
Recovering from a Depression

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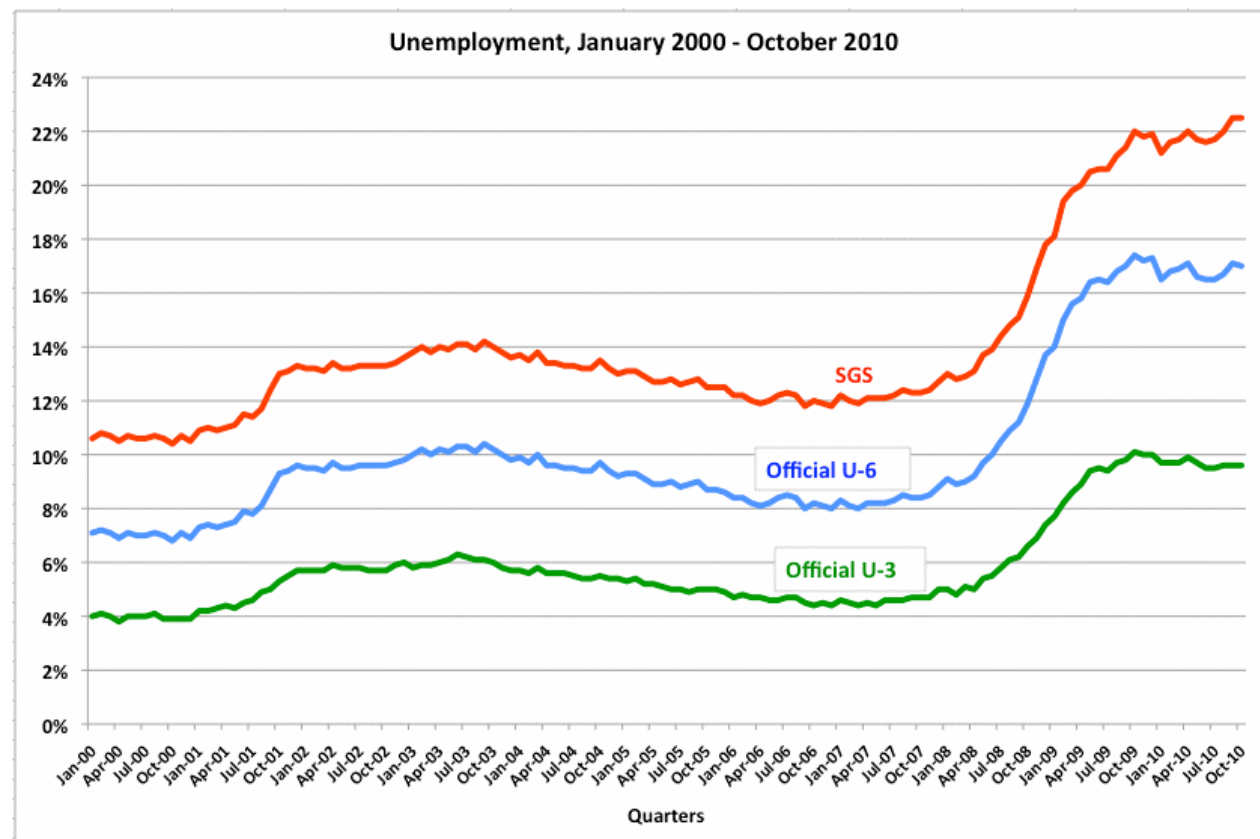
Since 2008 we have been mired in a depression with severe unemployment. We hear many claims that the depression/recession is almost over, but then more folks lose their jobs. Many voice conflicting demands on the federal government to “do something about it.” Unfortunately most government actions are counter-productive.

This paper explores the historic record of government policies that have been either promising or ineffective. I am not going to describe how the country gets into a depression, that is a much more complicated topic than recovery.

I assume our government wants to get out of this depression rapidly. However, since crises tend to move power toward government and we have the most rabidly power-seeking administration in my memory, I could be wrong in this assumption.

Unemployment

While unemployment has not yet set an all-time record, this chart shows it has reached painful levels.



The 3 lines on this chart show unemployment has increased substantially above that in the recession of President Bush's first term (2001-2003).

U-3 shown in green is the statistic normally published in the press.

The government also publishes a few other estimates of unemployment, the most expansive of which is **U-6**. The U-6 includes "discouraged workers" who have been discouraged less than one year.

The **SGS** (John William's *Shadow Government Statistics*) line adds back in the longer term "discouraged workers" that were removed from **U-6** in 1994.

2009 -2010 activity

Should we, or can we, do something to shorten unemployment, or must we just treat the symptoms?

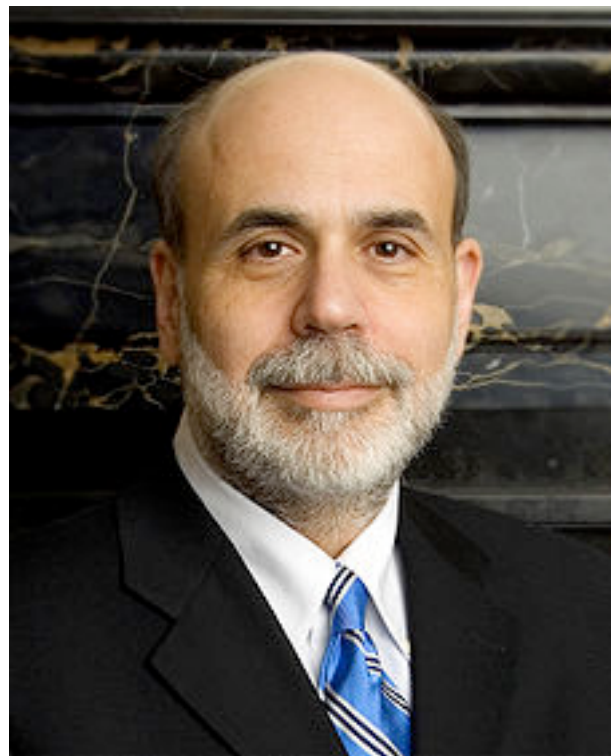
At the Federal level, President Obama continues to claim recovery, while more people lose their jobs.

Ben Bernanke, Chairman of the Federal Reserve (Fed) is the most active player trying to do "something about it."

Bernanke is printing new money that he says will prevent deflation. Is preventing lower prices is a good thing? I guess, if your mortgage is underwater. But it certainly penalizes the folks that would like to buy something.

However, there is a very political aspect to a glut of dollars. New money allows President Obama to expand government while as it subtracts value from everyone else's dollars.

Bernanke was a very bright student. He received his BA in Economics from Harvard in 1975, his PhD from MIT in 1979, taught at Stanford, and New York U. He was tenured at Princeton, later serving there as Economics Department Chairman there.



Ben Bernanke, 14th Chairman of the Federal Reserve

He was appointed to the Fed Board of Governors in 2002 and resigned in 2005 to become Chairman of President Bush's Council of Economic Advisors. Bush appointed him Chairman of the Fed in 2006.

A serious student of the Great Depression that started in 1929, he has given credit to Friedman and Schwartz for their monetary policy work. But in practice he has sided with Keynes in flooding us with newly printed money. He has chosen to call his money flood "QE" (Quantitative Easing). QE uses

government bond purchases to inject new money into the economy. The first round of QE failed, so we are now into QE2.

When questioned about taxation and other fiscal policy matters he has said it “was none of his business.” This from a man who on the Board that oversees the fiscal TARP bailouts.

I predict Bernanke will fail

I predict Dr. Bernanke’s policies will fail because he assumes the economy is held back by people not spending enough. People don’t spend when they are trying to improve their balance sheets and avoid bankruptcy.

Bernanke also ignores people’s unwillingness to invest and spend when faced with governmental uncertainty. Most people prefer to ease back on new investments and spending when the government appears to be unable to deal with an economic downturn.

He ignores the government’s added complex rules that make doing business more costly without getting more money.

He ignores the fact that the Feds’ own policies have been adding too the uncertainty.

By not vigorously browbeating politicians to reduce their level of theft and spending, Bernanke has made recovery unlikely and will most likely cause the depression to be a very extended affair.

In spite of his careful academic study of the 1929 depression, Bernanke appears to be adopting the very policies that extended it.

Dr. Bernanke has failed to compare the depression of 1920 with the depression of 1929 or the current depression.

He badly needs to study the fiscal policies of President Harding.

The Depression of 1920–21

Why should we look 90 years into our nation’s past at a President who is little remembered, and, when remembered, is renowned only for the scandals that marred his administration?

President Harding inherited a very sharp depression from President Wilson. It was fully as painful as the early phases of the depression of 1929.

Economic statistics were very rough in 1920 but the Commerce department claimed production declined nearly 7%.

The estimated GDP dropped 24% from \$92 billion to \$70 billion.

The number of unemployed rose 133% from 2.1 million to 4.9 million.

The depression started in January 1920. As early as March, when Harding announced his candidacy for President, he advocated a cut in government expenditures and stated that the government ought to ‘strike the shackles from industry... We need vastly more freedom than we do regulation.’

In Harding’s 12 June 1920 speech accepting the Republican nomination, he laid out his approach to the depression.

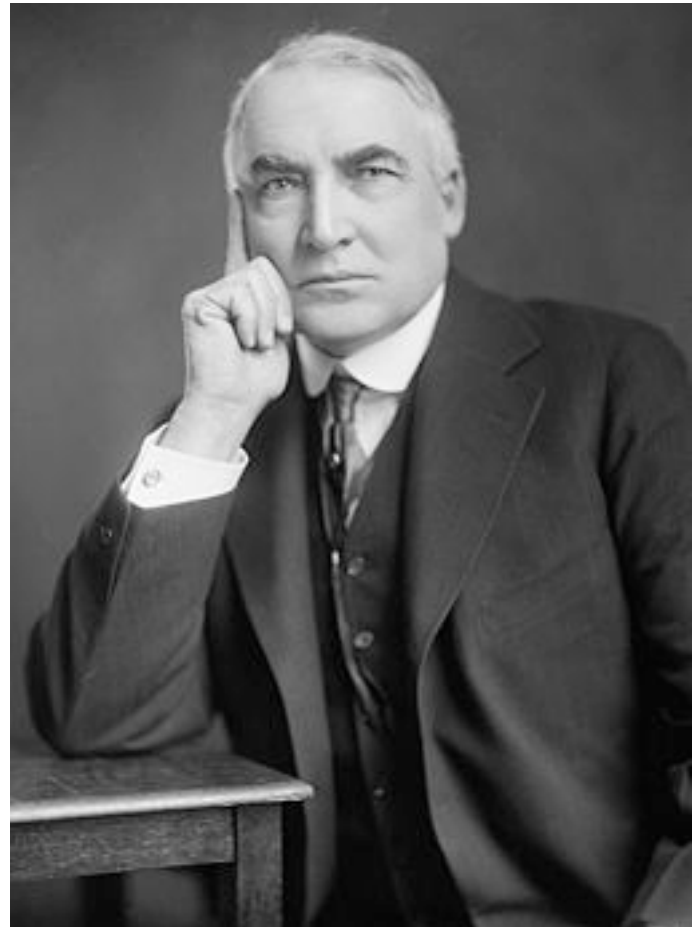
He would:

- Encourage deflation,
- Cut government borrowing and debt,
- Attack government costs and waste,
- Encourage savings, and
- Reduce tax rates.

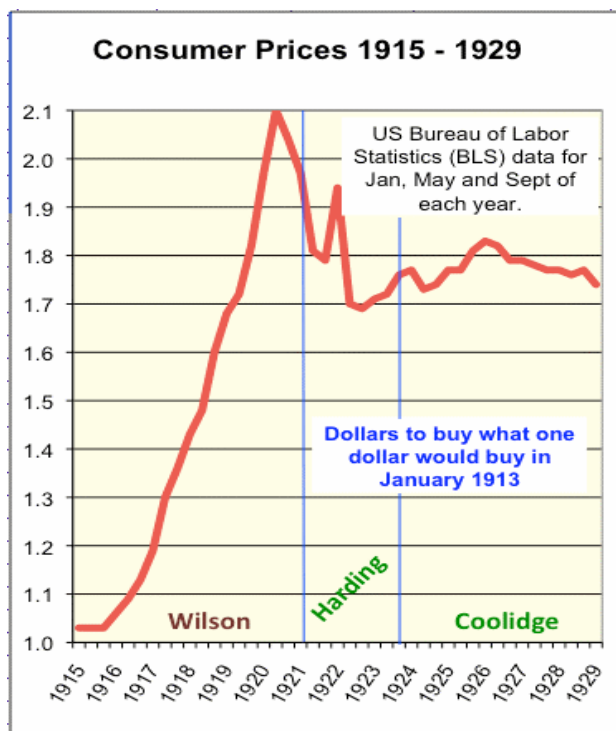
His economic policies for the country began when he was inaugurated in March of 1921.

The speed of recovery was dramatic.

Neither Harding nor the Federal Reserve tried to prop up prices and they fell 18% according to the Commerce department.



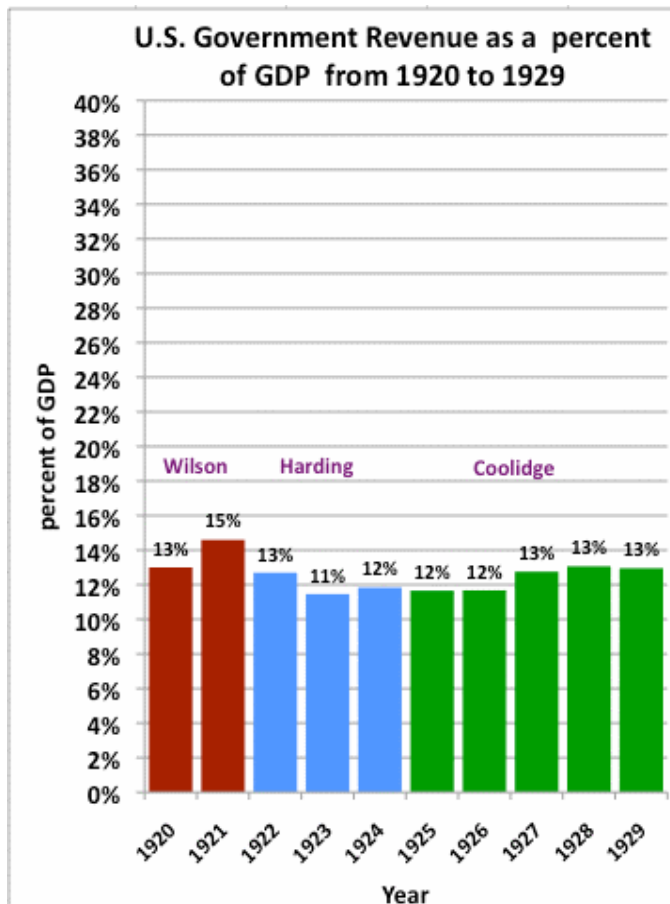
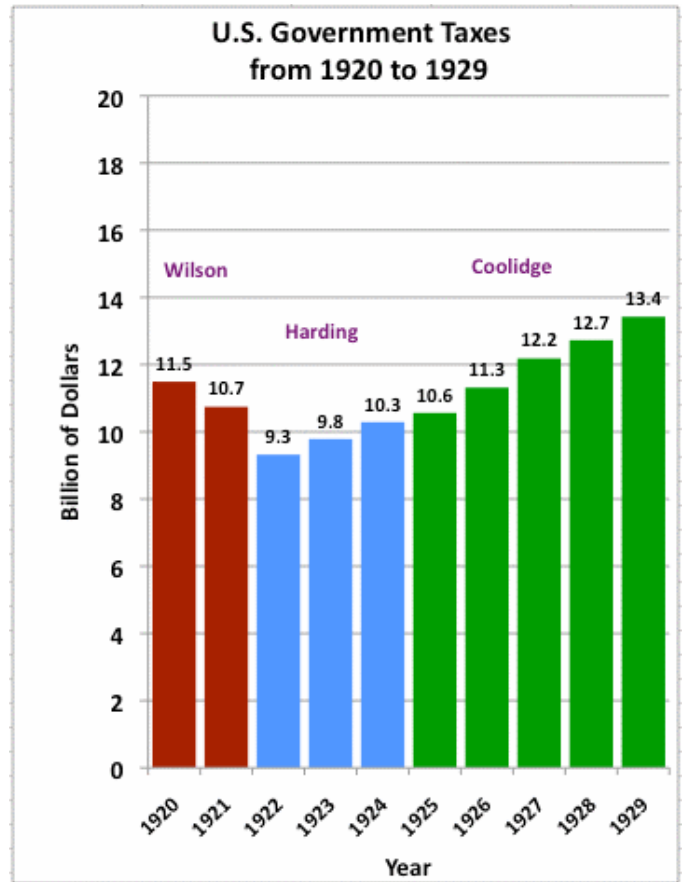
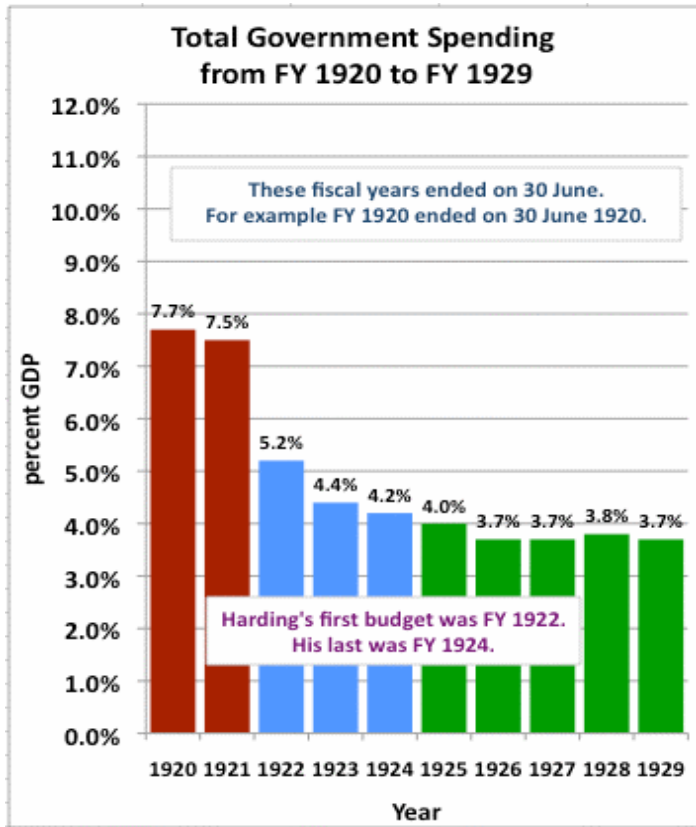
Warren G. Harding, 29th President of the United States, 04 March 1921 – 02 August 1923



Harding’s attack on government costs was equally successful. He trimmed over 30% from Federal spending in his first fiscal year. He continued to trim and the reductions were held down by his successor – President Coolidge.

He also reduced the federal debt.

Harding cut tax rates on the very high earners, taxes on corporate profits and “excess” profits taxes. Low income tax rates were unchanged. He explicitly favored those who might provide jobs.



The combination of tax cuts and the depression, reduced Government revenues by nearly 9% in 1922. However, for the next 7 years, government revenues steadily increased.

The *Revenue vs. GDP* chart, shows that increased government revenues were from renewed growth in the economy, not from higher tax rates.

The depression reached bottom when Harding had been in office for only 6 months (August 1921); by 1922 unemployment was down to only 6.7%. In 1923 unemployment reached a record low of 2.4%.

With minimal intervention the American people had recovered from a severe depression in a very short time.

Japanese actions in 1920-1928 form an instructive contrast to Harding's actions.

Starting in 1920 the Japanese instituted a planned economy. They held prices artificially high believing deflation would make the depression worse. As a result, they stagnated for 7 years, producing a disastrous banking crisis in 1928. To avoid one year of losses on inventory, Japan had lost 7 years of potential growth.

The Depression of 1929-41

In 1929 President Hoover inherited a booming economy from President Coolidge. He had been in office only 7 months, when the market started its long tumble.

Hoover had worked for all of the preceding 3 presidents. For Wilson, he mobilized food for the war. Harding and Coolidge appointed him to the minor post of Commerce Secretary.

He was a very hard worker; always initiating new endeavors. In spite of this frenetic activity, neither Harding nor Coolidge respected his judgment. Harding consistently ignored his interventionist advice and Coolidge derided him as “wonder boy.”

As president, Hoover rejected the policies that had gotten us out of the previous depression and tried numerous interventions.

He made many attempts to prevent layoffs, erosion of wages, deflation, price declines and other symptoms of depression. The depression only stretched on and got worse.

In essence Hoover’s policies slowed down the realignments necessary to recover to a robust economy.

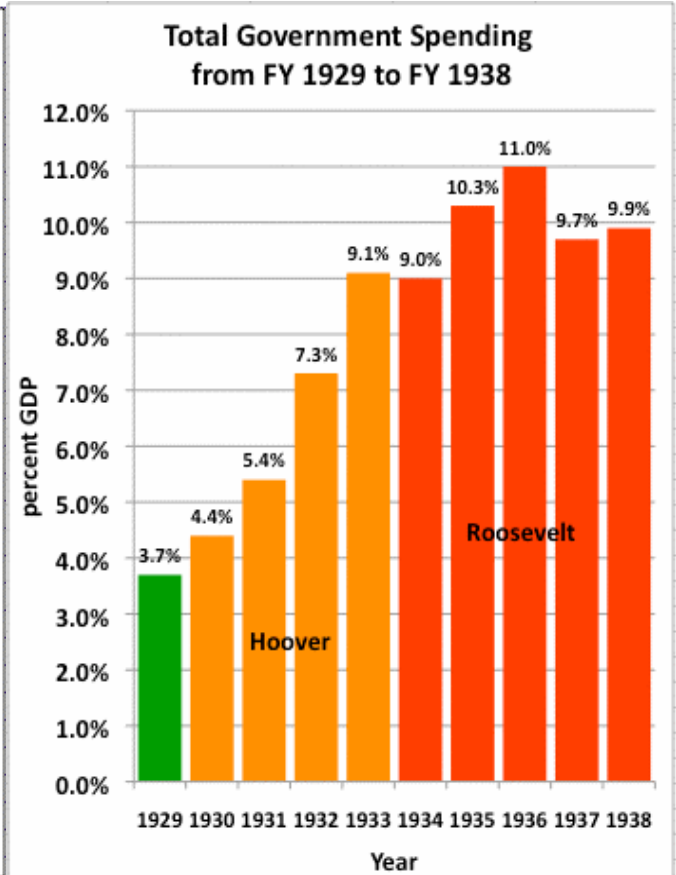
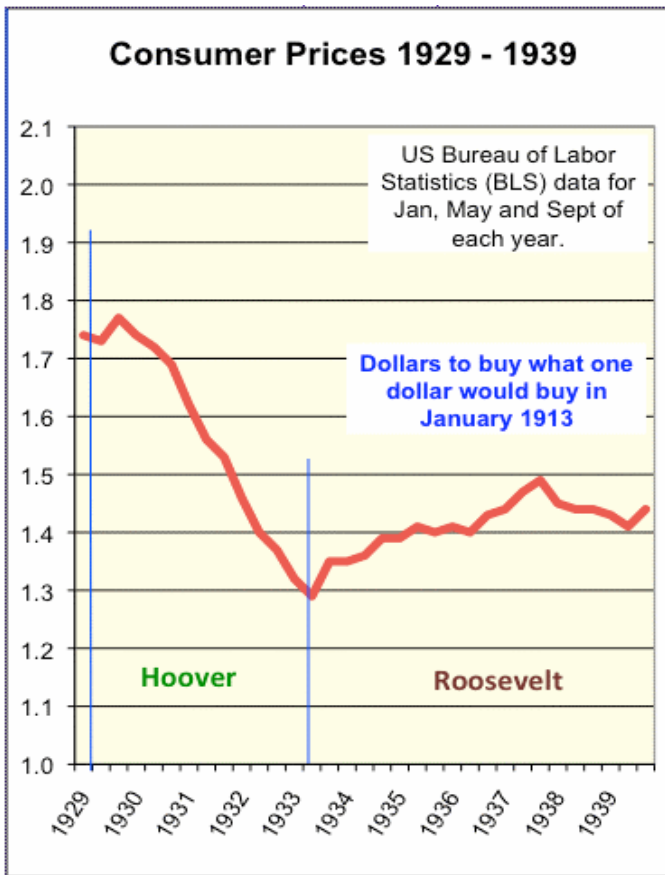
He did reject the dole as addictive, but also adopted a number of pro-labor policies that delayed economic adjustments.

His National Credit Corporation (NCC) formed to prevent bank failures -- failed.

In spite of Hoover’s efforts to curb deflation, it continued, although not as rapidly as in 1920-21.

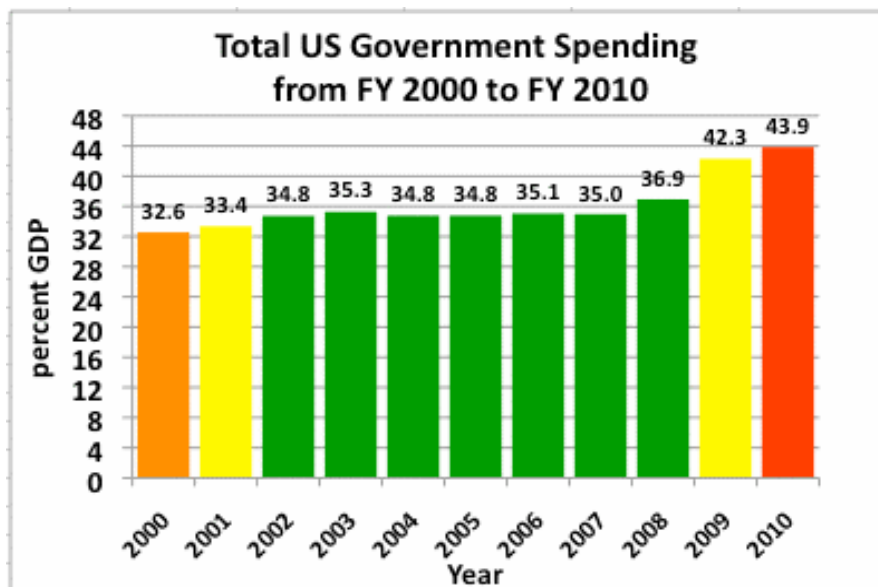


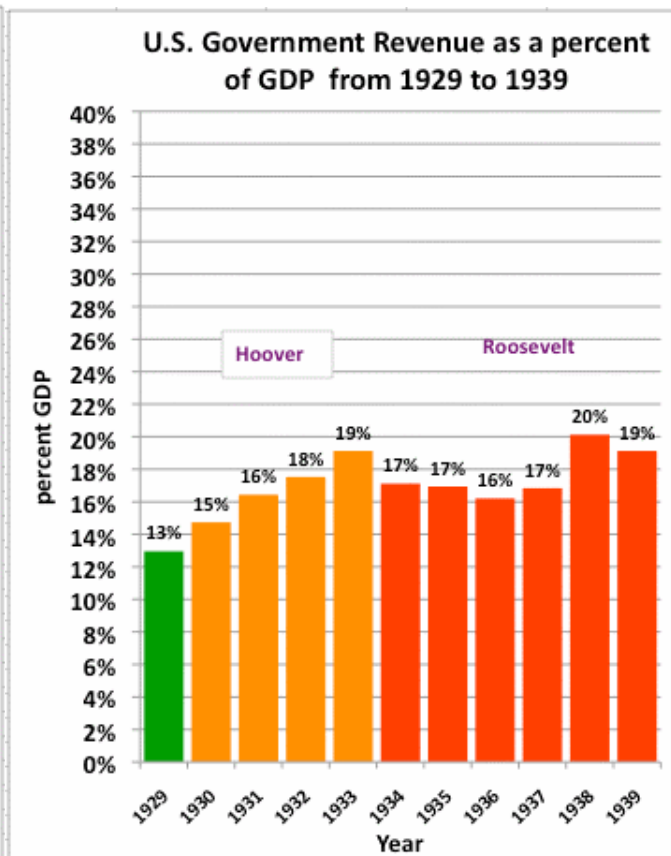
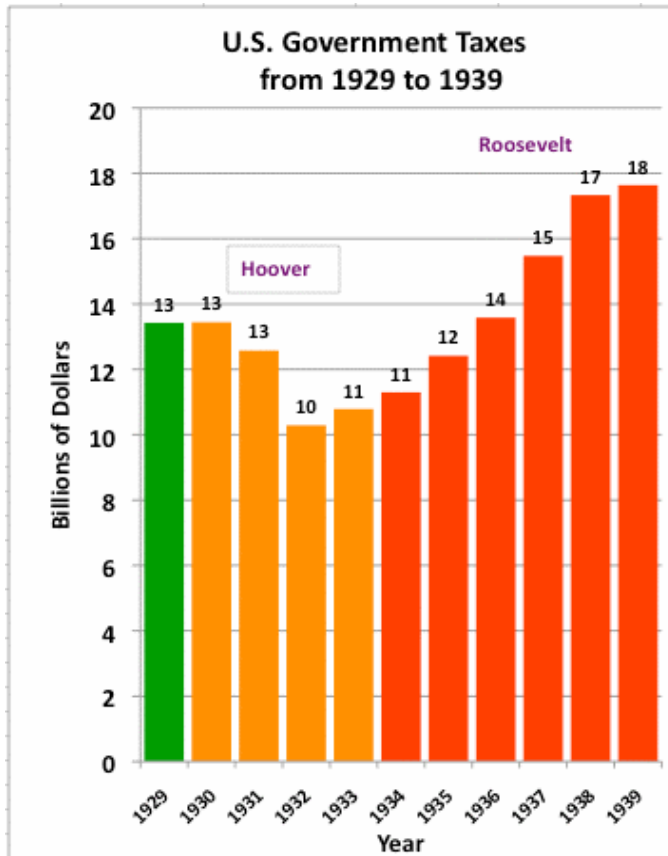
Herbert Hoover, 31st President of the United States,
04 March 1929 – 04 March 1933



Hoover allowed government spending to increase throughout his term. By Roosevelt's election in 1932, government's "share" of the economy was twice what it had been in 1929.

Compared to President Hoover's making citizens 5.6 % poorer, President's Bush and Obama have made them 11.1 % poorer in FY 2009-2010.





As the economy slowed down government taxes produced less revenue.

For the 1932 tax year, Hoover signed a massive tax rate increase on upper incomes, that more than doubled their tax bills. This discouraged investment and further lowered the government’s revenue, putting it at the lowest level of the Great Depression.

Roosevelt’s Depression of 1933-41

Hoover was defeated as “too profligate” by Franklin Roosevelt in the 1932 election. But Roosevelt not only failed to change the direction of Hoover’s programs, but employed deficit spending and expanded the government intervention with a host of new agencies. The economy would periodically attempt a recovery, but then slip back. New taxes, new programs, and labor laws added to the uncertainty. They combined to cause a particularly serious downturn in 1938.

Roosevelt took office with extremely strong support and passed a great deal of legislation in just a few weeks. He declared a 4-day bank holiday on Monday and submitted an Emergency Banking Act which was passed at the end of his first week.

He signed into law 13 major pieces of legislation in the next couple of months as well as starting major public works projects.

When the Supreme Court struck down some of his legislation as unconstitutional, he tried to expand the court to add some of his own appointees. This “packing” of the court did not get a favorable response from Congress, who looked a little more carefully at his additional proposed legislation.



Franklin Delano Roosevelt, 32nd President of the United States, 04 March 1933 – 12 April 1945

Prices came back slightly after the extreme deflation, but never rose to 1920 levels until well into WWII.

Taxes went up every year. Particularly excise taxes on things that form a major part of spending by the poor.

FDR did not change the income tax rates that Hoover had escalated in 1932 until 1936 when a new top rate of 79% was instituted. Rates on lower incomes were static from 1919 until 1941 when they were more than doubled.

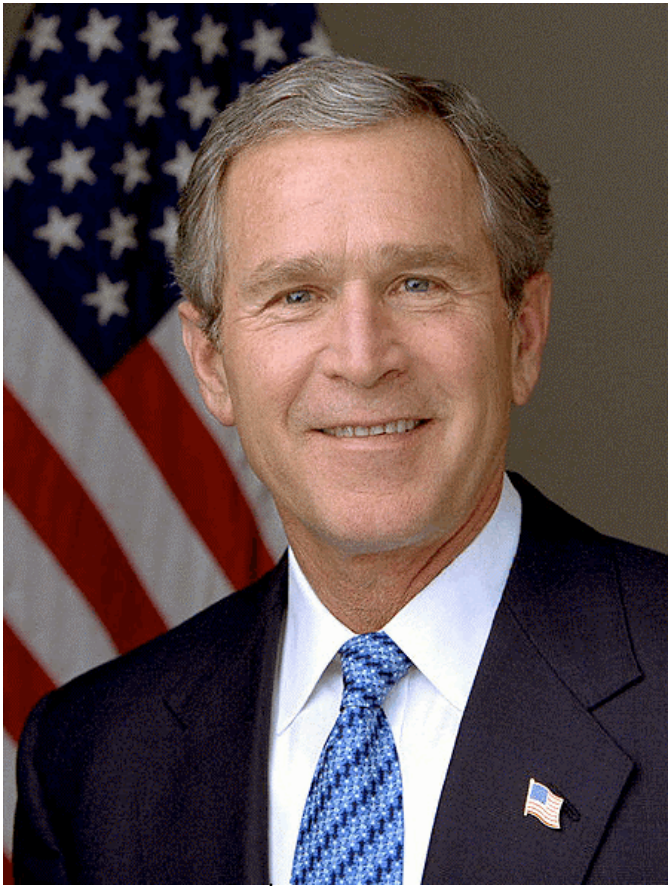
Even more than most politicians, Roosevelt failed to understand that creating public sector jobs extracts serious resources from the private sector. We now know that to fund one public sector job, we lose more than one private sector job.

Economists at UCLA have estimated that FDR's efforts to fix the depression lengthened it by 7 years added to Hoover's 3 year delay in facing the music.

The Depression of 2008 - ?

Our current depression has seen:

- a doubling of unemployment.
- an attempt to increase taxes on job providers, and
- unemployment payments have been extended multiple times, often delaying painful, but required, adjustments to lower wage rates.



George W. Bush, 43rd President of the United States, 20 January 2001 – 20 January 2009



Barack Obama, 44th President of the United States, 20 January 2009 - ?

President's Bush and Obama have mimicked policies similar to those that led to such despair between 1929 and 1942.

Specifically these policies are:

- Keeping taxes high
- Increasing the money supply
- Government business takeovers
- Increasing regulations
- Failing to rescind counterproductive past regulations
- Increasing government spending
- Adding public works
- Adding government employees
- Bailing out private concerns

These policies are going forward even though we are the biggest borrower on Earth. Our federal debt now exceeds the annual GDP.

A major portion of our debt is owed to foreign borrowers. These debt owners are complaining bitterly since we are now driving down the value of the dollar.

The threat of hyperinflation not only exists, but it is hard to imagine a scenario in which it does not almost totally destroy the value of the dollar.

The table below compares some major features of the policies used to treat these three American depressions.

Comparing the 3 depressions:

	<u>1920-1921</u>	<u>1929-1941</u>	<u>2008-?</u>
Presidents	Wilson- Harding	Hoover-Roosevelt	Bush-Obama
Employment	sharp drop	gradual drop	medium drop
Duration	short	very long	?
Monetary base	no change	slowly doubled	rapidly tripled
National debt	reduced	increased	wildly increased
Government spending	slashed	increase	major increase
Public works	none	many	many
Market drop	severe	very severe	moderate
Bailouts	no	some banks	yes

Or looking at it from a general policy perspective:

Fiscal stimulus	no	yes	yes
Monetary stimulus	no	yes	yes

Looking at this summary, it certainly appears that increased government spending, public works, easy money, and bailouts serve only to extend the duration of a depression.

Keeping a stable money supply, slashing government spending and taxes appears to make the correction occur rapidly.

Our current national policies appear designed to extend the depression!