Treacherous Myopia

By The Mogambo Guru

03/15/04 Why was the Great Depression so Great? Because the Fed did not implement the policies it has today, argues Ben Bernanke. Below, the great Mogambo tells Mr. Bernanke he needs to get his glasses checked…unless he is purposely avoiding seeing the truth.

Today we come to Federal Reserve Governor Ben Bernanke, who thinks he is smarter than everybody. This arrogance probably comes from the fact that he was the top dog in the economics department of Princeton, where he was molded by years of him being able to run his fat mouth without anybody having the guts to tell him that he was full of crap. Perhaps because he took the wise precaution of assembling his department out of his own coterie of lackeys, hangers-on and yes-men.

I cast these rude aspersions on him because this guy, this Bernanke person, actually said, in a speech entitled "Money, Gold and the Great Depression" to Washington & Lee students a mere two weeks ago, that he thinks that the Depression of 1930′s was the result of having a gold standard! Hahaha! This guy is too much! The Depression was caused by the gold standard! Hahaha!

Let's let Mr. Bernanke set the scene in Bernanke-world. "Some [have] argued, for example, that overinvestment and overbuilding had taken place during the ebullient 1920s, leading to a crash when the returns on those investments proved to be less than expected." You can tell by the way Bernanke says this that he does not believe that overinvestment and overbuilding are even possible. But when you look at the data, sure enough, there was a lot of rampant speculation and borrowing all through the '20′s, all facilitated by the Federal Reserve acting like the morons that they are and providing the money with which to engage in that kind of activity.

Ben Bernanke: No Such Thing As Overbuilding

And the Fed, even today, almost eighty years later, still does not believe that there is such a thing as overbuilding or overinvestment, although they DO recognize that there is excess productive capacity everywhere, which is, according to them, NOT overbuilding or overinvestment, but is something else entirely, although they won't say what it is. And where did all this productive overcapacity come from? Same as today! From the Fed and the miracle of fiat currencies in a fractional banking system run amok!

Then Bernanke goes on to announce, in that "I'm so smart and you're so stupid" way people have when they belabor the obvious, "Another once-popular theory was that a chronic problem of 'under-consumption' – the inability of households to purchase enough goods and services to utilize the economy's productive capacity – had precipitated the slump." So we are right back to the same ridiculous Fed-speak: the economy was suffering because people weren't buying enough stuff!

And why didn't people buy stuff? Hey! Easy one! I figure that this is my big chance to show off how smart I am, so without waiting to be called upon, I happily jump to my feet and announce "For the same reason that ALL people don't buy things they want: They didn't have the money!"

And then Bernanke also laments that they didn't buy things on credit, either. Which the Fed is urging people to do right now, which translates into those old-timers not going into debt when they didn't have any money, but us new-timers ARE going into debt when we don't have any money? And the lesson is – and notice how I am all scrunched up over my little desk, pencil poised, ready to write down the pearl of wisdom that is about to be dropped into my lap – that if they had borrowed the money, see, just like people are doing nowadays, then the Great Depression would have been, and notice by the way my voice quivers in anxious anticipation, avoided completely?

Ben Bernanke: Prosperity Through Debt

I swallow – gulp! – and can only manage to say "Wow!" You mean that a big-shot at the Federal Reserve is saying that it IS possible to achieve prosperity, and get out of an impending depression, by going into ever-more debt? You mean, I can buy lotsa neat stuff, and a real nice house, with a big 'ol wad of equity in the stock market, and a bulging 401(k), and jet-skis, and a second home, and fancy cars, and more, if I keep borrowing until I die? You never have to pay money back?

But Bernanke doesn't go on to tell you WHY people were not borrowing like mad to buy SUV's and the like in the late 20′s and all the '30′s. But I, the MoGu, will give you three, count' em three, very good reasons why people did not go into crushing debt to buy SUV's in the late 20′s and all the 1930′s: They didn't buy them because 1) they didn't have the money, and 2) SUV's weren't invented yet, but even if they HAD been invented, they STILL wouldn't have had the money to buy them, and 3), they were smarter than we were, and everybody knew back then that you couldn't have an economy that was predicated on everybody and everything going farther and farther into debt. The whole idea seemed ludicrous. And it is.

Then Bernanke drops what he thinks is some big bombshell or something. "However, in 1963, Milton Friedman and Anna J. Schwartz transformed the debate about the Great Depression. That year saw the publication of their now-classic book, A Monetary History of the United States, 1867-1960. Friedman and Schwartz argued that 'the [economic] contraction is in fact a tragic testimonial to the importance of monetary forces' (Friedman and Schwartz, 1963, p. 300)."

This ignores the fact that Friedman himself has subsequently admitted the errors in his strictly monetarist theory. But this does not deter Bernanke one iota. Maybe he ain't heard the news, or something. So if you personally know Milton Friedman, tell him to call Ben at the Fed, as he is seriously behind in his reading, and would probably appreciate being brought up to date. Obviously nobody at his old alma mater is going to tell him.

Ben Bernanke: Don't Prick the Asset Bubbles

Bernanke does go on to admit that taxes were raised, but like all good collectivist yahoos, he doesn't think high taxes have any deleterious effect of economies, so he doesn't linger there. He goes on to say that the reason things went downhill is that the Fed raised interest rates. He asks: "Why then did the Federal Reserve raise interest rates in 1928? The principal reason was the Fed's ongoing concern about speculation on Wall Street. Fed policymakers drew a sharp distinction between 'productive' (that is, good) and 'speculative' (bad) uses of credit, and they were concerned that bank lending to brokers and investors was fueling a speculative wave in the stock market. When the Fed's attempts to persuade banks not to lend for speculative purposes proved ineffective, Fed officials decided to dissuade lending directly by raising the policy interest rate." Ergo, the current Greenspan-Fed rationale for not trying to prick an asset bubble, but merely dealing with the aftermath.

Now we start getting into the really weird stuff. Bernanke admits that "the gold standard appeared to be highly successful from about 1870 to the beginning of World War I in 1914. During the so-called 'classical' gold standard period, international trade and capital flows expanded markedly, and central banks experienced relatively few problems ensuring that their currencies retained their legal value." So it worked well! So something happened, he says, between 1914 and the Depression.

He does not admit, however, that the newly formed Federal Reserve system, in operation for fifteen short years, had anything to do with subsequent calamitous economic events. The simultaneous appearance of these two things were, I suppose, merely a, you know, huge coincidence or something.

He extrapolates to announce: "Perhaps the most fascinating discovery arising from researchers' broader international focus is that the extent to which a country adhered to the gold standard and the severity of its depression were closely linked. In particular, the longer that a country remained committed to gold, the deeper its depression and the later its recovery." I agree that this is probably true. Economic distress is the downside of the requirements that gold places on an economy, which dictate that you NOT get into an economic mess to start with, because there is no way out. And a gold standard prevents you from doing the excessive monetary expansion thing to get inflation cooking, which is supposed to bail out the debtors. In that regard, thank God for America being on the gold standard, or the Great Depression would have been much worse than it was!

Ben Bernanke: Fire up the Printing Presses!

But – and I guess this is the lesson to be learned, according to Bernanke – countries wherein you could just fire up the printing presses must have gone on to achieve lasting prosperity, like the Weimar Republic in Germany or something. Hahahaha!

Then Bernanke asks the Big Question: "What caused the Depression?" Well, he figures that it is deflation, which is confusing cause and effect. "Deflation, like inflation, tends to be closely linked to changes in the national money supply. While the fact that money, prices, and output all declined rapidly in the early years of the Depression is undeniable, the interpretation of that fact has been the subject of much controversy." Not to me, it hasn't.

Then he gets back to the discredited monetarist approach. "Friedman and Schwartz emphasized at least four major errors by U.S. monetary policymakers. The Fed's first grave mistake, in their view, was the tightening of monetary policy that began in the spring of 1928 and continued until the stock market crash of October 1929 (see Hamilton, 1987, or Bernanke, 2002a, for further discussion)." Note how he uses himself as a reference!

"The gist of the Friedman and Schwartz argument is that, for a variety of reasons, monetary policy was unnecessarily tight, both before the Depression began and during its most dramatic downward phase. Friedman and Schwartz concluded therefore that they had found the smoking gun, evidence that much of the severity of the Great Depression could be attributed to monetary forces."

This flies in the face of an article by Frank Shostak entitled, "Does a Falling Money Stock Cause Economic Depression?" who writes, "However, a close examination of the historical data shows that contrary to Friedman, the Fed was extremely loose and pumped reserves into the system in its attempt to revive the economy (on this see Murray Rothbard's 'America's Great Depression'). The extent of monetary injections is depicted by changes in the Fed's holdings of U.S. government securities. Thus on January 1930 these holdings stood at $485 million. By December 1933 they had jumped to $2,432 million – an increase of 401%. Moreover, the average yearly rate of monetary injections by the Fed during this period stood at 98%."

So the Fed was NOT stingy in pumping up the money stock, as alleged by Bernanke. Mr. Shostak goes on to say, as I go on to say, as all thinking people go on to say, that earlier Fed excesses were, in fact, responsible for the Great Depression. "In addition to this, at some stages monetary injections were massive. For instance, the yearly rate of growth of government securities holdings by the Fed jumped from 19.7% in April 1924 to 608% by November 1924." In half a year!

This bit of evidence garners support for the brilliant Austrian school of economics insight that, as Mr. Shostak puts it, "Contrary to popular thinking, depressions are not caused by tight monetary policies, but are rather the result of previous loose monetary policies."

Ben Bernanke: Goosing up Money and Credit

In this case, the damnable Fed had spent the entire 20′s goosing up money and credit at a breathtaking pace that was unheralded in American history. A fact ignored by Mr. Bernanke, who wants us to focus on the RESPONSE to the crash and depression, NOT what caused it. And why is he so myopic about that? Because that is what he is doing right now! He goosing up money and credit, just like in the 20′s! This very minute!

Bernanke, however, goes on to give us more evidence of his profound ignorance: "The finding that leaving the gold standard was the key to recovery from the Great Depression was certainly confirmed by the U.S. experience. One of the first actions of President Roosevelt was to eliminate the constraint on U.S. monetary policy created by the gold standard, first by allowing the dollar to float and then by resetting its value at a significantly lower level." In other words, he says devaluing the currency, hopefully not to worthlessness, but just this side of worthlessness, is a "good" thing!

So Robert Rubin and all the other Treasury Secretaries up till now were wrong when they professed a desire for a strong dollar, that was supposed to be "in the best interests of America"? Get Rubin on the phone! I'll bet he wants to hear this!

Currency devaluation might have been thinkable in 1930…but then again, we did not have a current account balance that is today, even as we speak, over $541 billion a year! 5% of GDP! A devalued currency is NEVER a good thing to a nation that imports things. It is a BAD thing to have a devalued currency if you are a nation that imports things. We import a lot of things.

By this time Japan, which has been following this ridiculous Bernanke policy prescription for fourteen years in a row, should be roaring. It is not. Bernanke does not explain why. And, in a similar vein, the United States economy should be roaring along, too, given the record-setting levels of monetary and fiscal stimulus that have been pounded into the economy, especially for the last three years. Three years!

Likewise, the U.S. economy is not roaring at all. The lessons Bernanke "learned" from the Great Depression have not resulted in his leading us into greener pastures along with his fellow partner in crime, Greenspan. Instead, we are sinking farther and farther into the stinking swamp that is shown on your maps as the area with the skull-and-crossbones, labeled "Kiss your debt-besotted butts goodbye."

Regards,

The Mogambo Guru
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Mogambo Sez: In a nutshell, hopefully figuratively and not literally, we are going to be economically killed, and we are going to be killed because we are stupid, and we deserve to die. History is very cruel to stupid countries full of stupid people doing stupid things.