fold-out timeline produced and annotated by Ayres for the Cleveland Trust Company in 1933. On this timeline, Ayres tracks all of the major and minor booms and busts in the U.S. economy since 1790 and measured thirty-seven downturns from 1790 to 1933. Fifteen of these slumps apparently were too mild to warrant a name. By today's standards, we would refer to these as recessions.

Ayres labeled the remaining twenty-two downturns as crises, panics, and depressions. By his reckoning, the Crash of 1929 heralded the twelfth economic depression in the U.S. Furthermore, Ayres indicates that a First and a Second Post-War Depression followed the War of 1812, the American Civil War, and the First World War. Consequently, the Great Depression of the 1930s originally was referred to as the Secondary Post-War Depression in respect to World War I. For those readers keeping count, we have produced the following list of all twelve depressions and their dates:

1. The Embargo Depression--1807 to 1809
2. The Primary Post-War Depression (War of 1812)—1819 to 1821
3. The Secondary Post-War Depression—1826 to 1830
4. Debt Repudiation Depression—1840 to 1845
5. The Secession Depression—1860 to 1862
6. The Primary Post-War Depression (Civil War)—1865 to 1866
7. The Secondary Post-War Depression—1873 to 1879
8. Depression of 1884—1883 to 1886

9. Silver Campaign Depression—1896 to 1897
10. War Depression (WWI)—1914 to 1915
11. Primary Post-War Depression—1920 to 1922
12. Secondary Post-War Depression—1929 to 1933

"What We Got Here Is…Failure to Communicate!"

So, what has happened since 1933? We have taught the average economics student that the United States has not experienced a depression since the 1930s—only recessions. However, if educators were to ask the ordinary Joe on the street, s/he likely would grimace with gritted teeth and shake his/her head in despair. As actor Strother Martin, the prison captain in the film *Cool Hand Luke* (Warner Brothers, 1967), said commandingly, "What we got here is…failure to communicate!" Effectively, our country has been in denial about depressions since World War II. The New Speak from Washington, D.C. became "Depressions are now called recessions." The "D" word became politically incorrect to use. Uttering that word would have spelled political suicide, even though we have passed through a number of downturns that Ayres and his predecessors would have labeled as mild to moderate depressions.

"What we got here" is a situation that parallels the grade inflation in our school systems that has turned "D" students into "C" students and "C" students into "B" students. Our readers also may remember how the unemployment rate dropped suddenly during the Reagan administration. The modus operandi to redefine the unemployment rate was very simple: The U.S. Bureau of Labor Statistics began to include all military personnel in its calculation of the unemployment rate. Previously, only non-institutionalized civilians were included. The apparent logic behind this reformulation was that all military personnel are employed. Therefore, the adjustment increased the size of the labor force while leaving the number of unemployed civilians the same. The result was an instantaneous reduction of the unemployment rate but migraine headaches for economists, sociologists, and statisticians.

Voldomort!

As a result of renaming depressions as recessions, our country has grown scared to death of the "D" word. Most people believe that hardly anyone under the age of eighty ever has lived through a depression. At one time, Americans considered a *depression* a cyclical economic event. However, depression now is a mental pandemic that has 10% of adult women and 5% of adult men ingesting pharmaceutical antidepressants. In respect to the economy, we have learned to treat the "D" word in the same manner that the students of Hogwarts avoided saying the name of "He who must not be named." Only Harry Potter and Professor Dumbledore had the *cojones* to call Voldomort by his real name, thus diminishing his power over them.

Nevertheless, the dance goes on. In their article "Diagnosing Depression" (30 December 2008), *The Economist* magazine states that, from their "search of the Internet," there are "two principal criteria for distinguishing a depression from a recession: a decline in real GDP that exceeds 10%, or one that lasts more than three years. A Gallup Poll report of 28 April 2011 states that, currently, "More than half of Americans (55%) describe the U.S. economy as being in a recession or depression." It remains unclear whether or not anyone polled can discern the difference.

Why might Americans believe this? Let us look at the evidence:

- The Dow Jones average dropped 40%, from a high in October 2007 to a low in March 2009. Currently, the large pool of rogue investment funds that fueled the Internet Bubble of 1999 and the Housing Bubble of 2006 favors the commodity market. As a result, their speculation has driven up the price of gasoline, beef, pork, wheat, corn, rice, and most other staple goods at a time when real consumer incomes have fallen.
- Credit to businesses and to homebuyers has virtually dried up. We may attribute much of this debacle to a shift away from stocks and mortgage-backed securities and towards commodities. Furthermore, the U.S. Government and governments around the world are being forced to provide most, or all, of the liquidity to frozen credit markets.
- Failures and near-failures of banks and allied institutions in both the private and public sectors in the United States and abroad have taken a devastating toll on investors and taxpayers.

Are we heading for--or are we already in--a depression? Let us consider the pros and cons to this debate. Supporting this assertion, we find that weaknesses in stock- and bond-markets, which make it more difficult for firms to raise growth capital, result from the shift towards commodities and a probable forthcoming commodities bubble. Additionally, this shift impacts the value of 401Ks and similar long-term consumer savings. In respect to real-estate equity, falling home prices have resulted in more than $1 trillion in losses to the financial sector as well as the erasure of home equity for most American households. For years, consumers have used home equity as a bank. Now, that bank has closed.

On the opposing side of the argument, we have not seen a trigger event like the one that followed Black Tuesday in 1929: in this case, the Dow dropped 30% in one week. The current slide downward has gone more slowly, not exceeding 30% in any one year. In respect to the housing market that remains glutted with foreclosures, the Federal Reserve took unprecedented measures to restore credit in order to give the housing market a chance to recover. Since events have affected business credit the most, the central banks of the world have pumped in much of the needed liquidity and, perhaps, have replaced the financial system itself. At home, fumbled contractionary monetary policies of the Federal Reserve Bank, which led to a rapid decrease of 30% in the money supply in 1929, have not been repeated by the present Board of Governors. Instead, the Fed seems to be using innovative financial tools in order to maintain liquidity. Also, the Fed is seizing banks before they go bankrupt and then reselling them to more sustainable—though often gargantuan—institutions (e.g. Bank of America, Chase, Citigroup, and Wells Fargo) that hold half of all bank assets.

In and out of the classroom, many people ask me (Dr. Sase), "What's going to happen? What should we do? I suppose that it depends on whether you are a pessimistic, glass-half-empty kind of person or an optimistic, glass-half-full kind. Either way, we may be operating at 50%. In the short run, most of us should reduce or eliminate our personal credit balances, take a more defensive posture in respect to retirement portfolios and other long-term savings, and learn to live within a more frugal balanced budget. In the long run, we need to snap to attention and realize that we are competing in a global market in which we do not have as much advantage as we did sixty years ago. Therefore, we and our family members need to invest more time and money in relevant education and competitive skills. Furthermore, we need to use the political clout of our votes to pressure all levels of government to invest likewise.

What does this mean for attorneys? When counseling their clients, we would suggest that they bear the above information in mind. In these economically uncertain times, one must help a client to decide whether or not to accept a pre-trial settlement or to carry the case forward to trial. Let us remember the outcome of John Grisham's novel *The Rainmaker* (Doubleday, 1995). The verdict awarding $50.2 million to the plaintiff, the estate of Donny Ray, evaporates when the defendant, Great Benefit Insurance Company, declares bankruptcy.

Dr. John F. Sase has taught Economics for three decades and has practiced Forensic Economics since 1997. He earned an M.A. in Economics and an MBA at the University of Detroit and a Ph.D. in Economics at Wayne State University. He is a graduate of the University of Detroit Jesuit High School. Dr. Sase can be reached at 248.569.5228 and by e-mail at drjohn@saseassociates.com. You can find some of his videos on Economics for Attorneys at www.youtube.com/saseassociates.

Gerard J. Senick is a freelance writer, editor, and musician. He earned his degree in English at the University of Detroit and was a Supervisory Editor at Gale Research Company (now Cengage) for over twenty years. Currently, he edits books for publication and gives seminars on writing and music. Mr. Senick can be reached at 313.342.4048 and by e-mail at gary@senick-editing.com. You can find some of his writing tips at www.youtube.com/senickediting.