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The U.S. Fed is the systemic risk

Posted: October 26, 2009, 7:44 PM by NP Editor

[Steve H. Hanke](#), [stimulus](#), [Depression](#)

***Government efforts to save economy have done more harm than good***

**By Steve H. Hanke**

There is no more reliable rule than the 95% rule: 95% of what you read about economics and finance is either wrong or irrelevant. Just reflect for a moment on the most frequently repeated lessons drawn from the Great Depression (1929-33). According to most accounts, the stock market crash of October 1929 was the spark that sent the economy spiraling downward.

How could this be? After all, by November 1929, the stock market had started to recover, and by mid-April 1930, it had reached its pre-crash level. Contrary to the received wisdom, massive government failure — not the stock market crash — pushed the United States into the Great Depression. It was the Federal Reserve that ushered in that terrible nightmare. During the course of the Great Depression, the money supply contracted by 25%. This sent the economy into a deflationary death spiral, with the price level falling 25%.

The Federal Reserve was not the only culprit. In the name of saving jobs, the Smoot-Hawley trade bill became law in June 1930. That intervention increased U.S. tariffs by over 50%. It was quickly followed by the imposition of retaliatory tariffs in 60 other countries. In consequence, world trade collapsed and the unemployment rate in the U.S. surged from 7.8% in June 1930 to 24.7% in 1933.

In addition to the Smoot-Hawley tariff wedge, the Hoover administration and the Democratic Congress imposed the largest tax increase in U.S. history, with the top tax rate on income jumping from 25% to 63% in 1932. If these government policies weren't destructive enough, the Roosevelt administration's New Deal created regime uncertainty because major policies were being changed so rapidly. As a result, investors were afraid to commit funds to new projects and private investment collapsed.

Far from saving the patient, government intervention came close to killing it. But you wouldn't know it from listening to the current discourse about the Panic of 2008-09. Indeed, politicians and pundits throughout the world have unfortunately dialed back to the Great Depression and drawn on the false lessons of history for policy guidance and justifications for their mega-interventions.

In consequence, the key enabler of both the Great Depression and the Panic of 2008-09 — namely the Federal Reserve — is scheduled to become America's systemic risk regulator. This is the world upside down. The Federal Reserve is the systemic risk.

The true lesson to be drawn from business cycle history is that, if left to run their natural course, severe downturns are followed by rapid snapbacks. For example, during the 1921 recession, wholesale prices, industrial production, and manufacturing employment fell by 30% or more, reaching their low in mid-1921. But, absent government intervention, the economy recovered naturally, and by early 1922, it had fully recovered, from its mid-1921 low.

Never mind. The crisis has energized the interventionists. One of the most hyper-active is French President Nicolas Sarkozy. In addition to leading

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***Watson's Why I Love Economics***

*When he's not contributing to FP Comment, [William Watson](#) teaches economics at McGill University. He periodically posts abstracts and links to some of the more notable studies and papers he discovers through his work.*

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the charge to impose wage controls on top bankers, he has grand visions. He wants to move away from the “fetichism of GDP.” The Sarkozy conjecture is that GDP metrics don’t measure “happiness.” To correct that alleged flaw, President Sarkozy appointed a “Commission on the Measurement of Economic Performance and Social Progress.” It is led by two Nobel laureates: Columbia University’s Joseph Stiglitz and Harvard’s Amartya Sen. The commission’s report, which was issued in September, presents the known shortcomings associated with national income accounting, including the GDP metrics. That said, the commission failed to produce any new, reliable measures that account for overall economic health. The commission will, no doubt, go down as a typical Sarkozy fireworks display, with no measured “happiness” at the end of the performance.

For the foreseeable future, GDP metrics, as well as other standard economic measures, will remain center stage for economists and policy makers. President Hu of China made this clear in a speech on climate change before the U.N. General Assembly in September 2009. While bowing to “greenery,” China’s President Hu stressed that developing countries should “go for growth.”

This was a cold shower for President Sarkozy and other interventionists. After all, GDP growth and levels of GDP per capita are closely, and positively, associated with metrics that measure the vitality of free markets and the ease of doing business. And that’s not all. Economic growth is, quite literally, a matter of life and death. Prosperity (measured by standard metrics) affects life expectancy (health) in a positive way.

President Hu took note of the main lesson of economic history: “go for free markets” and prosperity and longevity will follow.

*Financial Post*

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by Ron Saff  
Oct 27 2009  
12:19 AM

#### METRICS

When the numbers look bad, people look to the politicians. So the politicians change the calculations (CPI) or try to remove the (GDP) metric altogether. If the governments don't report the GDP, does that mean the economy doesn't shrink? The falacy is in expecting the economy to expand indefinitely.

#### DEBT

The US Federal (FED) Reserve is democracy's way of (centrally) planning the economy. Just because you can do something, doesn't mean that you should. That is lowering the interest rate to near zero, and then lending to anyone and everyone for whatever amount they want. And then they go and invest in anything but US assets. This is called the 'US carry trade'. Does issuing more debt cure a debt problem?

#### WATCHDOG

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Nothing has changed. The politicians, the economists (politicians with calculators), the banks and the FED are all the same people. They just play musical chairs. If that isn't the fox guarding the hen house, then I don't know what is.

## BUBBLES

There have been three major economy/market crashes (1997, 2001, 2008) in the last twelve years. The first two recoveries generated bubbles (technology, real estate) thanks to then FED Chairman Alan Greenspan's easy money policies. When it looked like he wouldn't or couldn't support even easier money, Ben Bernanke was brought in. Watch the politicians try to blame the speculators. Who, but the FED, financed them?

Finally, people like Steve Hanke are speaking out, and people are listening.

by rossbean  
Oct 27 2009  
8:44 AM

Need to look at matters closer. We are dealing with myopic "problem solvers", in a monopoly position, by their legislated position (perspective) in our hierarchical civilization. History and human nature is very clear. They will state they are doing things for "our best interests", arrange matters for their benefit, profit greatly at our loss and state "oops, unintended consequences, sorry" while thinking: nature of next fraud to profit from? We, the people will accept "shit happens" as an excuse.

The basic economic problem is: not enough productivity and too much waste. We will NEVER be able to understand, let alone control this problem (the whole point) so long as we consider GDP as a monolithic sum of production PLUS consumption and try to maximize. We need to realize that a large portion of GDP is waste which is killing us. GDP needs to be calculated as productive activities ONLY. Consumption is a negative which eats GDP. Then, we can see what is really going on economically, something our predators definitely do not want:

[www.cli.gs/MathematicsOfRule](http://www.cli.gs/MathematicsOfRule)

The economic stats obscuration game is played to confuse us. Hierarchical command / control organization is imposed on us because it allows central control and corruption of decision makers by crooks.

Learn how to THINK and you may have a chance, in what is inevitably coming:

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## JUNK SCIENCE



FP Comment's annual Junk Science Week is over, though you can [still read this year's columns](#) here on FP Comment.

Thank you to all who nominated winners for our new [Rubber Duck Award](#), which recognizes the scientists, NGOs, activists, politicians, journalists, media outlets, cranks and quacks who toil to advance the principles of junk science.

Junk Science Week will be back again next year, but from time to time you'll still find related columns right here on FP Comment.

## JACK MINTZ

Bi-weekly columns from Canada's leading tax policy theorist.

*Exclusive to FP Comment*

## NOPIGOU CLUB

The NoPigou Club aims to counter the ideas of the Pigou Club, an informal assembly of economists and pundits who support the idea of raising gasoline taxes. Arthur C. Pigou was an early 20th-century British economist, one of the fathers of welfare economics. We view the Pigou approach as just another form of central planning dressed up in free market terminology.

## THE DENIERS

The National Post's sensational series on scientists who buck the conventional wisdom on climate

science. Written by Lawrence Solomon, the series profiles the ideas and the scientists who do not share the “consensus” United Nations’ theories on climate change and global warming. Read them all.

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