

What Recession? It's Not That Bad. Get On With It!

When Wall Street crashed in October 1929, my maternal grandmother was 16 years old. Like many of her generation in New Zealand, she had been working since she was 13, having left school after completing Standard 6, (Year 8).

By 1932 she was 19 and the misery of the Great Depression was well underway. Nana was working as a nurse/housekeeper for the local doctor in a small Taranaki town. In order to be able to keep her job, her weekly wage was slashed by 25% from 10 shillings to '7 and 6d' and stayed that way until she finished work to marry my grandfather in 1938.

I blanched at the drastic cut. "How did you manage?" I asked. "Well, it wasn't easy", she replied, "but you learned to make do. You learned to live within your means. The easy part was making the decision to accept it. It was either accept it, or no job. And 75% of something was a damn site better than 100% of nothing!"

There is a lot of wisdom in those few sentences. It has been only a few months since the global credit crunch started to bite and much has been written by economists, politicians and journalists of all persuasion, all largely quoting each other and all largely saying the same. In reality, though, there is little wisdom to be found in much of it.

What happened? One day, the developed world seemed to be chugging along quite nicely and then we awoke the next day to find that the fiscal sky was starting to fall, à la Chicken Little. It started in the US with major financial corporations in various stages of collapse, spreading quickly to major corporations within other industries, of note the parlous American auto industry. Treasury Secretary Henry Paulson and Federal Reserve Chairman Bernard Bernanke leapt into action throwing money – and lots of it – at seemingly everything that looked remotely dodgy. It wasn't money belonging to either Messrs Paulson and Bernanke, or even President Bush or President-elect Obama, but the US taxpayers.

Well, it *would* have been public money, had it existed, but it didn't. It was created out of thin air via the Federal Reserve's printing presses which have been running red hot ever since. The US taxpayer has instead been landed with the additional debt – on top of a mountain of debt that already existed – which has further served to devalue the dollar in the process, while the US economy remains as critical as ever.

So, will all this intervention help? Well, it hasn't to date in spite of all the cash. Personally, I think it is only going to make matters worse, to ultimately extend the life of the upcoming hardship. For proof, we should look back to the last major recession known as the Great Depression of the 1930s.

There is an old saying that warns of those ignoring the lessons of history being doomed to repeat them. Talk of doom could be frighteningly prophetic in that the prescriptions recommended for the current crisis are looking alarmingly like those adopted 75 years ago. US President Franklin Roosevelt (popularly known as FDR) followed his predecessor Herbert Hoover's policy of increased government intervention in the marketplace and increased public expenditure, all of which served to stretch out the misery of the Great Depression for a long, dark decade.

There are some things that cannot be denied and what goes up must come down. Economic cycles are no different and a bust

will always follow a boom, particularly if that boom has been artificially fuelled by a 'bubble' such as the "Tulip Mania" of the 17th century or the Dot-com bubble of the 1990s.

Recent history has seen a housing bubble take place in the developed world whereby the price of real estate has increased dramatically. In New Zealand, the natural appreciation has been exacerbated by restrictions to the residential land supply which further forced the prices up, together with ever-increasing local council compliance costs. Credit was cheap and easy to get, attracting both market speculators and buyers. Tradesmen were kept busy with the demand, as were their suppliers and so on. When prices become too high for the market, the latter will adjust, resulting in a drop in prices.

If only it were that simple. What goes up too highly *would* come down, if politicians didn't interfere. The truth is that there is a better chance of winning Lotto than of politicians keeping their hands to themselves. US Congressman Ron Paul from Texas tells the story of FDR being determined to not run the risk of losing the large agricultural vote by letting prices fall naturally to meet the local demand, which would have reduced farmers' returns. So he paid them a certain price for their produce. Unfortunately, the poor people struggling financially could not afford the artificially high prices and went hungry, while the growers ploughed their unsold produce back into the land. Welcome to the Law of Unintended Consequences.

Everybody is always screaming for affordable housing and it would be if prices were allowed to meet the existing market. The same applies for all commodities. But there are also other factors at work. If the market was left to sort itself out, a fall in prices would go hand in hand with a fall in costs. However, trade unions will almost certainly resist all efforts to see government interference such as the minimum wage laws that keep wages at inflated levels, abolished. And it is a safe bet that they will strenuously oppose any general reduction in wages, all of which means that both prices and wages are kept artificially high.

US businessman Peter Schiff has been an outspoken advocate of letting the market work instead of chaining it up and burdening it with regulation, and then screaming when it goes wrong. He predicted the current crisis more than two years ago and was roundly ridiculed. His many detractors are not laughing now. Schiff opposes the concept of a government-lead recovery, believing that the problem lies in too much regulation as it is. He points to the brokerage/banking industry being one of the most highly regulated and bankrupt as a result. Like his ideological twin in academia George Reisman, Professor Emeritus of Economics from Pepperdine University, he refutes the concept of increased consumer spending being the solution to the crisis, in that spending per se does not create economic growth. Conversely, real economic growth via increased productivity makes spending possible. To that end, Schiff, Reisman and Ron Paul all believe that a recession is the natural adjustment by which to prune the poor performers, re-establish *real* values and start again as quickly as possible.

