The Monetary Factor in the Economic Downturn

To see the role of the monetary factor one must look beyond the present or even the recent past. One could go back to the late nineteenth century or earlier, but the problem really got underway with the creation of the Federal Reserve by the Wilson administration in the early twentieth century (ostensibly to prevent recessions -- that's worked out really well hasn't it?). This was followed by Roosevelt taking the U.S. currency off the gold standard (and confiscating gold from citizens) during the depression. This action significantly devalued the currency and giving the Federal Reserve a larger financial space in which to operate. Devaluing the U.S. currency in effect inflated the money supply, which allowed paying off government debts and obligations at a discount. The USG agreed to continue redeeming obligations to foreign governments in gold but at the new set price, which significantly discounted the obligations.

The problem really began catching fire with Johnson and his Great Society (War in Vietnam, War on Poverty and Medicare), which greatly increased federal debt and obligations. At the time, I recall reading an article in the "New Republic" lamenting the long-term economic effect this was going to have. The effects didn't take long to catch up as the Nixon administration soon found itself facing foreign government obligations and demands for more gold than the U.S. had in its reserves. Thus, Nixon was faced with either defaulting on some or all of the debt and obligations or finding a way to appear to meet them. Thus, Nixon took the U.S. the rest of the way off the gold standard declaring that the U.S. would no longer meet obligations to foreign governments in gold (implicitly saying we didn't have the gold to meet the obligations we had incurred).

This contributed to the runaway inflation of the 70s and a further devaluing of the currency. The original link between a dollar and an ounce of gold was $1:1oz. It is currently around $1200:1oz. It was during this period that a scheme for tying the value of the dollar to the price of oil was devised. This was achieved by forging an agreement with oil producers to price oil in dollars. One side effect of this scheme was to significantly elevate the power and importance of big oil companies. The USG under both Democrat and Republican administrations has continued merrily on down this path, which can only end in financial ruin and economic chaos. Russia's recent financial collapse should serve as an object lesson. The current administration seems hell bent on achieving "pedal to the metal" speed as we careen toward the immovable wall represented by what appears to be unavoidable insolvency. I'm not necessarily an advocate for tying the value of the dollar back to gold but it needs to be tied to something that isn't easily subject to political whim.

In short, the USG has declared de facto bankruptcy twice. The first time was in the 1930s and the second time was in the 1970s. It appears we're facing a third episode of bankruptcy, except this time there appear to be no easy exits from the burning house of cards. Some think it could be avoided by economic growth but the kind of growth required is only found in entrepreneurial dreams. We need to create 150,000 jobs per month just to keep up with new workers entering the work force for the first time. We need to create 350,000 jobs per month, every month, for five years just to get back to where we were before the current economic downturn. There has never been a five years period in the U.S. history that created jobs at the level now required to get back

to the status quo of a few years ago. Even leaving aside such an unlikely degree of growth, the anti-growth policies that define the U.S. economic climate mitigate against much economic growth at all. We will be indeed fortunate to generate enough growth to tread water at or near our current levels.

Look at the Japanese economy of the past two decades and you're probably looking at the U.S. economy for the foreseeable future. The one major difference is that Japan had a huge cushion of private savings to soften their economic fall. Another option would be to simply let the house of cards collapse. This would be very economically painful and disruptive and there is not any stomach for it, especially among the political class. A third option that some see, based on a flawed understanding of the what ended the depression, is massive government spending to stimulate growth, which produces growth in the same sense that "speed" generates energy. What pulled the U.S. out of the depression was not the economic activity generated by war time spending but the industrial infrastructure destruction of war that left the U.S. as the only industrially intact economy in the world. The recovery from the depression was thereby produced by manufacturing and exporting goods to the rest of the world, until their infrastructure was replaced and they began competing with us rather than depending on us.

Of course, there is the insane solution, a nice little tactical nuclear war that wipes out a lot of infrastructure around the world but not most of the populations while leaving our infrastructure intact. Facetiously speaking, what have we been spending all of this money on the military for, if it doesn't pay off when really needed? A somewhat less insane strategy would be to start a nice big conventional war (something along the lines of Vietnam) in the irrational belief that the war will stimulate enough economic activity to bail us out of our mess. At best such a war would provide a temporary distraction while digging the hole deeper. Iran maybe? Could Barack Obama be the next Lyndon Johnson? Let's hope not.

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