

The Consequences of a Failed Monetary System: The Great Depression and The Great Depression II

By S. Joseph Kowalski, September 11, 2010

Franklin Delano Roosevelt's election to the presidency in 1932 and his subsequent New Deal administration was a revolutionary event for the United States, but was not an isolated event in global affairs. At the turn of the 20th century, the world experienced a collapse of its monetary system, the international gold standard, a collapse which reverberated worldwide, and especially in the 1930s, produced calamitous economic disintegration and revolutionary political changes.

The 19th century economic and political system rested on four institutions: the balance-of-power system in Europe; the international gold standard, which was the 19th century monetary system; the self-regulating market; and, the liberal state. The international gold standard's collapse transformed the global economic and political systems, and resulted in revolutionary changes. The revolution that brought Franklin Delano Roosevelt to the presidency also precipitated Great Britain abandoning the gold standard, brought about the Russian Bolshevik revolution and its 5-Year Plans, Adolf Hitler and the German National Socialist (Nazi) party, and the collapse of the League of Nations. Karl Polanyi in his book, *The Great Transformation* states: "The breakdown of the international gold standard was the invisible link between the disintegration of world economy since the turn of the century [20th century] and the transformation of a whole civilization in the thirties."ⁱ

Karl Polanyi ably argues, in my opinion, why the world economy disintegrated at the turn of the 20th century, and why the revolutionary transformation of the civilization took place. This essay will discuss the revolutionary political changes of the 1930s United States, and will offer some observations relative to our most recent monetary system collapse. What we all must understand is that as with the consequences of the early 20th century monetary system collapse, the collapse of our monetary system will likely have significant political and economic consequences.

The United States greatly benefited from World War I. At its end, the U.S. was the strongest economic country in the world, and now a creditor country with a positive current account balance. Great Britain lost its political and economic power, and Germany no longer was a competitive economic threat to the U.S. The post-World War I economy is referred to as the Roaring Twenties. All was well, or apparently well, until 1929 when the stock market crash ushered The Great Depression. By the end of Hoover's term as president in March of 1933, the U.S. economic and political systems were in dire straits. In March of 1933, President Roosevelt was sworn into office. This was the U.S. political revolution.

Arthur M. Schlesinger's opening words in *The Age of Roosevelt: The Crisis of the Old Order* were:

The White House, midnight, Friday, March 3, 1933. Across the country the banks of the nation had gradually shuttered their windows and locked their doors. The very machinery of the American economy seemed to be coming to a stop. The rich and fertile nation, overflowing with natural wealth in its fields and forests and mines, equipped with unsurpassed technology, endowed with boundless resources in its men and women, lay stricken. "We are at the end of our rope," the weary President at last said, as the striking clock announced the day of his retirement. "There is nothing more we can do."ⁱⁱ

Milton Katz, a lawyer in the Reconstruction Finance Corporation, recollections of what the country's crisis looked like were:

Then came the great crisis, the closing of all the banks and the arrival of Mr. Roosevelt as President. I can only describe the change as physical, virtually physical. The air suddenly changed, the wind blew through the corridors, a lot of old air blew out the windows. You suddenly felt, "By God, the air is fresh, it's moving, life is resuming. April may be the cruelest month, but now the world is beginning over again." I had lived in a world in which for practical purposes, there appeared to be no government, in which there was an almost demoralized people who had the feeling that there was no one to whom they could turn. There was something called "the government," but it seemed so feeble, so overrun by the forces that were loose in the land, that it seemed no one was in charge.ⁱⁱⁱ

The economy collapsed and the political system was paralyzed. Real income fell 35% from 1929. In constant 1929 prices, the GDP collapsed over 25%. Industrial production in 1932 was 55% of 1929. Civilian labor force unemployment went from 3.2% in 1929 to 25.2% in 1933. Non-farm unemployment was significantly worse: 37.6% in 1933. The year 1933 was rather bleak.^{iv} Capitalism's backbone, the self-regulating market system, failed. Capitalism in 1933 was visibly decaying and the U.S. political system stopped functioning. This economic mess is what Mr. Roosevelt's administration inherited.

In his first inaugural address, President Roosevelt spoke these electrifying words:

"Let me assert my firm belief that the only thing we have to fear is fear itself – nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."

These words, along with his dramatic closing of all the banks, his compassion for people by going out and talking to them, and his attitude of experimenting with various programs gave the masses hope. Obviously, the industrialists, financiers, bankers, and the other wealthy hated Roosevelt, and said that he was a traitor to his class.

President Roosevelt accomplished four important results: saved capitalism from its self-destructive internal contradictions by regulation and regulating agencies; rationalized capitalism, and in so doing, prepared it for its post-World War II successes; addressed the worst of the inequities suffered by Americans by instituting various New Deal programs; and, set the stage for the country's 1945-1973 Golden Age of prosperity and dignity for its masses. His revolution was to initiate programs which provided 'social justice' for the masses. 'Social justice' was the political underpinning from which the poorer Americans shared in the post World War II prosperity.

The two key 'social justice' acts enacted were the Social Security Act of 1935 and the National Labor Relations Act of 1935. "The 1935 [Social Security] act provided for several programs. It established a cooperative, federal-state system of unemployment compensation program by which the federal government taxed equally both employers and employees and rebated most of the money to those states that agreed to set up their own systems. It also provided an entirely federal system of old-age and survivors' insurance, financed by employers and employees. Workers reaching the age of sixty-five were eligible for retirement benefits depending on how much they had contributed in taxes in their lifetimes. Finally, the act authorized federal matching grants to the states for a wide variety of social services." The National Labor Relations Act removed the impediments to labor organizing and labor unions. The key was the National Labor Relations Board which had the power to organize collective bargaining units, to conduct the union elections, determine who labor's representatives' are, and to hold hearings relative to unfair labor practices. The Board had the ability to issue cease-and-desist orders.^v Both of these acts set the stage for the post-WWII improvement in income distribution between the various classes. The lower rungs obtained a bigger portion of the income pie and allowed many of the laboring class to have a middle-class standard of living.

The New Deal confronted the wealthy elite's exploitation of the masses, allowed a more equitable distribution of income, and returned to the masses the human dignity which it enjoyed prior to the advent of capitalism.

Much has been preached about the wrongness of 'social justice'. The critics articulate the wrongness of incorporating 'social justice' into the state's values. This, it is said, is governmental interference with the self-regulating market system. Less is said about government intervention in behalf of capitalism. Nineteenth and twentieth century U.S. capitalism is rife with government interference on its behalf: financing "improvements" for its benefit, such as, canals and railroads; government actions which limited competition between companies and which would permit the setting of minimum prices for various consumer goods; and, governmental loans and other devices to facilitate foreign trade. The U.S. government has historically provided capitalism with corporate welfare, and we must acknowledge, corporate welfare can be in the best interest to the United States. With

Friedrich List and his *National System of Political Economy*, what was important was what is in the self-interest of the nation both now and for future generations. His economics was based on 'national economics' rather than the 'individual economics' and 'cosmopolitan economics' of Adam Smith and J.B. Say. List emphasized the importance of producing wealth rather than the possession of wealth; the importance of developing and protecting manufacturing, agriculture and commerce; and, that the self interest of individuals does not lead 'to the highest good of society'. In developing his economic system, he visited the United States and conferred with Alexander Hamilton. The ideas of Alexander Hamilton, Friedrich List, and others defined the United States economic system for much of its life. Today, the *National System of Political economy* is important to Japan, China, and the other Asian countries and city-states. Some believe that List's economic system is the basis of the European Economic Community. In regard to 'corporate welfare' or 'social justice', with Friedrich List the question becomes: what is best for the nation both now and for future generations?

Franklin Delano Roosevelt's New Deal revolution lasted roughly to the 1980s, the Ronald Reagan presidency years, although the U.S. economy already showed weakness in the latter 1960s. The global monetary system, the quasi-gold Bretton Woods system, dissolved in 1973 during the Nixon presidency when the U.S. would no longer redeem dollars with gold. The post-World War II U.S. wars, such as Vietnam, and preoccupation with geo-political issues took precedence over the more important cultivation of the domestic economy. The post-1960 dollar inflation provided the money for the U.S. foreign adventures, but the same inflation debased the dollar and encouraged foreign dollar holders to convert to gold. When the torrent of gold leaving the U.S. became substantial, the U.S. closed the gold door, and, with this act, the global monetary system of fixed currency rates ended with the substitution of Bretton Woods II floating exchange rate 'system'. From that point, dollar inflation chiefly in the form of ever increasing credit, both private and public, propelled the U.S. economy with an artificial prosperity.

Globalization and the hollowing-out of manufacturing was well entrenched by the 1970s. Unionism was one concurrent loser. Militarism became the chief basis for our economy. The Clinton administration accelerated globalism with NAFTA and ushered the finance economy with the repeal of the Glass- Steagall Act. Out-sourcing of service jobs, call-takers, customer service, tax matters, medical, and accounting, became a torrent. George Bush accelerated militarism, deficit spending, lower taxes on the wealthy, and smothered effective regulation, such as that provided by the Security Exchange Commission. President Obama: retained the incompetent duo of Geithner and Summers (with Rubin always in the background) who controlled the Treasury Department and, quietly, the Federal Reserve; sponsored much higher deficits than President Bush; enacted the health care bill which is a huge tax on small business and the public; and, has taken no effective action to increase U.S.

jobs. All of this plus the Federal Reserve's reckless encouragement of ever escalating debt levels, culminated in the 2008 credit crisis, and the continuing disintegration of the economy. Only a significant increase in employment along with income growth can have a chance to increase aggregate demand and to strengthen the economy. What the current and the previous two administrations have done is useless for this purpose.

What is today's status of the economy. John Williams, proprietor of Shadow Government Statistics, characterization of the economy tells us what has been accomplished in regards to its 'fixing':

- "The current downturn, as reported, already is the longest and deepest business contraction since the first downleg of the Great Depression in the early 1930s."
- "Net of gimmicked methodologies that have inflated GDP reporting over the decades, the U.S. economy has been in recession since late-2006, entering the second down-leg of a multiple-dip economic contraction, where the first downleg was the recession of 2001, which actually began in late-1999. The current downturn may evolve into a further multiple-dip circumstance. The Great Depression was a double-dip contraction."
- "The U.S. economy is in a deepening structural change that has resulted from U.S. trade, social and regulatory policies driving a goodly portion of the U.S. manufacturing and technology base offshore."
- "The deterioration in median household income has resulted in greater variance in income[the distribution of income]" "Historically, extremes in income variance usually are followed by financial panics and economic depressions. Income variance today is higher than it was coming into 1929 and 1987, and it is nearly double that of any other "advanced" economy."
- "The broad point on income is that it is inadequate to sustain positive, inflation-adjusted economic activity. In the absence of income growth, debt expansion can act as a short-term prop for the economy, but that is not available at present. The system is in the throes of a solvency crisis, with banks reducing lending to consumers."^{vi}

The economy is not getting better. Economic disintegration is still with us. The Great Depression II looms its dark shadow over the world. According to those who got us into the economic mess, massive stimulus will solve our problems. This was started during President Bush's administration. Stimulus, rather than a cure, is more akin to mouth-to-mouth resuscitation, or placing the economy on life support. J. Anthony Boeckht's opening words in Chapter 1 in his *The Great Reflation* regarding the massive stimulus tells us:

The Great Reflation is the term we use to describe the government's massive monetary and fiscal stimulus program. Initially, its purpose was to stop the possible death spiral of the economy in 2008 and early 2009. Now its purpose is to prevent a relapse.^{vii}

Our government has been trying to revive the economy with placebos, and they are not working.

We are in the midst of The Great Depression II and revolutionary political changes, if they are to happen, are for the future. As was the case in the early 1930s, the oligarchy is well in control of government. But, the early 1930s suffered serious social consequences: unemployment, poverty, starvation, homelessness, and illness. Four important 'social justice' programs are key to the present lack of civil disorder: Social Security, food stamps, unemployment compensation, and the Medicare and Medicaid health programs. The first three were instituted by President Roosevelt's *New Deal*. The health programs come from President Johnson's *Great Society*. We must always remember that the United States' economy is on life-support. It is based on borrowed money and monetized debt of all kinds. The first, borrowed money, will eventually dry-up, and, the second, monetization of the federal debt, will, if continued, end with the debasement of the dollar and the accompanying hyper-inflation. 'Extend and pretend' is not sustainable, and if anything is not sustainable, eventually it will collapse. Then, the crisis will come.

Tony Judt's in his *Ill Fares The Land* has much in it to inform us, but his conclusions in regard to recent political leaders and their competence is especially important. Some excerpts from Chapter Three, *The Unbearable Lightness of Politics*:

- Speaking about the victory of conservatism: "In the course of little more than a decade, the dominant 'paradigm' of public conversation shifted from interventional enthusiasm and the pursuit of public goods to a view of the world best summed up in Margaret Thatcher's notorious *bon mot*: "there is no such thing as society, there are only individuals and families. In the United States, at almost exactly the same moment, Ronald Reagan achieved lasting popularity for his claim that it was "morning in America". Government was no longer the solution – it was the problem."
- "If government is the problem and society does not exist, then the role of the state is reduced once again to that of facilitator. The task of the politician is to ascertain what is best for the individual, and then afford him the conditions in which to pursue it with minimal interference."
- From Keynes, he quotes, "Practical men who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas."
- "So what have Keynes's 'madmen in authority' done with the ideas they inherited from defunct economists? They have set about dismantling the properly *economic* powers and initiatives of the state. It is important to be clear: this in no way entailed reducing the state *per se*. Margaret Thatcher, like George W. Bush and Tony Blair after her, never hesitated to augment the repressive and information-gathering arms of central government."

- “Meanwhile, if we had to identify just one consequence of the intellectual shift that marked the last third of the 20th century, it would surely be the worship of the private sector and, in particular, the cult of privatization.”^{viii}

Later in Chapter Five, *What Is to Be Done?*, Tony Judt states:

- “But if we leave the challenge of radical renewal to the existing political class – to the Blairs and Browns and Sarkozys, the Clintons and Bushes and (I fear) the Obamas -- we shall only be further disappointed.”
- “During the long century of constitutional liberalism, from Gladstone to LBJ, Western democracies were led by a superior class of statesmen. Whatever their political affinities, Leon Blum and Winston Churchill, Luigi Einaudi and Willy Brandt, David Lloyd George and Franklin Roosevelt represented a political class deeply sensitive to its moral and social responsibilities.” “Politically speaking, ours is an age of the pygmies.”^{ix}

Our politics are controlled by ‘political pygmies’. Political revolution will not come from them. It is hard to hear any voices that sound like that of Franklin Delano Roosevelt. Likely, the political revolution will come when ‘extend and pretend’ no longer is viable: when the country is financially ‘bankrupt. Then we will have a 1930s type of social crisis. Only a serious social crisis will catalyze change. Only a serious social crisis will reform or revolutionize our political system. Then, the country will initiate economic policies which will be in the best interests of the United States rather than in the best interests of the oligarchy.

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Notes:

ⁱ *The Great Transformation* by Karl Polanyi (Beacon Press. Beacon Hill, Boston, 1944)

ⁱⁱ *The Age of Roosevelt: The Crisis of the Old Order* by Arthur M. Schlesinger, Jr. (Houghton-Mifflin Company, Boston, 1957)

ⁱⁱⁱ *The Making of the New Deal: The Insider’s Speak*, edited by Katie Louchheim (Harvard University Press, 1983)

^{iv} *War, Prosperity & Depression: The U.S. Economy 1917-1945* by Peter Fearon (University Press of Kansas, 1987)

^v *The Making of the New Deal: The Insider’s Speak*, edited by Katie Louchheim (Harvard University Press, 1983)

^{vi} *Hyperinflation Special Report (Update 2010) Commentary 263* by John Williams. Privately published by John Williams in 2009 and 2010.

^{vii} *The Great Reflation: How Investors Can Profit from the New World of Money* by J. Anthony Boeckh (John Wiley & Son, Inc., 2010)

viii *Ill Fares The Land* by Tony Judt (The Penguin Press, 2010)

ix *Ibid.*