

DEPRESSION HYPE AND HYSTERIA

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President Obama warns that trillion dollar deficits may be around for years. Nobel economist Paul Krugman suggests that to avoid Depression II the USA economy requires WWII level spending not New Deal levels. He even suggests that the five decades of Nobel winning work of Milton Friedman be ignored. This hyperbole has created the current economic hysteria exhibited by some politicians, media and pundits. I suspect that the result if not the intent of these prognostications is to generate support for expensive social service programs like universal health care, income redistribution and college education entitlements.

Economists generally agree with Professor Krugman that it was WWII not FDR's New Deal programs that brought the USA out of depression. Hence, he suggests, that the same level of expenditure will ensure that a second great depression does not happen. What he omits is that WWII not only spent a lot of money on waging war but conscripted millions of employed and unemployed men into the military. So many men were drafted that females had to enter the labor force in record numbers to provide all the necessary materials.

Unless the new administration intends conscripting labor in massive numbers, the 'stimulus' spending proposals will not, in all likelihood, do anything more than increase the size of the public sector and decrease the size of the private sector. Huge spending programs on infrastructure will not reemploy laid off auto workers, investment bankers, and commercial bank employees. These programs will result in additional roads, bridges, and public buildings on one hand and new social entitlements on the other. The likely net effect on the economy is small, if any, despite many prognostications to the contrary.

Ignoring Friedman's Law [*Inflation is everywhere and always a monetary phenomenon*] comes at a heavy risk—accelerating inflation. The adjoining chart indicates the recent growth rate in the Monetary Base. As its name implies our nation's money supply is a multiple of the monetary base. Despite recent worries of deflation, Friedman would warn that several quarters down the road inflation will become our major economic concern. The public will not sit on a mountain of liquidity forever. As Friedman and Anna Schwartz so creditably pointed out in their monumental work on monetary history in the US and UK, the 'greatness' of the first depression was the result of the Federal Reserve initially *contracting* the monetary base and money supply. As the chart shows, the FED has recently *expanded* the monetary base at an unprecedented rate. The implications for economic stability in the not so distant future are drastic.

Rather than pile one government expenditure on top of another, economic policy should concentrate on longer term stability by revamping federal tax policy to encourage investment and thereby foster economic growth. In the near term, the FED must stand

ready to undo its recent monetary actions quickly and massively lest we suffer from the cruelest tax of all—inflation.

