THE RISE OF HOOKERNOMICS
Measuring the Urge to Splurge

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Call them the world’s oldest profession. Call them women of the streets. Call them call girls. But can you call them a leading indicator of the overall economy?

There’s a controversial and eerily accurate way to predict where the markets are heading. I call it “Hookernomics” and you guessed it, we’ll be using prostitutes and other “sins” as our proverbial crystal ball.

What Hookers Can Tell Us About Spending Habits

Economic expansion is best measured by the extent to which people are spending on non-essentials. Are people going on vacations, going to concerts, buying electronic gadgets and so on?

At the top of the discretionary spending pyramid is luxury. It's the form of spending with the least amount of practical utility, making it the canary in the coalmine for when the economy shifts up or down.

Most economists have an excessively narrow definition of luxury goods: items that have an absolute premium price such as yachts, or fine china. However they forget to note that one person’s luxury is another person's normal purchase. So while Tiffany’s sales tell us a lot about the 1%, it tells us nothing about the vast majority of Americans.

Instead, let’s expand luxury to mean something that (1) has no utility other than psychological gratification and/or (2) is a big-ticket purchase, consuming a substantial part of one’s income. There is only one form of spending that fits this definition and at the same time cuts across every socioeconomic group: vice.

Vices: A Special Type of Luxury Spending

Far more people indulge in booze, gambling, drugs and prostitution than those who buy Teslas or fine wines. There are an estimated 17 million pot smokers in America. Tens of millions of people visit Las Vegas every year. Millions of customers visit prostitutes. Every socioeconomic group is represented. Casinos cater to both upper and lower income consumers. There are low-priced prostitutes and $5,000 an hour escorts. Wealthy and poor alike smoke marijuana. Vice spending is the universal common denominator for luxury.

Before you dismiss gambling or prostitution as trivial indulgences, remember that the median American income is $51,000 a year. That’s $1,000 a week before taxes. For most Americans, two hours with a high-class hooker is a week's (after-tax) salary. That is the epitome of big-ticket splurging.
I introduced the concept of *Hookernomics and Vice Spending* in November 2013. That's when I released the Vice Index, the first quantification of vice spending in the US, and began using it to forecast retail spending. (Since then, my retail forecasts are among the most accurate on Bloomberg.)

![SouthBay Vice Index & US Retail 1995-2014](image)

In the chart above you can clearly see the correlation between vice and retail spending. What you don't know is that I have lagged the Vice Index by a few months. That means that vice spending leads discretionary spending and provides advance insight into inflation expectations and retail spending.

Most hookers or drug dealers don't accept American Express. Thus vice spending is dependent on cash flow, and it's very, very big. Even if they did take credit cards, would spenders want that on their records? If spenders must have cash in their pockets today and be confident that their vice spending won't impact tomorrow's needs, then the Vice Index is very sensitive to near-term changes in spending. This is why it leads retail and other broad economic benchmarks of consumer spending.

For example, back in 2013 when the federal government sequester hit, Washington DC area escorts immediately began to complain that business was slowing. That's how fast Hookernomics reacted to the big-dollar drops in the local economy.

**Hookernomics: Capitalism in Action**

The Internet did what has never been possible. It enabled the tracking of vice spending. Prostitution went digital a long time ago. One major website that catered to California prostitution since the 1990s, MyRedbook.com, was shut down in July 2014 by the IRS and FBI tag-team. By major, I mean that thousands of escorts were advertising their services over the course of the year. Back of the envelope math would say that this website
represented a $150M-$250M marketplace (assuming that (1) this was the single source of income to cover all expenses and (2) the minimum income requirement is $30K).

In addition to the size of its business, MyRedbook.com was unique because it catered to both providers and consumers of prostitution. It was the ultimate capitalistic marketplace where buyers and suppliers conducted business without intervention by government or unions... or middlemen (pimps). Market economics ruled. Even more so than in the commodities markets.

MyRedbook.com was successful because it behaved as a marketplace where buyers and sellers could communicate and share information in a consistent and quantified manner: quality of service, service details, pricing, availability and so on. There are similar websites that operate as information brokers and enablers but don't conduct actual transactions, such as Yelp, Craigslist, TripAdvisor and Angie's List. Each has come to dominate their market niche. In the case of MyRedbook.com, a fragmented market became concentrated and thereby ensured market efficiency.

In many ways, MyRedbook.com is better than the Chicago Board of Exchange:

- **Quality control:** Suppliers were rated and reviewed. Ensuring the quality of service has always been critical to every marketplace, from the CBOE to eBay. MyRedbook.com provided the same rating and review services as TripAdvisor, Yelp and Angie’s List, albeit to a niche market.
- **No barriers to entry:** Any buyer or supplier willing to take on risk had no barrier to entry. This ensured perfect competition.
- **Price transparency:** There were minimal pricing inefficiencies since fees were displayed, easy to see and updated. Excess supply or demand was immediately reflected in market pricing. Price shopping was easy.
- **Reduced the middleman:** The Internet has removed the need for a pimp, which effectively reduces the cost of business. Being able to advertise on the Web eliminates the need for an agent procuring business. Also, escorts have better ways to protect themselves via information sharing and even through Internet businesses that vouch for consumers (P411, for example, collects an individual’s personal information and ensures that he or she is who they say they are.) This is a dangerous business for providers. Beyond going to jail (the illegal aspect), clients can be dangerous. Every year the newspapers report about escorts killed by clients.

**Hookernomics Busted: Government Creates Inflation and Market Inefficiencies**

Removing the main marketplace in July caused severe market disruption. Instead of one website, there are now many, but none with the same coverage or level of information sharing. Imagine trying to find a new restaurant and not having Yelp.

Another change was the re-emergence of middlemen, or pimps. Pimps provide essential services in the form of security and in the form of practical help (hotels and car rental...
agencies have minimum ages). MyRedbook.com offered a means to share information that raised the escort's security. Without that, escorts are more exposed and more likely to seek outside help. Middlemen add costs.

With the market suddenly fragmented, competitive pressures have dropped and information flow interrupted. Buyers no longer have the easy means to shop around or compare prices. Inflation also emerged because escorts now have higher costs in the form of advertisements and pimps. Either way, extra costs must be passed on.

Existing and new websites have tried to step in to fill the breach. After all, MyRedbook represented $150M+ in annual transactions. That demand remains but the only thing missing is the marketplace. Current alternatives are of lesser quality, squeezing consumers and not in the nice way.

By eliminating geographical boundaries and enhancing access, the Internet increases the absolute size of any market by bringing more suppliers and consumers to the table. Remove the Internet, and business dies. MyRedbook.com proves the Internet's deflationary power. Since it was shut down, consumers are finding it harder and more expensive to shop.

So how do we put Hookernomics to work? One way is to quantify vice spending, which we can finally achieve thanks to the internet. That's the monthly Vice Index.

Another way is to look at the data qualitatively. Once we accept vice spending as a direct and early view into consumer spending, we can acknowledge that trends will pop up here before they emerge elsewhere. If a hotel starts offering free breakfast, then you know vacancy levels are up. In the same way, when casinos start offering free nights, it's time to wonder if business is robust.

**Hookers Want a Raise and So Do Las Vegas Workers**

Downtown Las Vegas casino workers almost went on strike in June. Participating unions were restaurant workers, housekeepers, bartenders and more. In all about 44,000 hospitality workers were affected. All casinos capitulated.

The trigger for the looming strike was a five-year contract that had expired and, after a year of negotiations, had not been renewed. Think about that: for a year union workers continued to work without a new contract. That is the opposite of labor strength.

Far from signaling oncoming wage inflation, the new contract terms hint at stagnant income growth. The terms are not clear, but last year MGM and other Strip casinos signed a five-year contract stipulating an extra $0.50 per hour in wages. That's a 3% hike (casino workers average $16 an hour). The catch is that the raise was for existing workers only. Casinos are allowed to hire more part-time workers at lower wages.
By trading full-time wage growth for part-time wage cuts, casinos face minimal labor cost inflation.

It's almost the exact same structure adopted a few years ago by Detroit's unions and automakers. Future workers' pay rates were sacrificed to ensure that existing workers got more money and benefits. Overall company margins are largely unaffected.

As for prostitutes, in 2013, escorts tried to raise prices. Demand drooped and they were forced to reverse course, except at the high end where prices held firm.

Fast forward to 2014. Escorts tried again to raise prices, and they succeeded – higher prices have held across the board. Unlike casino workers, escorts face more than just ordinary inflation. Hotel room costs have increased, among other business expenses.

However, just like casino workers, escorts felt that 2014 was time to raise their prices again, to pass on their higher costs to the buyer. Thus, they had same pressures and the same tentative move to raise wages.

Also notable is the expectation that consumers can pay. Escorts have found that their clients can afford the extra $50-$100. When consumers have cash, it is good news for the broader economy.

There's one important catch. Escorts are emphasizing a grandfathering system in which existing clients pay the old prices and new clients pay the higher costs. It's exactly like the casino worker deal: new entrants into the market pay the price. In the case of the casinos, new part-time workers are paid less. With escorts, new clients pay more. Higher costs are being phased in slowly, not all at once, and in a manner that is least disruptive to the current ecosystem. Current casino workers and hookers will get more money. Casinos and current escort clients pay no more. Being unpleasantly squeezed are the new entrants.

As a guide to the economy in general and retail spending and inflation in particular, there are four main takeaways from all this:

1) Inflation expectations are mild. Wage inflation pressure exists but it is slight.

2) Discretionary income growth is broad-based, spreading across all income levels.

3) Consumer sentiment is strong.

4) Retail spending is strong and likely to remain so.

While vice spending may not be the most savory and wholesome of topics, there's no denying it as an essential cog in the economic machine. So why would you ignore it?