

Lesson 30

The Great Depression

Text Book Reading:

Primary: *Modern Times*, pp. 230-260

Alternate: *Never Give In*, pp. 138-169

Opportunity:

none

Fun Extras:

Films: *My Man Godfrey* (1936), William Powell and Carole Lombard

Cinderella Man (2005), Russell Crowe and Renée Zellweger

Annie (1982), Carol Burnett and Albert Finney

The Thin Man (1934), William Powell and Myrna Loy

The Grapes of Wrath (1940), Henry Fonda

Internet: mises.org (lots of videos about economics, the Constitution, and history, especially the Depression and the New Deal)

www.econstories.tv: home of *Fear the Boom and Bust*, the rap video starring Keynes and

Frederich Hayek, a co-founder of the Austrian school of economics

John Stossel aired a show about Crony Capitalism that can be watched in several parts on YouTube

Extra Teacher Resources:

The Forgotten Man, Amity Shlaes; *Basic Economics*, by Thomas Sowell; *How an Economy*

Works, by Peter Schiff; *Economics in One Lesson*, by Henry Hazlitt; *Money, Greed, and*

God, by Jay W. Richards *The Politically Incorrect Guide to the Great Depression and the New*

Deal, by Robert Murphy

Background Topics:

The Federal Reserve; John Maynard Keynes; Ludwig von Mises; Herbert Hoover; Panic of 1920; New Deal; FDR; Andrew Mellon; Dust Bowl; Smoot-Hawley Act

Fun extras if you have time. Please research the films for appropriateness. Many more recent films will list reasons for the MPAA rating it received.

Websites with more information for further research, learning, and sometimes just plain fun!

For further study for teachers. We know that moms and teachers don't always have time to become experts on all topics, so some of these books are easier to read, while some delve more deeply into different topics.

Timeline:

- 1906: Upton Sinclair published *The Jungle*
- 1912: Ludwig von Mises published *The Theory of Money and Credit*
- 1919: J.M. Keynes published *Economic Consequences*
- 1928: Hoover is elected
- 1929 (10/24): Black Thursday's stock market collapse
- 1930: Smoot-Hawley Tariff imposed

Synopsis:

The history of monetary policy and government regulation is traced from Reconstruction to the Great Depression. Keynesian and Austrian schools of economics are examined through the lens of this history.

February 19

- 1377: Jon Wyclif was summoned to a trial at St. Paul's Cathedral in London.
- 1674: The Treaty of Westminister ceded the American Dutch colonies to the British.
- 1803: Congress accepted Ohio's statehood.
- 1807: Aaron Burr was arrested in Alabama.
- 1846: The Texas state government was installed.
- 1932: William Faulkner completed work on his classic novel, *Light in August*.
- 1935: The Emergency Relief Appropriation Act was introduced into Congress.

"The long economic constriction known as the Great Depression was caused by several factors, natural and man made. But the depth, breadth, and length of that sordid episode of human suffering was entirely the result of government intervention and poor fiscal management--the sort of economic foolishness that inevitably accompanies the machinations of modern elitists."
Murray Rothbard

Calamities Multiplied

There were runs on banks, which stripped away the life savings of two-thirds of the American people. There was massive unemployment, squatter camps throughout the nation where the homeless would gather. Foreclosure rates soared from 1929 to 1932 some 190%. It was the straw that broke the back of the American economy.

Notes taken during the lecture, included to save you time in lesson preparation.

Before the Collapse

- 1873: The Beginning of the "Long Depression"

The Great Depression began with an event called the Long Depression. Before the end of Reconstruction following the Civil War, the American economy was in tatters. Government regulation over all aspects of life in the South failed miserably and one-third of the wealth of the nation disappeared.

- 1887: Interstate Commerce Act

In an attempt to reregulate the economy, the Interstate Commerce Act was passed—the first time an independent agency was created outside of the direct control of the executive, judicial, or legislative branch—a kind of independent bureaucracy. It regulated any commerce that crossed state boundaries. It put into place wage and price controls, a regulatory approach to surplus goods. This power was turned toward the railroads to consolidate them. The profits of railroads plunged 60% and 40% of them went out of business.

- 1890: Sherman Anti-Trust Act

In a further attempt to regulate, the Sherman Anti-Trust Act was passed, which broke up large monopolies by breaking up all the individual industries the railroads depended on—communications industries, steel industries, and regulating labor, etc. It was also used to regulate prices and wages, negotiate for the labor unions, create credit unions. It extended the breadth of government's regulatory power.

- 1906: Upton Sinclair's *The Jungle*

Sinclair wrote a novel which exposed the Chicago meat packing plants and the horrors of workers' conditions. It was used as a prod to ask for more regulation.

- 1907: The Beginning of the "Great Recession"

- 1912: Ludwig von Mises' *Theory of Money and Credit*

Mises published his book after teaching at the Vienna University in economics. He was an advisor to the Austrian government until he fled Hitler. The Austrian, or Misian, School of Economics resulted, which taught that government regulation should be restricted to the areas of objective standards—making sure there is a fair and balanced approach to monetary exchange and to leave the free market alone to operate in accordance with moral standards of honesty and integrity; legally prosecuting cases only when those standards are violated. It was the beginning of a science of free market economics. He came to the U.S. His book was a manifesto for conservatives.

- 1913: Constitutional Changes

Woodrow Wilson pushed through the new powers that allowed government to intrude in ways they never had before.

- 1914: The First World War Begins

Then the war began—all in a time of economic instability.

- 1919 J. M Keynes' Economic Consequences

Keynes was born in 1883 and died in 1946. He believed government should run the economy through policies of careful regulation and in times of economic constriction through deficit spending. The idea was to flood new markets with money from the government. So the government should bail out the economy. According to Misesan economics, bad businesses should fail. That's better for the economy in the long run.

Mises said if the automobile business is putting the buggy wheel business out of business, it was not the government's job to keep the buggy wheel business afloat. Keynes said it was government's job to prop up the business so that people didn't suffer.

- 1928: Herbert Hoover is Elected

Hoover was the first president to adapt a Keynesian approach to economics. Immediately Hoover sought to improve the economy through the intrusion of government regulation.

- 1929 Agricultural and Business Regulation

Hoover began a series of agricultural and business regulation. This precipitated a catastrophic collapse.

After the Collapse

1929

- October 24: Black Thursday

The stock market collapsed on Wall Street.

- October 25: Blue Rally

There was a brief rally:

- October 29: Black Tuesday

The market plunged again with disastrous results.

1930

- Drought Turns to Dust on the Plains
- Smoot-Hawley Tariff
- Committee for Unemployment Relief
- J. M. Keynes' Treatise on Money

First, the Federal Reserve massively expanded the money supply. It began to try to stimulate the economy by putting hundreds of millions of dollars into the economy:

That created inflation which, properly defined, is an expansion of the money supply, making it cheaper and easier.

This caused interest rates to rise. For every \$1 a bank received in deposits, it was able to loan \$9, which led to imprudent investments stimulating overproduction in the manufacturing and housing sectors.

This created a crisis of confidence, a failure of demand, a liquidation of surplus, credit contraction, a shrinking money supply, a deflationary depression, and a collapse on Wall Street. It was a domino effect.

*Add to this the perfect storm—a long drought in the plains combined with a lack of proper soil management and crop rotation. The drought turned the vast areas of former farmland to dust, and the dust began to blow across the central portion of the U.S., in what's now called the Dust Bowl. Farmers who once had crops now had only a sand boxes, which buried farms, whole communities, and the American dreams of tens of thousands of people. Steinbeck's novel *The Grapes of Wrath* is the story of a family of Oklahomans fleeing to California.*

The breadbasket of the U.S. was devastated. Farm commodities and prices dropped. But Hoover had promised to prop up the economy with a stiff new tariff. So while the economy was devastated by the dust storm, the tax rate increased by 18% on any incoming food. This created a food crisis. Drought, decline in U.S. agricultural production, and government intervention created this larger problem.

Committee for Unemployment Relief attempted to prop up banks and the economy; but they failed to get much relief to the unemployed. The energy and wealth was squandered.

Keynes produced his second great work on government intervention. He argued the key to providing relief was to insert government regulations to restrain the private sector and provide more governmental control.

1931

- Interest Rates Raised Twice

The Hoover Administration decided to raise interest rates.

1932

- Largest Peacetime Tax Increase
- Largest Peacetime Interest Rate Increase
- Largest Reduction of Business Exemptions

These increases were meant to pay for the bailout. The economy was out of control, and the U.S. and the world walked through a miserable season of loss and shattered confidence and dreams.

Economies Explained

- Communalism: You have two cows. You keep one and give one to your neighbor.
- Communism: You have two cows. The government takes them both and then asks you to stand in line for hours in order to receive your "free" subsidy of watered down, spoiled milk.
- Fascism: You have two cows. The government takes them and sells you the milk at a premium.
- Bureaucratic Liberalism: You have two cows. The government takes them both, shoots one, milks the other, pays you for the milk, and then pours it down the drain.
- Democratic Socialism: You have two cows. The government taxes you to the point that you must sell them both in order to support a man in a foreign country who has only one cow which was a gift from your government.
- Free-Market Capitalism: You have two cows. You sell one and buy a bull.

- **Centralized, Multi-National-Corporation-Based Capitalism:** You have two cows. You sell one, force the other to produce the milk of four cows and when it dies you write off the depreciation, hire a lobbyist and garner a government subsidy or tax break in order to purchase two new cows. The cycle continues.

There are different economic theories that have real worldview implications. These implications came to bear during the Great Depression.

Economics 101

There are 3 kinds of economic wealth.

1. Intrinsic

- Rents/Wages
- Land
- Partnership
- Trade

Intrinsic wealth has value in and of itself because of its nature. You can make money through intrinsically valuable things like rent or wages or land.

2. Kinetic

- Interest/Profits
- Labor
- Stock
- Receipt

Kinetic wealth is created through work. You can make even more through interest and profits on investments.

3. Speculative

- Taxes/Estates
- Capital
- Usury

- Fiat

Speculative wealth comes from speculation about the future such as a .com company in Silicon Valley: They haven't sold anything yet, but they show great promise, causing people to invest in them. Think of something like Twitter: There's no business plan. Millions of people use it but no one pays for it.

Speculative wealth can be turned into something substantial and even kinetic. When we understand there are different ways to make money, we can understand how different approaches to economics can have dramatic effects on the economy:

There are causes and effects from the manipulation of the different types of wealth.

Causes and Effects

- Money Supply Expansion leads to Inflationary Boom

If the current money supply in this room is \$1, that \$1 is valuable because we all have to live on it. But if someone increases the money supply and gives each of us \$1, the value of the original dollar is reduced.

Forbes recent did a survey of the best restaurants in the world. They discovered that, of the top 100, none were in New York, Paris, Moscow, or other cities you would expect. They were in places like Haiti. In Haiti, if you have a pile of money, that money is worth a lot more than it would be in Paris or London. So you can be more extravagant with the same amount of money:

If you're creating products during inflationary times, you'll have to raise prices to get the same return. Inflation is not rise in prices. Rise in prices is the result of an increase in the money supply:

- Credit Expansion leads to Imprudent Investment

Because money is cheaper, the banks expand their credit listings, offering more loans at easier terms. It's easier to get a loan; anyone can buy a house. The credit is easy to obtain. This creates imprudent investment.

- Overproduction leads to Surplus Inventory

Imprudent investments lead to overproduction which creates surplus inventory. In the age of cheap and easy money, you ramp up every industry thinking the trend will continue.

- Crisis of Confidence leads to Failure of Demand

The cost of increased inventory creates a crisis of confidence. There's too much stuff out there, but money isn't worth what it was and prices are rising. So a failure of demand sets in.

- Liquidation leads to Credit Contraction

The failure of demand causes businesses to liquidate extra inventory. Everything goes on sale. That creates credit contraction. The banks aren't going to loan and people aren't going to buy.

- Shrunk Money Supply leads to a Deflationary Recession

So less money is available, which creates a deflationary recession.

When the government prods along or slows down the process, it aggravates everything and makes a mess.

Keynesian Response

- Inflate Further
- Bail Out Failures
- Deficit Spending
- Stimulate Consumption
- Discourage Savings
- Subsidize Unemployment
- The Uncle Sam Strategy

Keynesian economics says to inflate further, bailout businesses, provide taxpayer support. Do you know how much 800 billion dollars is? That's just the first phase of the federal bailout plan. If you spend 1 million dollars a day it would take you from the time of Christ till now, and you would still not be at 800 billion. History says bailouts don't work. They merely speed the process.

Misian Response

- Laissez Faire
- Liquidate Inefficiencies

- Debt-Free Development
- Stimulate Savings
- Discourage Consumption
- Encourage Private Initiative
- The Grandma Strategy

The Mesian approach says to allow bad businesses to fail and allow the institutions of society to care for the needy:

The Keynesian response is about right now. The Mesian is about building a foundation for a long-term future.

The Mesian response wants to find ways to create enterprise zones, tax breaks for new initiatives. allow the private sector to free up frozen assets.

Keynesianism is the Uncle Sam strategy, meaning the government takes care of all. The Grandma strategy is make sure you have enough stuff in the cupboard and make sure your neighbors are okay:

This past week an interesting thing happened. A world economic forum took place in Switzerland. Economists gathered to speak to the present global crisis of confidence and monetary collapse. Russian Prime Minister Vladimir Putin lectured the U.S. on the dangers of socialism: "One is tempted to make simple decisions in a time of crisis. We could treat the symptoms of the disease rather than the disease itself. We must not make decisions now we will regret later. The state's control in times of crisis makes a charismatic politician wildly popular but instead of streamlining market mechanisms, some are tempted to extend government intervention to the greatest extent. This could plunge us into a disaster of unprecedented proportions. The unjustified swelling of the budgetary deficit is just as destructive as adventurous stock jobbing. You cannot undermine members of the economic mafia by creating a government mafia."

Putin is paying attention to the lessons of history. He's looking back and saying we've been here before, we did these things, we had a massive transfer of wealth and it utterly failed. What are we thinking about?

You know you're really in trouble when the Russians are lecturing you on economic sanity. That's why this lecture is so depressing. If we will not learn from the past, if we won't look at causes and effects across the course of time, if we only think of the moment, if we fail to

recognize those lessons or aren't even aware of the lessons of the past, then we will create deeper and greater crises.

That's the great lesson of the Great Depression. It remains to be seen if we will learn it.