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THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

WINTER WARNING

The Hoover, Roosevelt and Obama Administrations – Unmasked

In order to fully appreciate the current state of economic depression in the United States, it behooves us to draw some policy comparisons and parallels between the Obama administration and those of Presidents Hoover and Roosevelt during the Great Depression of the 1930s.

We shall see how economic history repeats itself over the long term and how government responses are impotent in providing a quick panacea to reverse economic downturns and ward off their evil offspring of high unemployment. In the initial U.S. economic downturn from the third quarter of 1929 to the first quarter of 1933, there were six quarterly bounces in the GNP data, averaging an 8% annual growth rate. In the current U.S. economic downturn, since the fourth quarter of 2007 to the present third quarter of 2010, there have been four quarterly advances in real GDP, averaging a 3% annual growth rate. At present, there is about $6 trillion (U.S.) of excess household debt overhanging the economy that must be expunged: either by paying it down, or by defaulting, or by monetization.

Herbert Clark Hoover

Inaugurated as the 31st. President of the United States on March 4, 1929, Herbert Hoover's administration was besought by economic disaster in the very first year of his presidency. A decade of American economic prosperity had spawned a debt bubble and excessive speculation in the stock market. The speculation was ended by an historic stock market crash in October of that year. This was followed by the collapse of the debt bubble, which spawned the failure of the banking system, leading to the onset of the Great Depression. On October 25, 1929, President Hoover told reporters: "The fundamental business of the country, that is the production and distribution of commodities, is on a sound and prosperous basis." According to the Wall Street Journal, the President's message was "in harmony" with the leading bankers and industrialists, who emphasized that "the stock market break was a technical one within the market and not based upon fundamentals." Several weeks later, President Hoover reiterated his belief in the soundness of the American economy stating: "Any lack of confidence in the economic future, or the basic strength of business in the United States is foolish. Our national capacity for hard work and intelligent co-operation is ample guaranty of the future." President Hoover's failure to comprehend the magnitude of this and subsequent economic events resulted in him being blamed by millions for their cause and his stubborn refusal to seize control of the economic situation was deemed to have worsened matters. For instance, in June, 1930, in response to a visiting delegation requesting a public works program to help speed the economic recovery, President Hoover declared: "Gentlemen, you have come 60 days too late. The depression is over."

In his book, "The Great Depression and the New Deal," author Eric Rauchway depicts President Hoover as seeing "himself as a cheerleader to American enterprise, not as a referee, coach or player in the economy: he would call for teamwork and hope to see it produced. He invited important figures in American industry to meet, asking them to reason together, planning how to keep the crash from turning into a depression. He urged employers not to cut wage rates, and they agreed to co-operate. President Hoover went further still in his requests, asking state and local politicians to hasten and augment their spending on roads and other public works, believing that in various government treasuries there lay a substantial reserve for prompt expanded action. None of these strategies required much action from anyone in the federal government, beyond uttering the occasional encouraging phrase. None provided any immediate relief to Americans. None cost the federal government money. All depended upon people outside Washington, D.C. to stop the disaster. None worked."

However, during the next three years of 1930-1932, President Hoover did attempt to introduce various policies focused on reviving economic growth. In his book "Prelude To Panic," author Lawrence Sullivan recounts President Hoover "had built up public works, and spread work; organized the country against distress as a local responsibility supplemented with Federal support; strengthened the Farm Loan System; created the Agricultural Credit Banks; established the Home Loan Banking system; created the Reconstruction Finance Corporation; encouraged a large movement of sound credit expansion through the (Federal) Reserve system; held the gold standard impregnable from foreign attack; lessened the strain on the world by (issuing) the moratorium on intergovernmental debts; taken a large role in the initiation of a world conference on stabilization of currencies and the reduction of trade barriers; had increased taxes; and excepting increasing relief expenditure, had reduced (government) expenses until a balanced budget actually was in sight with moderate (economic) recovery. Under all these policies lay the foundation stone of firm adherence to the deep traditions of American life – to the fundamental concepts of individual liberty and ordered freedom under law." Of course, the combined impact of these economic policies and initiatives failed to produce economic prosperity.

As for political rhetoric, in his acceptance speech for the Republican Presidential nomination on August 11, 1932, President Hoover stated: "Through, it all, our first duty is to preserve unfettered that dominant American spirit which has produced our enterprise and individual character. That is the bed rock of the past and that is the guaranty of the future. Not regimented mechanisms, but free men is our goal. Herein, is the fundamental issue: a representative Democracy, progressive and unafraid to meet its problems, but meeting them upon the foundations of experience and not upon the wave of emotion; or the insensate demands of a radicalism which grasps at every opportunity to exploit the sufferings of a people. I shall seek to maintain untarnished and unweakened those fundamental traditions and principles upon which our nation was founded and upon which it has grown."

Franklin Delano Roosevelt

When Franklin Delano Roosevelt took the oath of office as President for the first time on March 4, 1933, unknown to him the United States was entering an economic trough, which would define a 45% contraction in gross domestic product (GDP) during the previous three years. Moreover, 1933 would also be the year that the unemployment rate would reach a depression high water mark of 25% from which it would not retreat into single digit territory at 9.9% until 1941. In her book, "The Forgotten Man," authoress Amity Shlaes observes: "Though Americans associated Roosevelt with bounty, his insistent emphasis on sharing – rationing, almost – betrayed a conviction that the country had entered a permanent era of scarcity. Roosevelt cared little for constitutional niceties and believed they blocked progress. His remedies were on a greater scale and often inspired by socialist or fascist models abroad. Deflation, not inflation was a big problem, both early on and also later in the mid-1930s. The loss of international trade played an enormous role – just as both Hoover and Roosevelt said at different points. If the United States had not raised tariffs at the beginning of the decade and Europe had not collapsed in the early 1930s, the United States would have had a trading partner to help sustain it. Part of the problem was the challenge of the transition to industrialization from agriculture. Part was freakish weather: floods and the uncanny Dust Bowl seemed to validate the sense of apocalypse. With money and the weather breaking down, men and women in America felt extraordinarily helpless. They were willing to suspend disbelief. But the deepest problem was the intervention, the lack of faith in the marketplace."

During his first administration, Roosevelt signed the Securities Act of 1933, requiring that stocks and bonds for public sale be filed with the Federal Trade Commission; convinced Congress to pass the Farm Credit Act; the Banking Act of 1933 which established the Federal Bank Deposit Insurance Corporation; and the National Industry Recovery Act establishing the National Recovery Administration and the Public Works Administration; as well as the National Labor Board which enforces the right to collectively bargain for organized labor. FDR established the Export-Import Bank in an effort to facilitate international trade; signed the Securities and Exchange Act establishing the

Securities and Exchange Commission; signed the Reciprocal Trade Agreement giving the President the authority to lower tariffs by as much as 50% to countries with most-favoured-nation status; signed the Communications Act establishing the Federal Communications Commission, a body of seven that will supervise telegraph, telephone, cable and radio; signed the National Housing Act establishing the Federal Housing Administration; and signed the New Federal Farm Bankruptcy Act permitting moratoria on mortgage foreclosures.

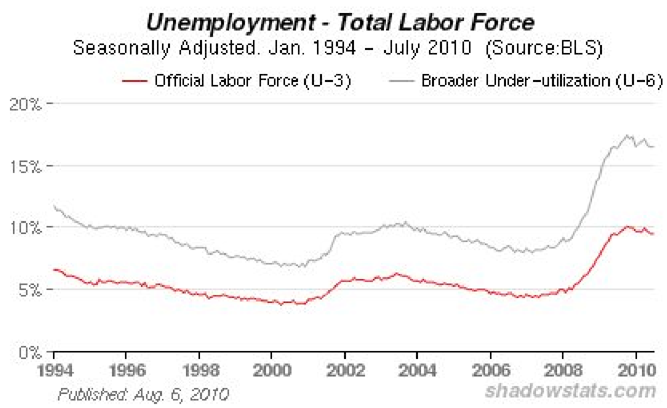
President Roosevelt signed the Emergency Relief Appropriations Act leading to the establishment of the Resettlement Administration, intended to move poor families to more productive greenbelt regions; created the Soil Conservation Service within in the U.S. Department of Agriculture; established the Works Progress Administration (WPA) providing millions with work through construction projects; established the Rural Electrification Administration to finance the construction of utility projects in areas developed by private companies; and signed the Revenue Act raising estate and gift taxes, the marginal rate on individuals and corporate income tax, as well as taxing dividends received from corporations, which were previously untaxed.

However, as documented in "The New Deal," author Paul Conkin relates: "Throughout 1937, government policies, instead of supporting economic growth, actually inhibited it. The beginning collection of Social Security taxes cut down on wages. A drastic curtailment of relief expenditures in 1937, plus the termination of the Public Works Administration, further reduced purchasing power. For the first time in years, the government cash budget was in balance. Also, in two moves in response to banking and business fears of inflation, the Federal Reserve Board, without rejecting an easy money policy, nonetheless raised the reserve requirements of member banks. Although idle funds usually covered the rise without direct economic effects, the move did lead to some increases in interest rates and had an inhibitory effect on a depression-jittery society. Thus, the whole burden of sustained growth passed to private business which tossed it right back in the form of an embarrassing depression."

Barack Hussein Obama

When President Obama was sworn in on January 20, 2009, the recent U.S. economic downturn was in full stride. Indeed, former Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke had already been proactive by instituting the $750 billion (U.S.) Troubled Asset Relief Program (TARP) in 2008 to bailout the major U.S. banks. Now, the new U.S. Treasury Secretary, Timothy Geithner, announces a plan to expand the government's Term Asset-Backed Loan Facility (TALF) in an attempt to initiate a restoration of the securitization market. As we know, the developed countries of the world operate on a credit-based economic system and interest rates represent the price of credit. However, the TARP, TALF and other government-sponsored assistance programs merely mask the risks the American banking community assumed in the securitization and derivatives markets during recent years. Government assumption of such "toxic assets" from the banks only transfers ownership from the private to the public sector, without addressing the underlying problem of banker avarice, greed and mismanagement.

As we commented in our Winter Warning of February 16, 2009, entitled A Man of Constant Sorrow: "Currently, there is a consistent theme that echoes through the offices of the U.S. Capitol, the White House and the American media that somehow, somewhere, there must exist a government plan to "fix the financial system" or "kick start bank lending" or "get people back to work." Few people seem to realize or understand that recessions and depressions are natural occurrences within the long term business cycle. There is no quick fix, magic trick or potent elixir to turn the course of events on a dime. As Mr. Geithner is now discovering, there is neither a politician (no, not even U.S. President Barack Obama), nor, a government mandarin of Churchillian stature and leadership presence to halt the incoming tide of economic depression."



As can be discerned from the above chart, the official U.S. unemployment rate appears to be leveling off at 9.5%, while the total unemployment rate is estimated at 16.5%. However, we believe this represents a temporary lull which will see the unemployment rate ultimately move much higher, as the economy sinks once again into depression. Indeed, President Obama has actually signed laws, issued executive orders and approved regulations that create incentives for private sector employers to issue layoff notices, or delay hiring people. As cited by Jim Powell, senior fellow at the Cato Institute: "Obama's forced restructuring of General Motors trashed established principles of bankruptcy law to give the United Auto Workers a sweetheart deal and subvert the rights of bondholders. The Union had $20 billion (U.S.) of claims and was awarded a 39% stake in the company plus a $10 billion (U.S.) payment into the UAW health care trust fund. The bondholders had $27 billion (U.S.) of claims and ended up with only 10% of the company. The administration's abuse of power discourages investors from making capital available to companies that might be targeted for government intervention. Furthermore, investors know that ultimately, Obama's higher spending initiatives must be paid for with higher taxes that will reduce the after-tax return on investment. Consequently, rather than making capital available now, many investors remain on the sidelines and many businesses are sitting on cash, waiting to see how high the taxes are going to be. By increasing the cost of hiring people, increasing the cost of doing business, reducing after-tax returns from investment and subsidizing unemployment; Obama is repeating FDR's misguided policies that prolonged high unemployment during the Great Depression."

The President and his team have spent huge amounts of money in an effort to get the economy growing again, but to little effect. As can be determined from the chart below, many Americans are now financially far worse off than they were in 2007. Government programmes designed to help people who are hurting on account of the economic downturn are serving one in six Americans and these programmes are continuing to expand.

More than 50 million Americans are on Medicaid, which is a Federal/State programme aimed principally to help the poor. That is an increase of 17% since December 2007.

More than 40 million Americans are receiving food stamps, which is an increase of nearly 50% from December 2007.

About 10 million Americans are receiving unemployment benefits, which is four times more than December 2007. Congress has extended unemployment benefits eight times beyond the basic 26 weeks to a current 99 weeks.

More than 4.4 million people are on welfare, which is an 18% increase since December 2007.

Source: USA Today, August 30, 2010.

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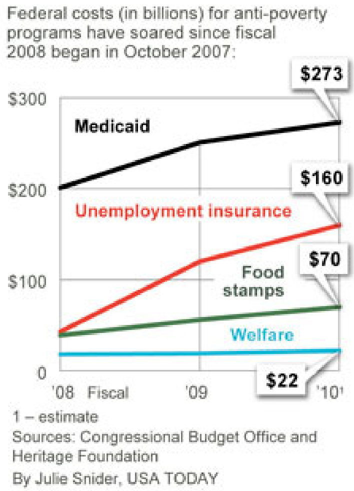

President Obama' efforts, like his predecessors, Presidents Hoover and Roosevelt, are doomed to fail.

Summary

Clearly, it is evident that America would not have emerged from the Great Depression of the 1930s without the massive increase in military spending which marked the U.S. entry into World War II. It must also be remembered that during the Hoover and Roosevelt administrations, America was the world's largest creditor nation, compared to the present time being the world's largest debtor nation – $13.5 trillion (U.S.) and climbing at the rate of $4.2 million (U.S.) per minute. Neither the Federal Reserve, nor the Obama Administration can grasp the reality that deficit and debt accumulation cannot be solved through the issuance of more debt. As the Globe & Mail's Terence Corcoran observes: "No amount of printed paper can offset Washington's massive spending increases, unprecedented deficits, program expansions, bank-bashing regulations and anti-growth energy regimes"

At Long Wave Analytics, over many years we have recognized the mounting U.S. debt problem and predicted the bursting of the debt bubble, leading the U.S. economy into a state of depression. Indeed, additional reliance by the Fed upon policy initiatives such as quantitative easing do nothing to stimulate final demand from a debt-burdened American consumer. A period of deflation and negative GDP growth must ensue, in order that significant portion of the $56 trillion (U.S.) of accumulated debt on all levels can be expunged from the U.S. economic landscape.

We end with these words, written by Robert Smitley in 1933 - "It is a delusion to think that a depression caused by credit can be resisted. All the panaceas, nostrums, and quacks invented by all the politicians in the world, can but hold off the eventual day of reckoning, prolonging the agony." Robert Smitley, Popular Financial Delusions, Roland Swain Company, Philadelphia, 1933. P. 9

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