

**Capitalism,
Government,
Money,
and the
Future of
the World**

*Finding
and Keeping
the Right Balance
in
Market-Capitalist
Democracies*

By its nature, capitalism is subject to
recurrent, inevitable crisis –
sudden, unpredictable spasms of collapse,
contraction, and economic destruction

Capitalism is **bipolar** –
always alternating inevitably
between boom and bust

What happened in the Great Depression?

- The huge stock bubble pops in late 1929, with the market crashing spectacularly, then continuing to decline for the next 3 years, as the rest of the economy spirals downwards
- Banks start to fail, with large amounts of deposits lost / made inaccessible for extended periods
 - Bank failures continue and accelerate, with mass bank runs and panics, all the way up until the spring 1933
 - As massive numbers of banks fail and deposits are lost, the money supply contracts dramatically, setting off a severe **deflation** that demolishes the economy



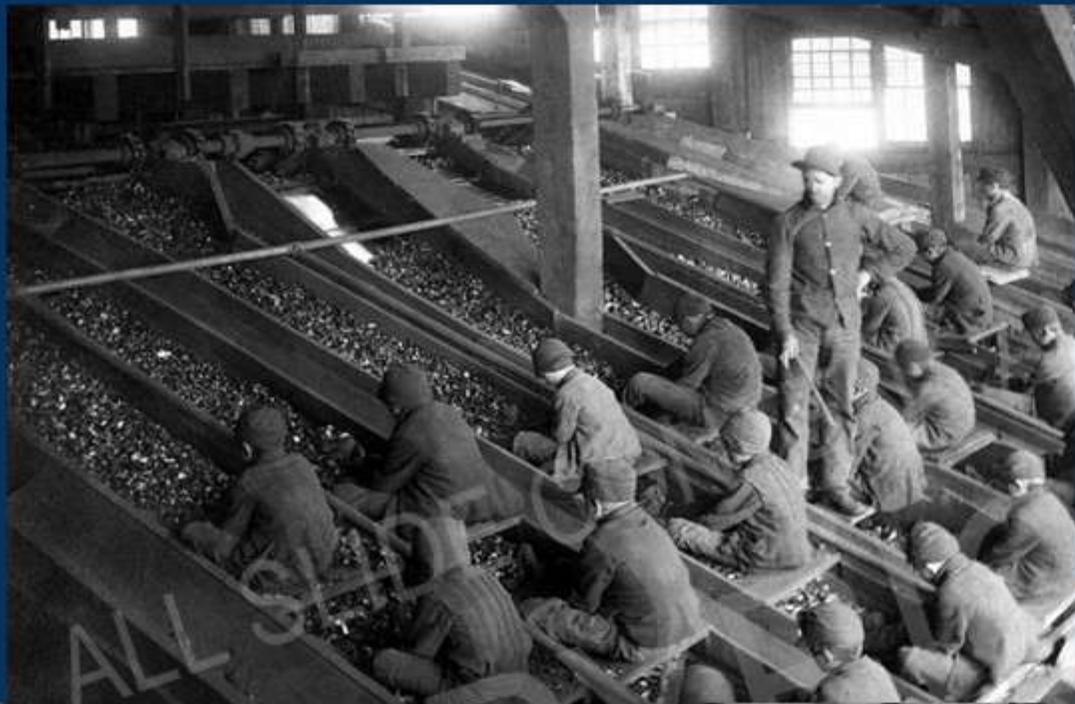
International political eruption against capitalism

We can't go on like this

This isn't sustainable

*We've now had over a hundred years
of capitalism, and the panics
and crashes just keep getting
worse and worse*

*If it's this bad this time,
what will next time be like?*



In the United States, by 1933 there is an overwhelming political consensus for change, to address capitalism's persistent instability and alleviate its deep perceived injustices

Banking and Securities Acts of 1933 ('Glass-Steagall'):

- Established government-backed deposit insurance, to prevent bank runs and bank panics
- Strengthened role of Federal Reserve as lender-of-last-resort to banks
- Tightened bank regulation and supervision, and separated commercial and investment banking
- Established the SEC to regulate securities issuance and trading

National Labor Relations Act of 1935:

- Ensured the right of workers to form unions, perform collective bargaining, and conduct strikes

Fair Labor Standards Act of 1938:

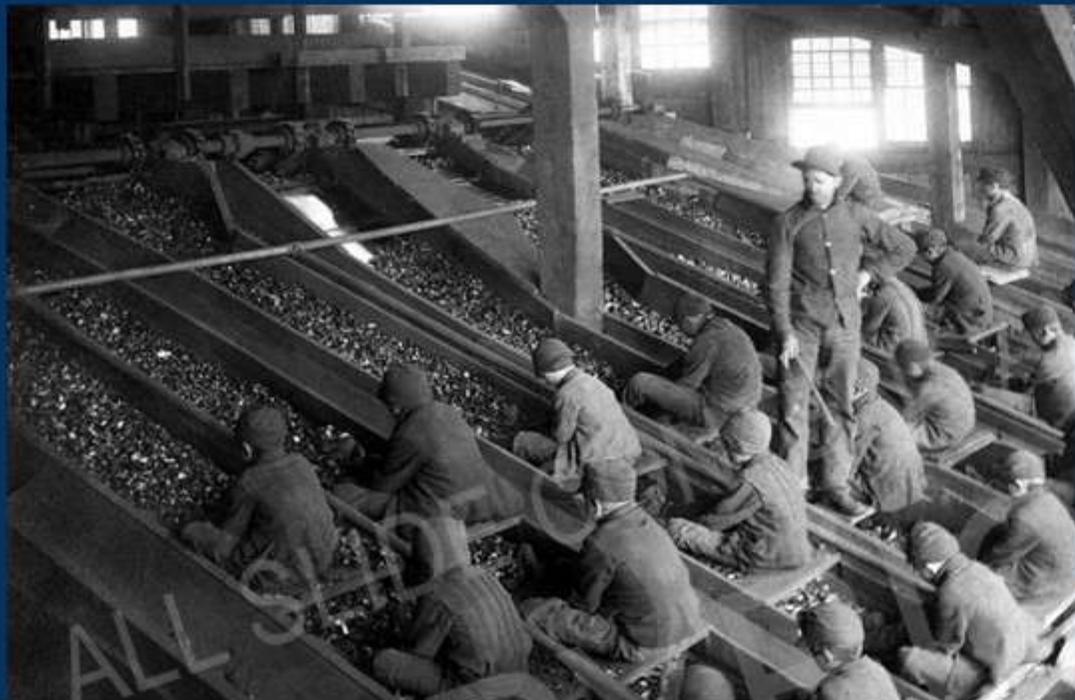
- Banned child labor, established the 8-hour workday with time-and-a-half overtime, and a minimum wage

Social Security Acts of 1935 and 1939:

- Established a baseline old-age pension for most workers, as well as support for dependent children, funded by a dedicated payroll tax

These permanent steps were supplemented by a variety of temporary programs to try to alleviate unemployment and revive the economy





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*Instead of getting rid of capitalism entirely, let's try to **stabilize it**, and let's try to **take the roughest edges off of it**, so it has a chance of providing people with the opportunity for a decent life*

The financial reforms of the 1930s were highly successful in stabilizing the American banking and financial sector for the next 50 years

- Financial panics, bank runs, and the loss of customer deposits in bank failures came to an immediate end
- Bank supervision by the Federal Reserve and by the FDIC was highly successful in preventing losses to the US taxpayer from bank failures, from the 1930s until the 1980s
- But the Fed did not intervene to stop the collapsing money supply until after 1933, and the Fed and Treasury took other actions, for specific reasons, that had the effect of reducing the money supply *further*
- As a result, the economy was ravaged by the worst sustained deflation in US history, from 1930-1933
- Deflation in the United States came to an abrupt end with the end of the gold standard in 1933

The maturation of monetary functions in the United States

ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY 1860s	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY 1913	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE and FED AS LENDER OF LAST RESORT 1934	FULL CENTRAL BANK OPERATIONS BEGIN 1934-35			
Civil War need to raise huge amounts of money to prosecute war	Panic of 1907 need to be able to react strongly to stabilize during bank panics	Great Depression need to end bank runs and enforce banking stability	Great Depression need to end severe deflation			
Elimination of private bank notes Currency issued on gold standard	Federal Reserve established as a new entity distinct from Treasury, with technocratic governance. But a significant part of the political establishment disagrees with the need for such an institution, and with the idea that govt should ever intervene in the economy	Deposit insurance established after banking industry is devastated by runs and panics. The Fed begins to act more assertively as lender of last resort to banks, with much closer bank supervision and regulation	Convertibility to gold is ended, effectively ending the gold standard. The US dollar is devalued from \$20.67 to \$35, to stop deflation. Everyone required to sell their monetary gold to the government, to prevent hoarding, and to get money to start circulating more freely			



In terms of government fiscal and spending policies, the economic recovery programs of the 1930s were conceived and managed from a pre-Keynesian perspective during both the Hoover and Roosevelt administrations, and were not nearly sizeable enough to spur a robust turnaround

The economy struggled with a weak recovery from 1934-37, then sank back into recession in 1937-38 before resuming slow growth in 1939-40

By 1941, the US economy was back to the size that it was in the summer of 1929

201-08

Ben Bernanke Says "Hitler Was the Guy Who Got Economics Right in the 1930s"

Historians/History

tags: Hitler, economics, Ben Bernanke



[IG Farben factory in Monowitz \(near Auschwitz\) 1941](#) - Bundesarchiv, Bild 146-2007-0057 / CC-BY-SA 3.0, [CC BY-SA 3.0](#)
de, [Adolf Hitler](#) By Bundesarchiv, Bild 146-1990-04B-29A / CC-BY-SA 3.0, [CC BY-SA 3.0](#) de

Ben Bernanke has had his finger on the pulse of macroeconomic convulsions, and many have called him the man who "doctored" the financial crisis of 2008, and brought the American economy back into good graces.

He is considered the pre-eminent living scholar of the Great Depression, and one can say he conducts himself as such. The first paragraph in the preface to Bernanke's 2004 book, *Essays on the Great Depression*, reads as follows:

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- To compare to the US path: Germany went off the gold standard 4 years earlier than the US, and the spending and investment programs implemented by the Nazi government were *several times larger* than the New Deal was in the United States. These programs did succeed in quickly turning the German economy to robust growth, beginning in 1933



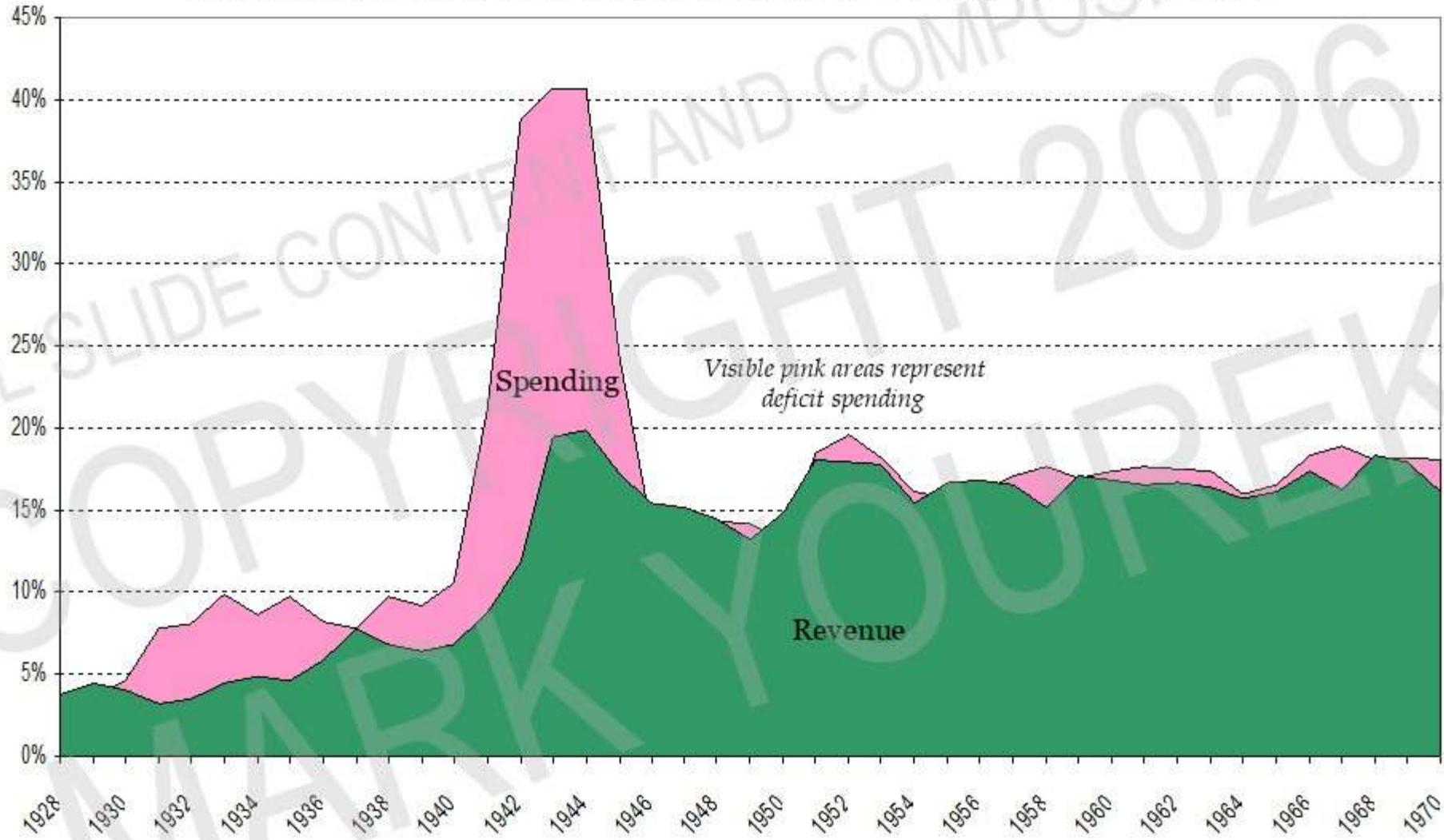
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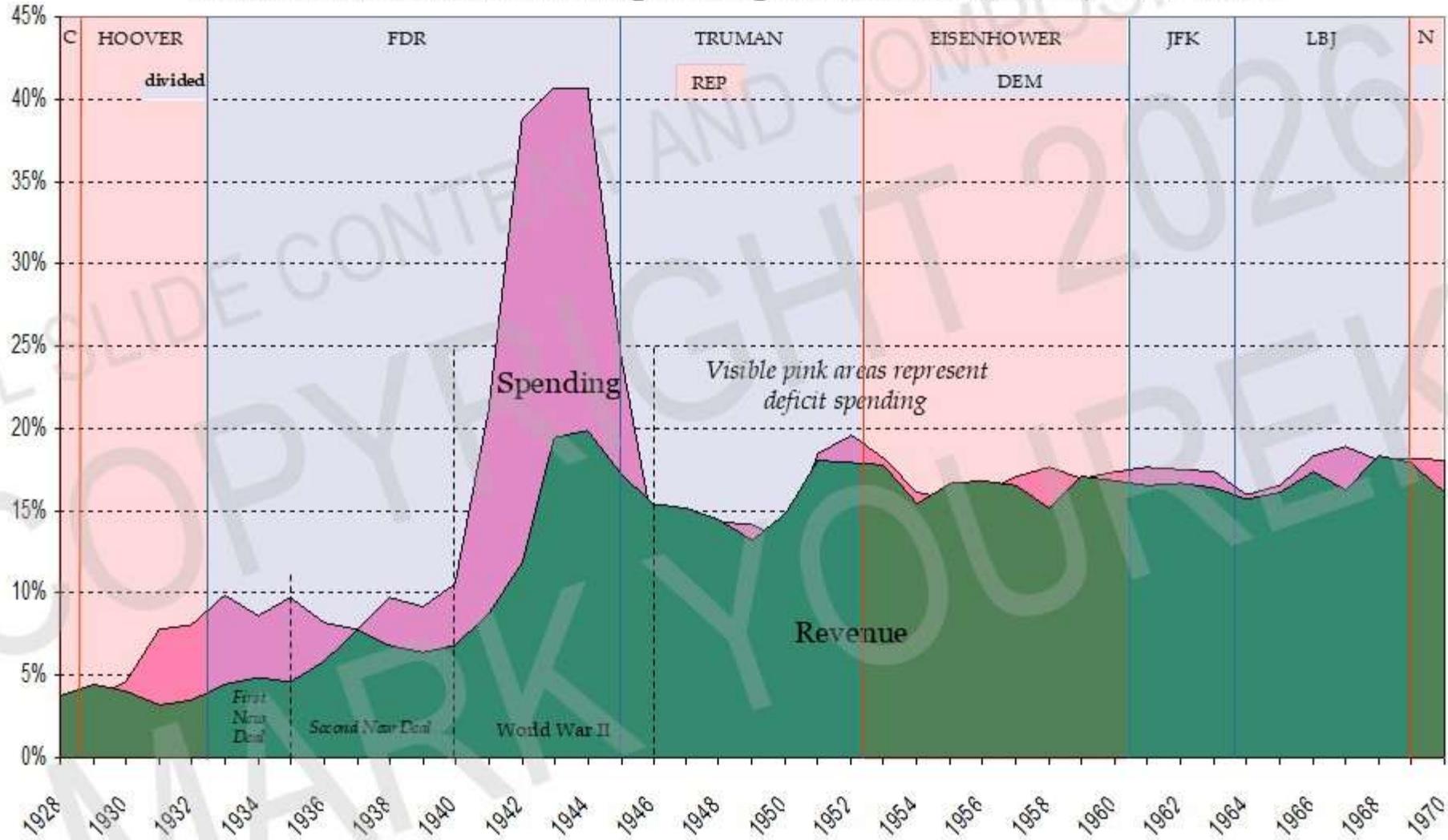
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For the United States, the effort to fight World War II from 1941-45 constituted a vastly larger 'government stimulus' – the largest by far in American history – and was itself hugely successful in lifting the US to a higher economic plane

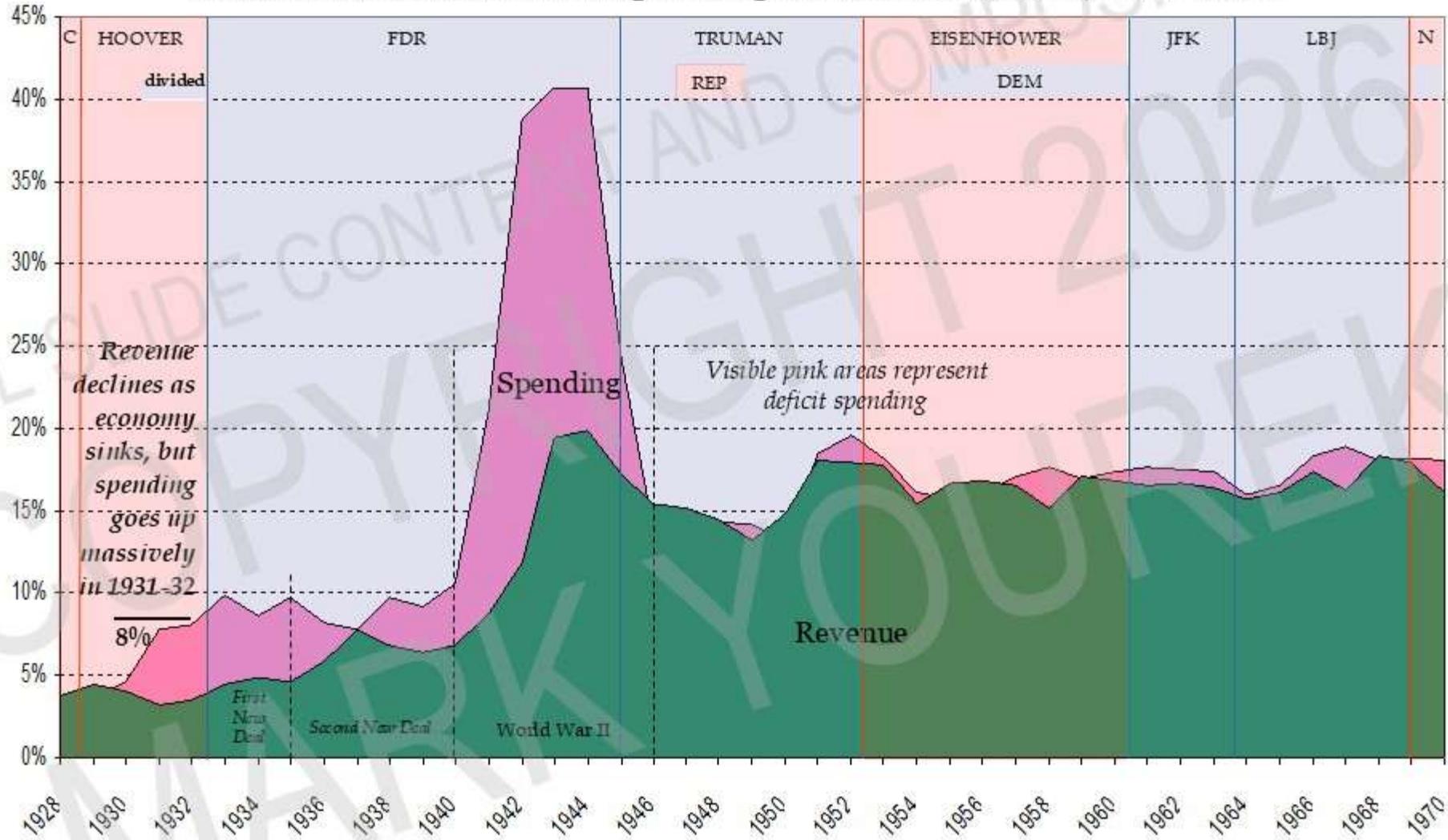
US Federal Revenue and Spending as a Share of GDP, 1928-1970



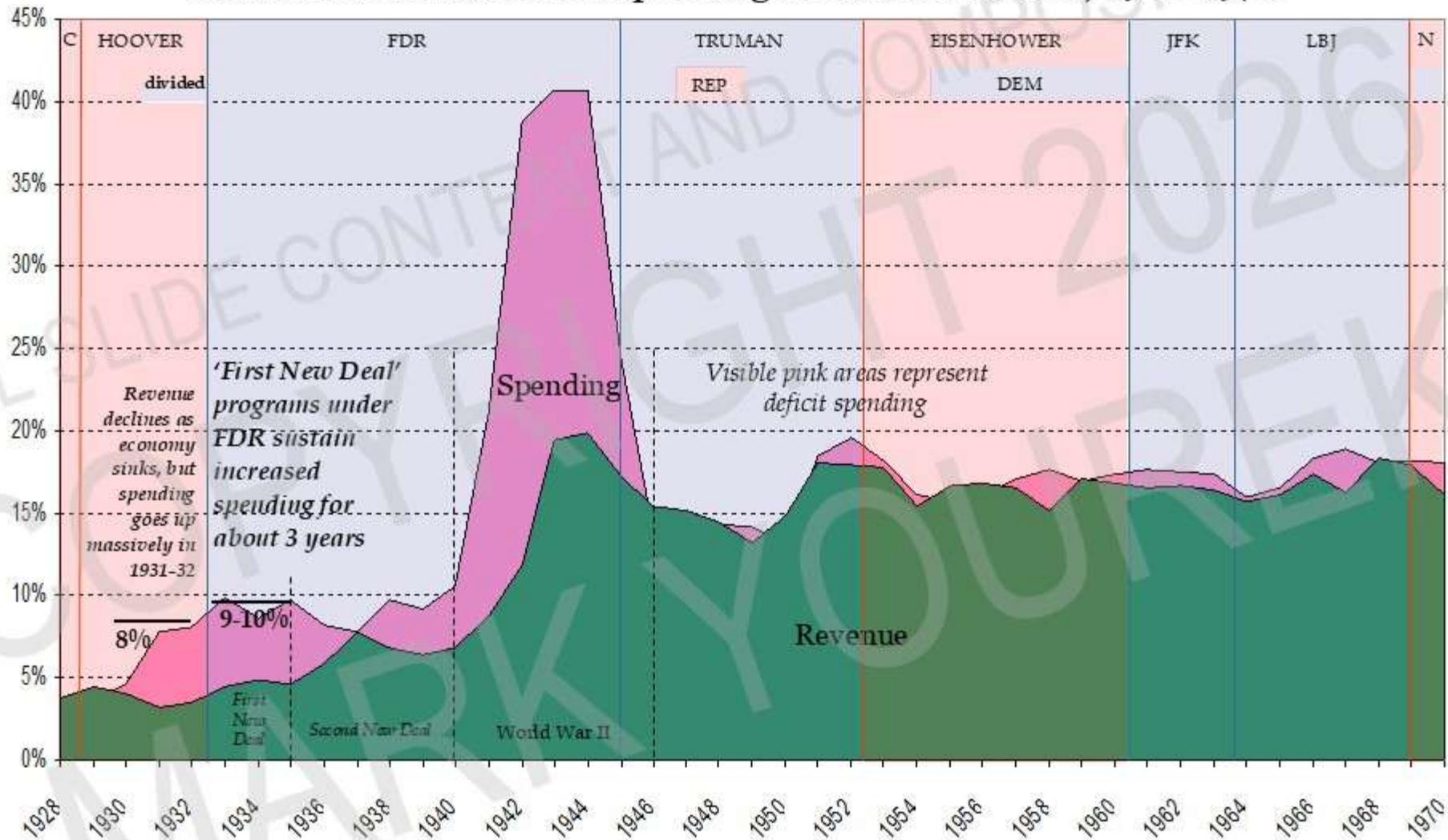
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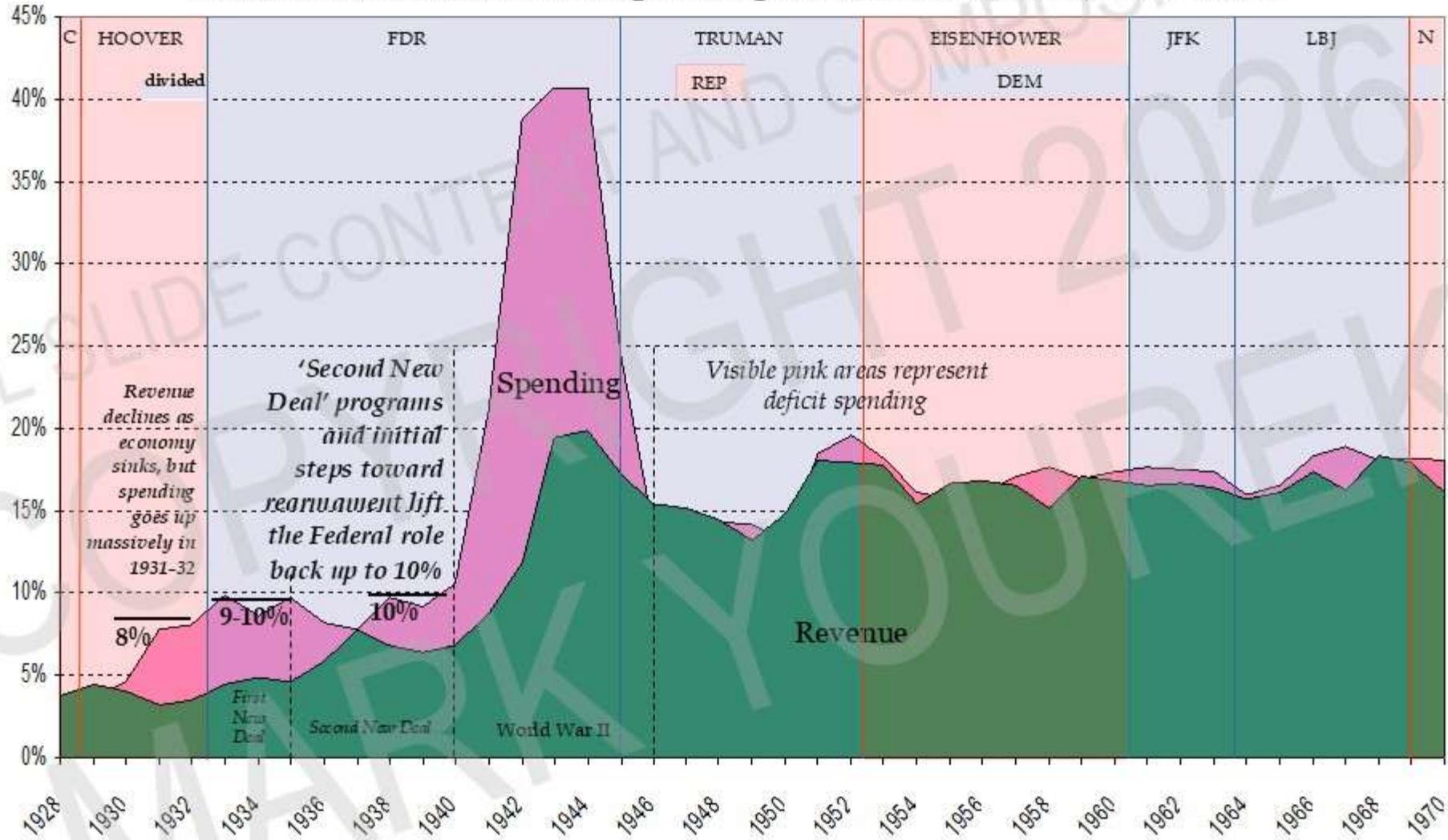
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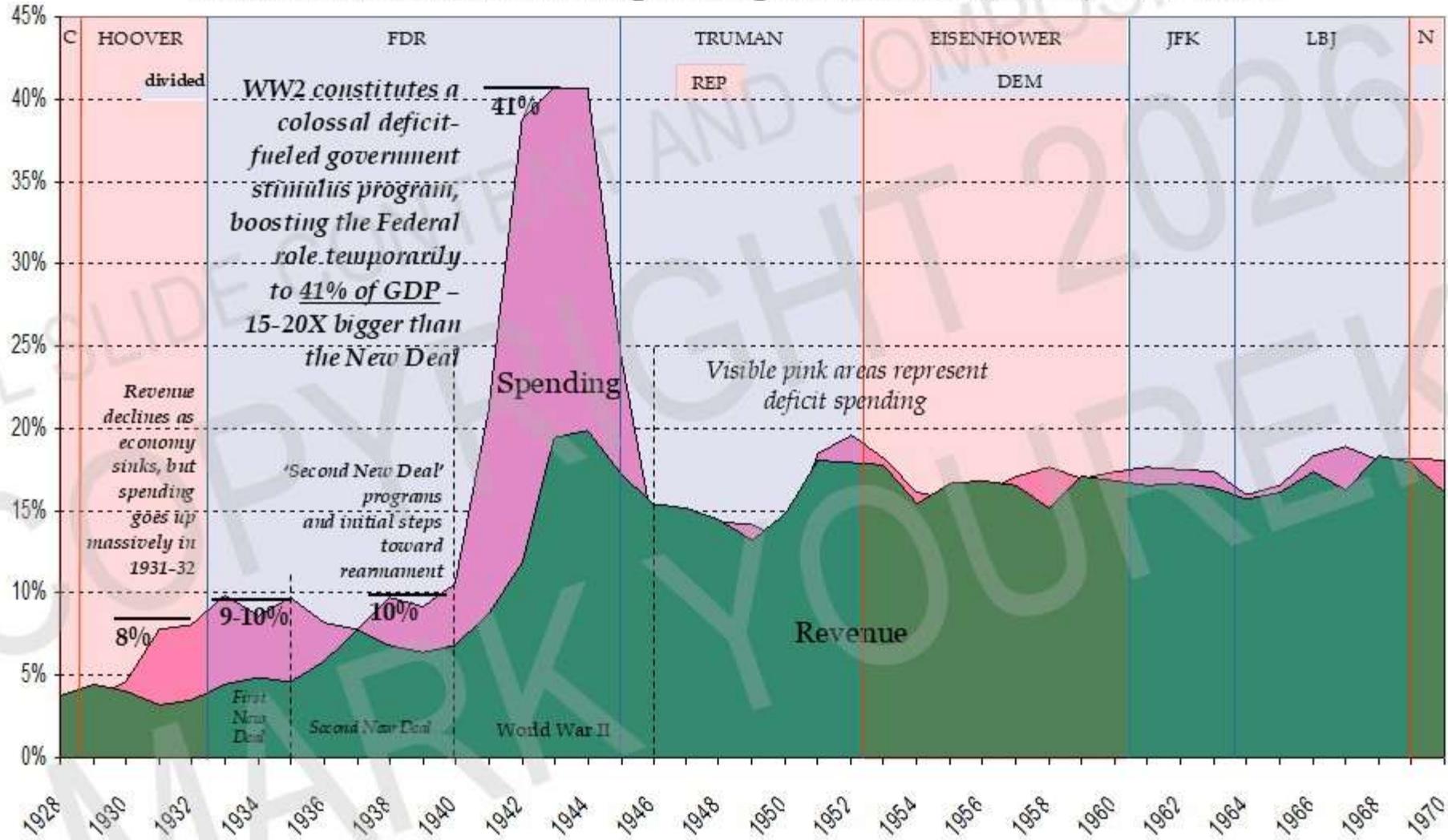
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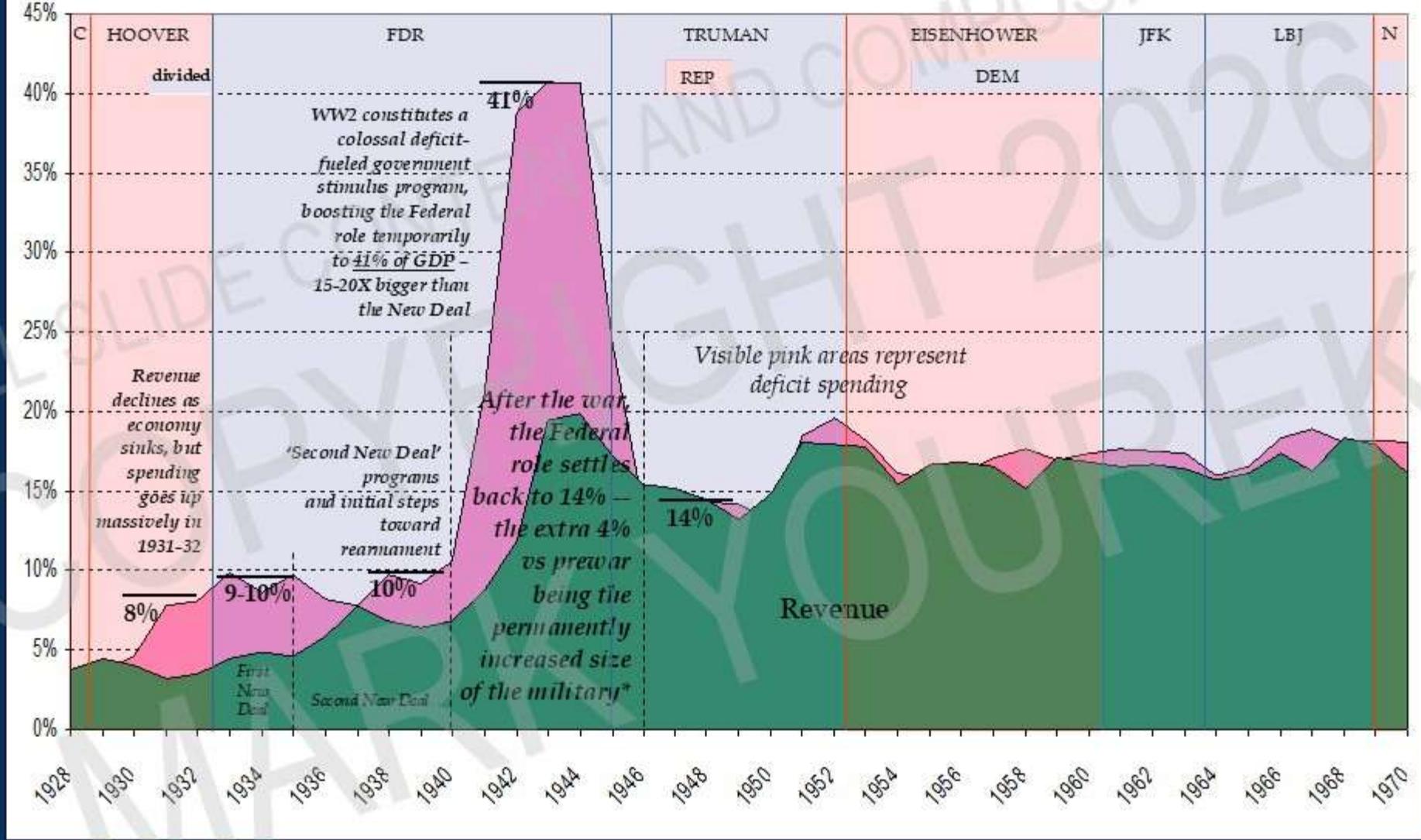
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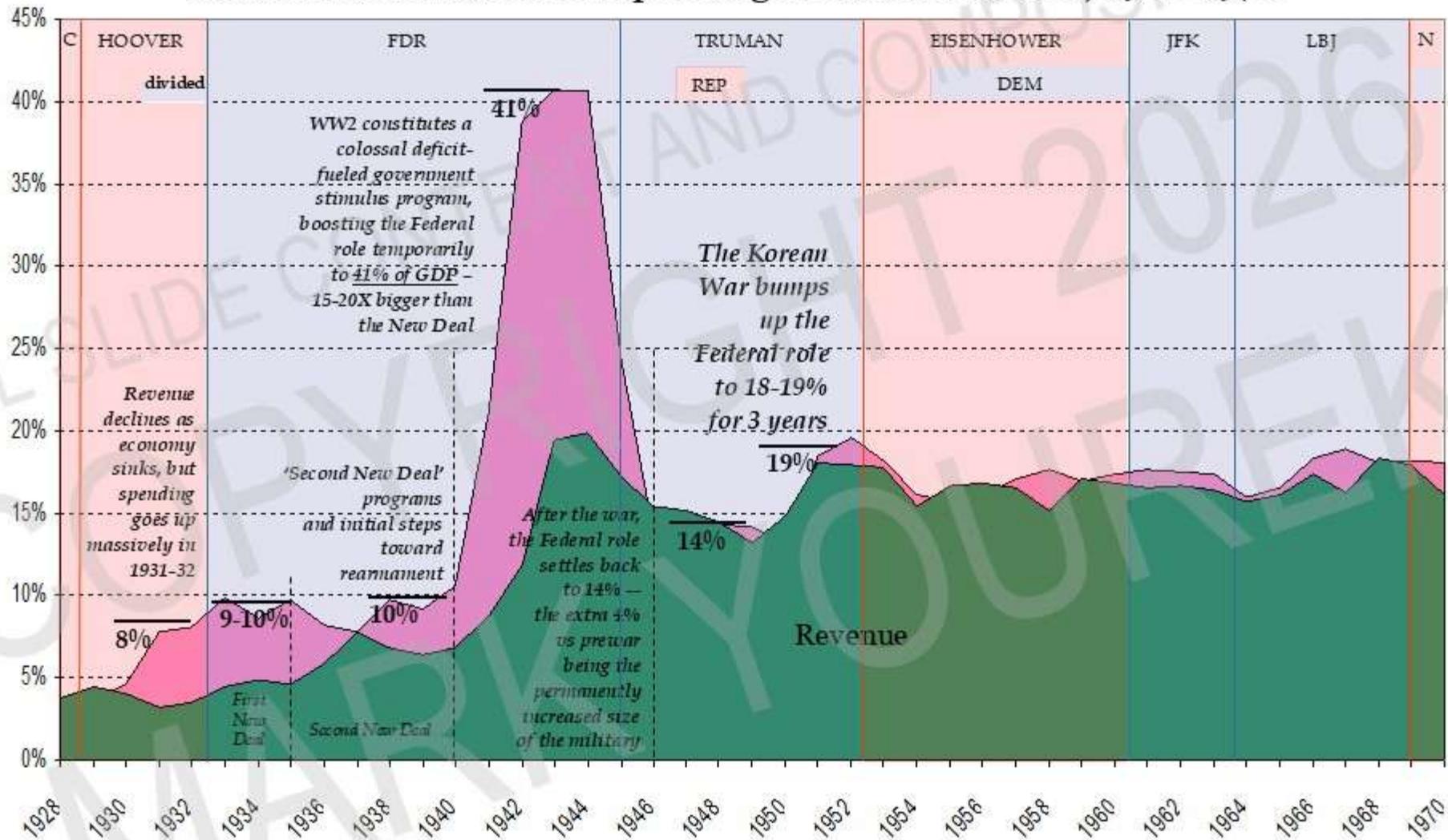


US Federal Revenue and Spending as a Share of GDP, 1928-1970



*also: increased interest payments on the national debt; increased inflows / outflows for Social Security; and expenses related to the GI Bill

US Federal Revenue and Spending as a Share of GDP, 1928-1970



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Revenue declines as economy sinks, but spending goes up massively in 1931-32

8%

'Second New Deal' programs and initial steps toward rearmament

9-10%

10%

41%

WW2 constitutes a colossal deficit-fueled government stimulus program, boosting the Federal role temporarily to 41% of GDP - 15-20X bigger than the New Deal

After the war, the Federal role settles back to 14% - the extra 4% vs prewar being the permanently increased size of the military

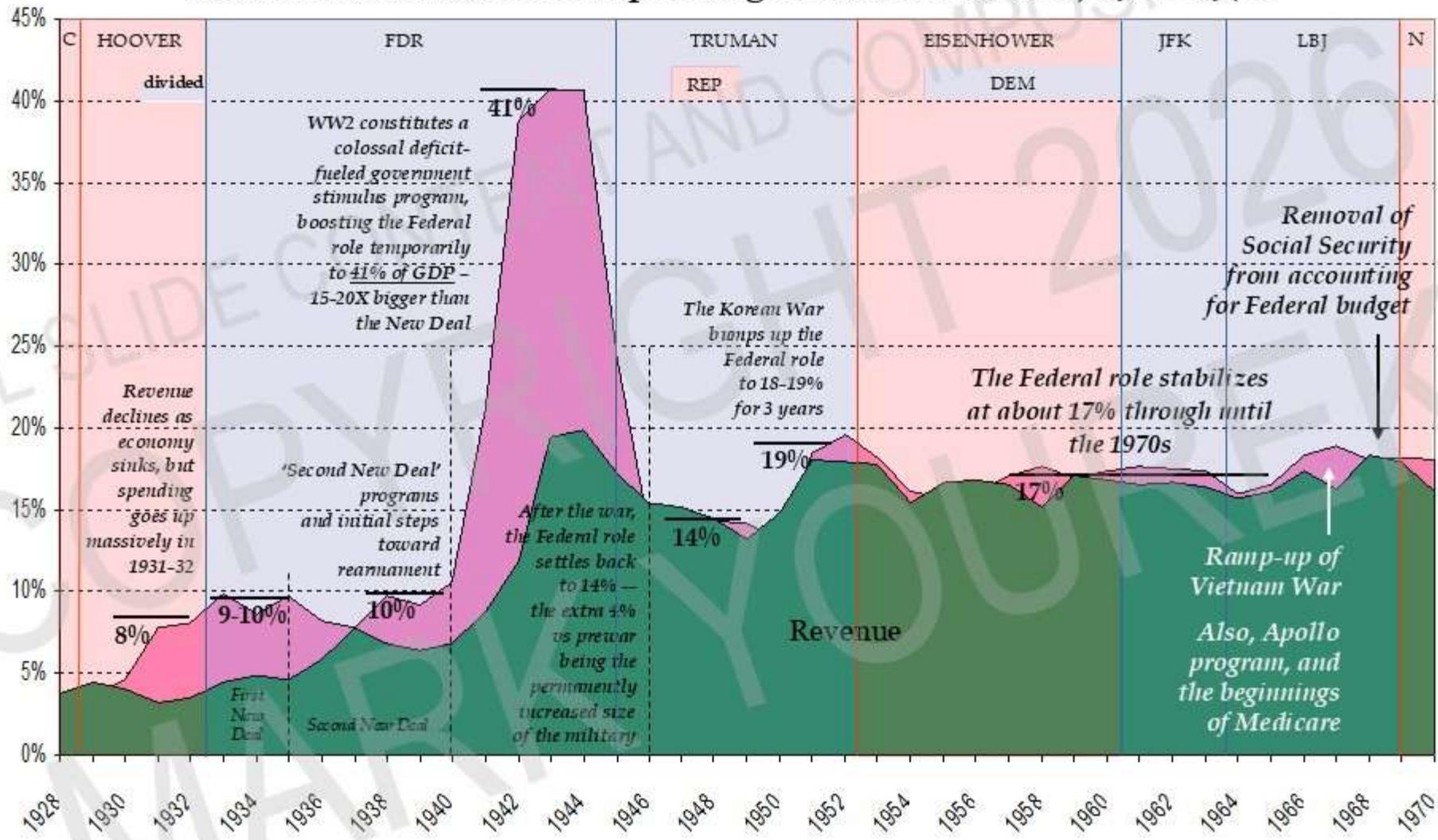
14%

The Korean War bumps up the Federal role to 18-19% for 3 years

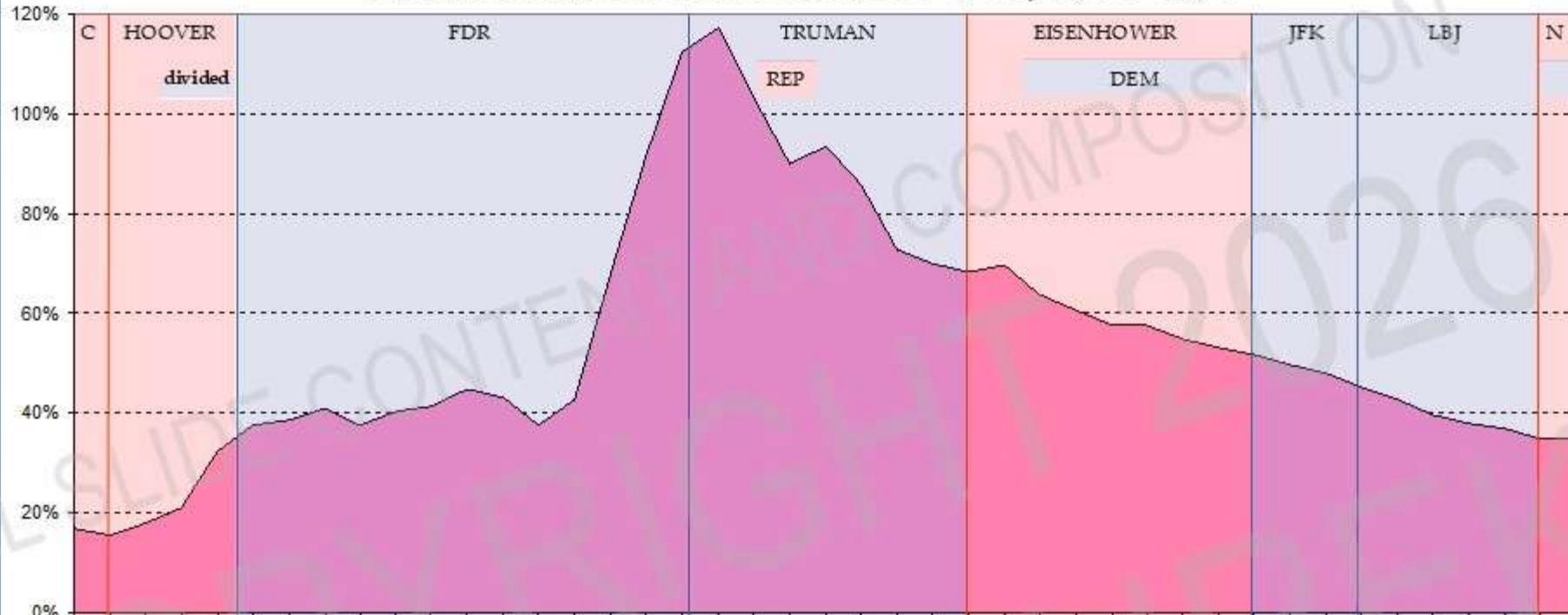
19%

Revenue

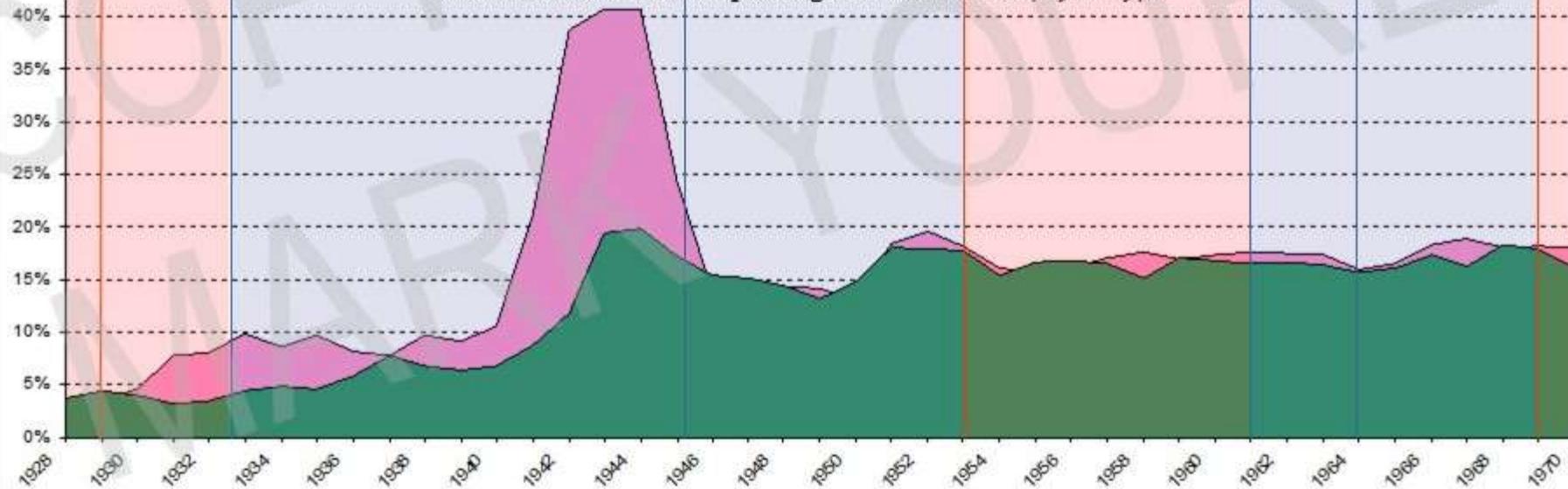
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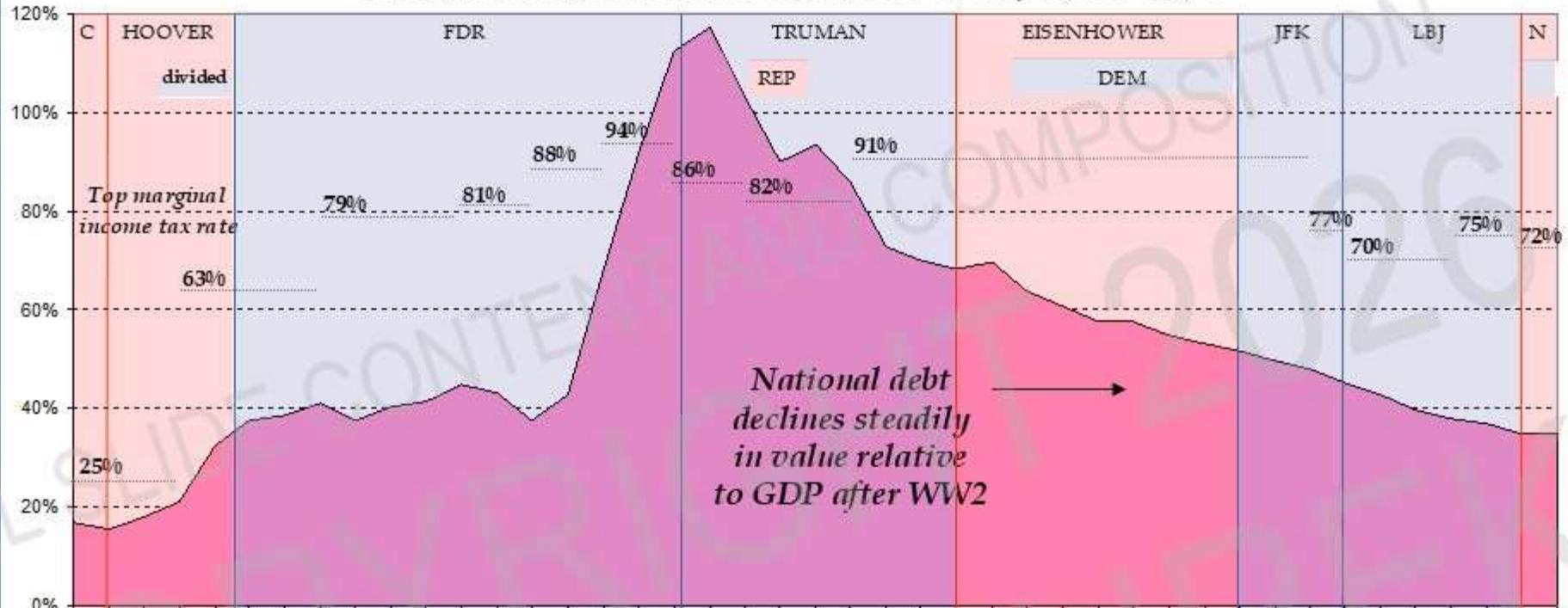
US National Debt as a Share of GDP, 1928-1970



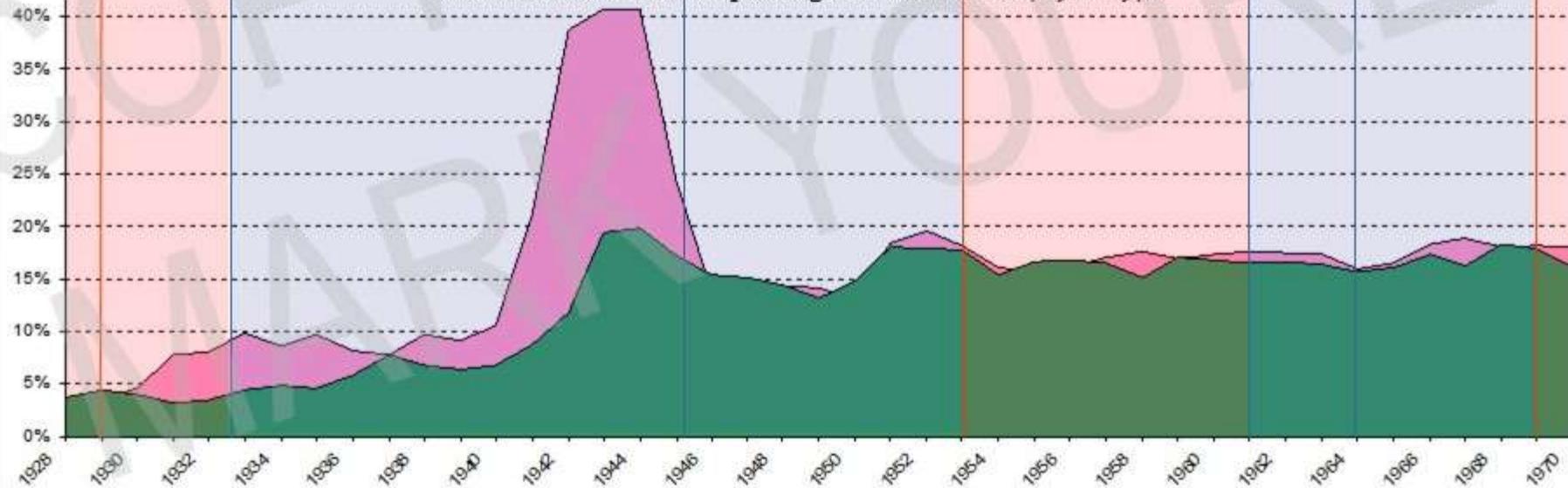
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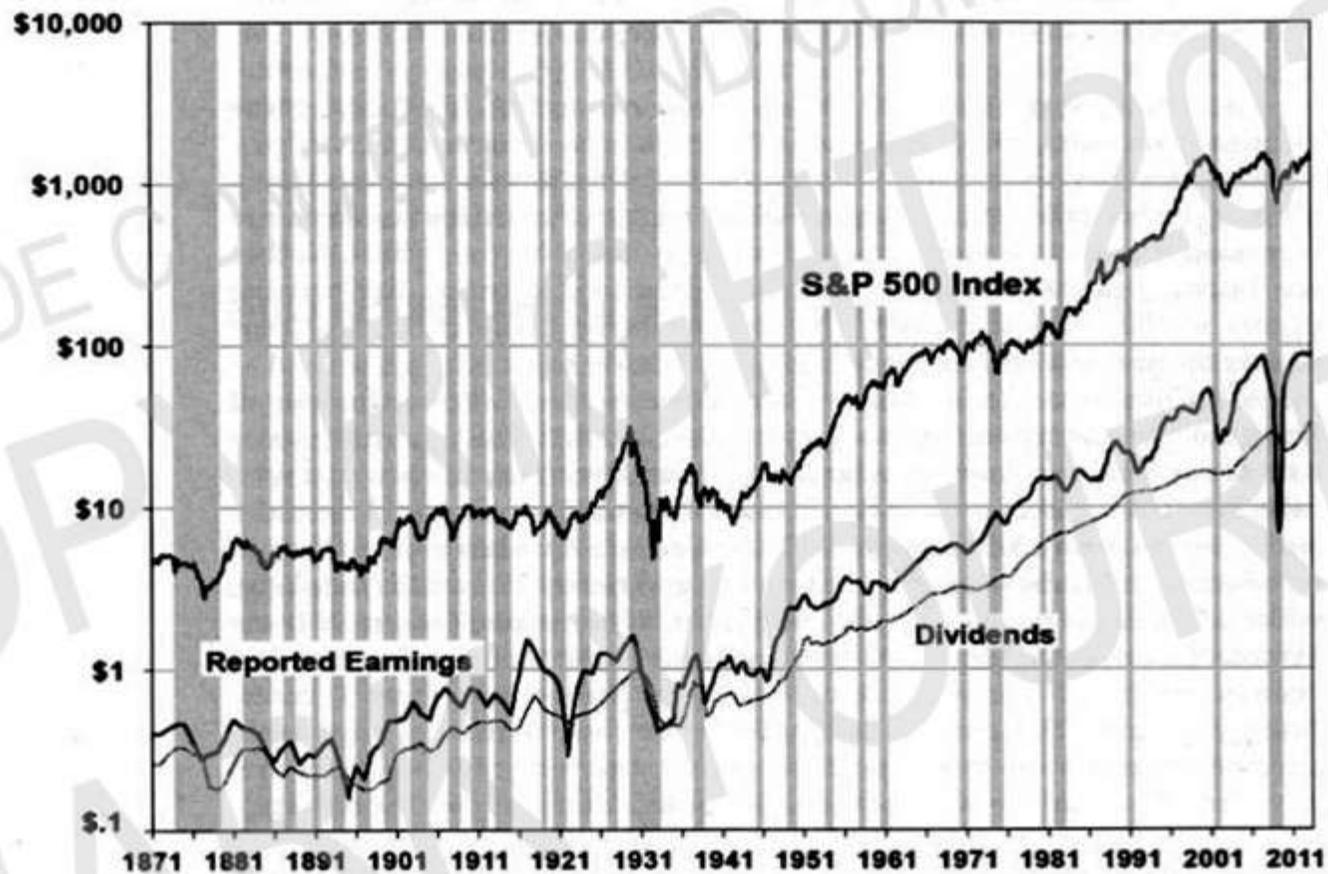
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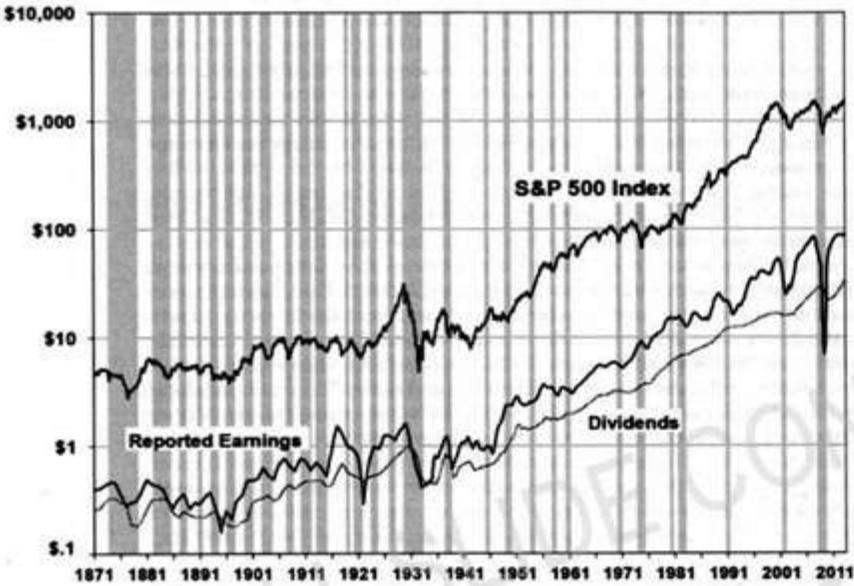
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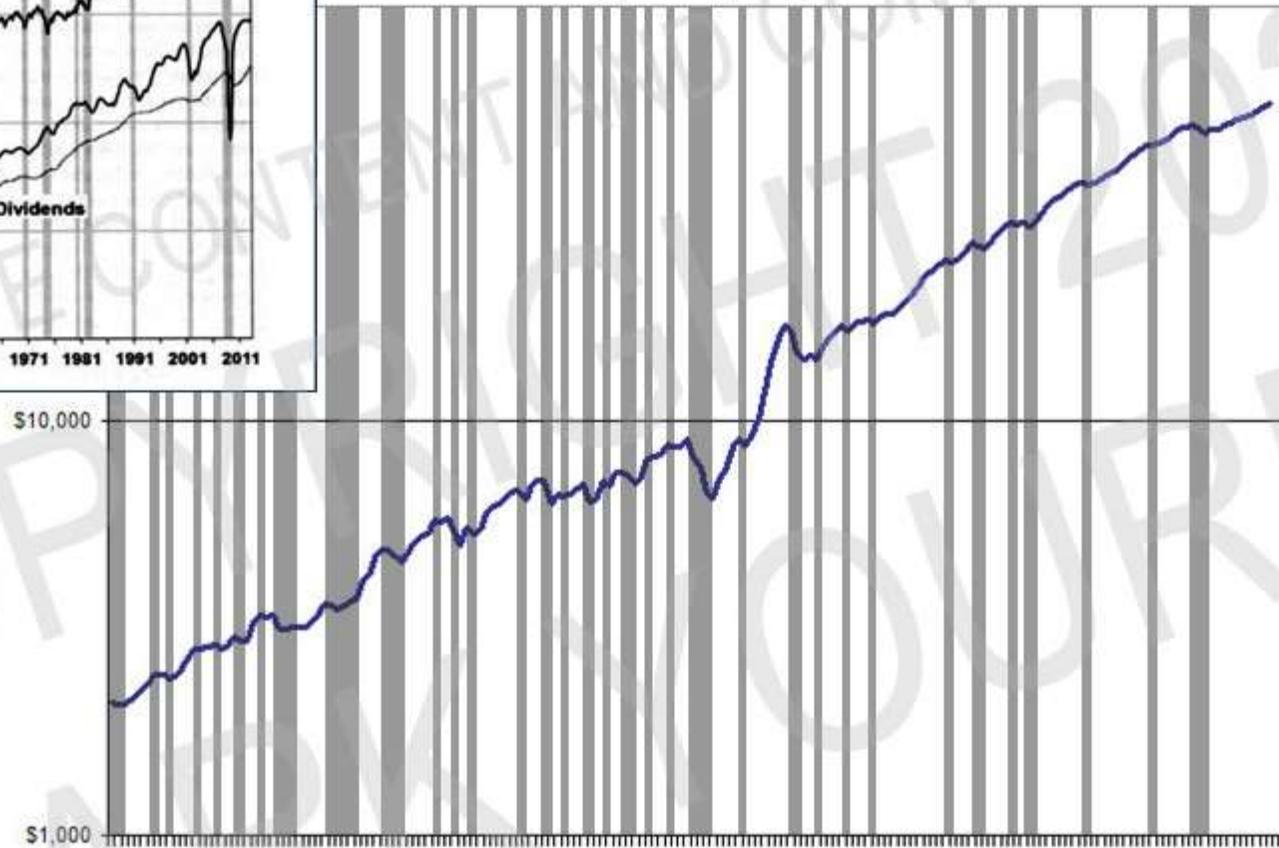
Stock Prices, Earnings, Dividends, and Recessions 1871–2012



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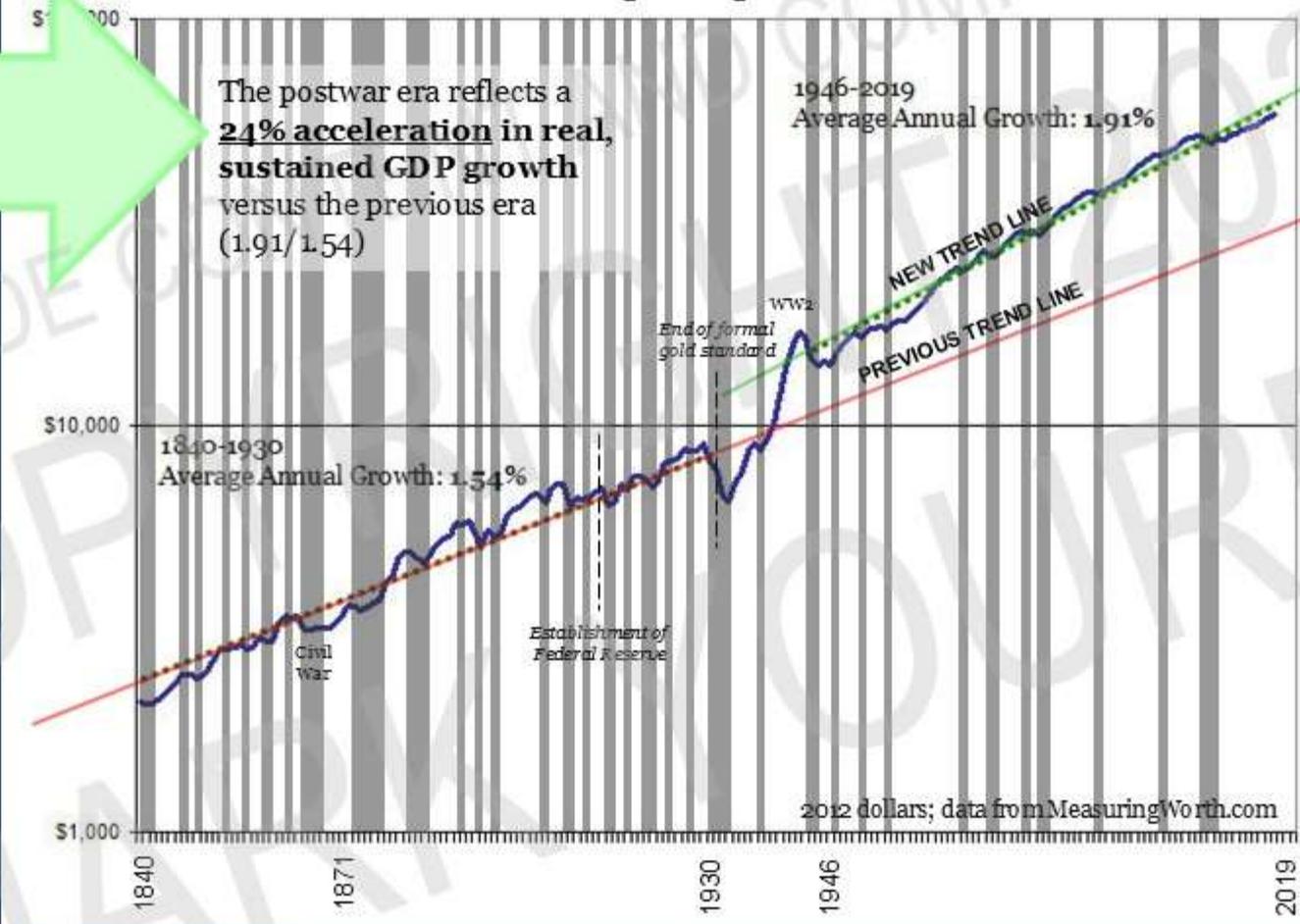


US Real GDP per capita 1840-2019



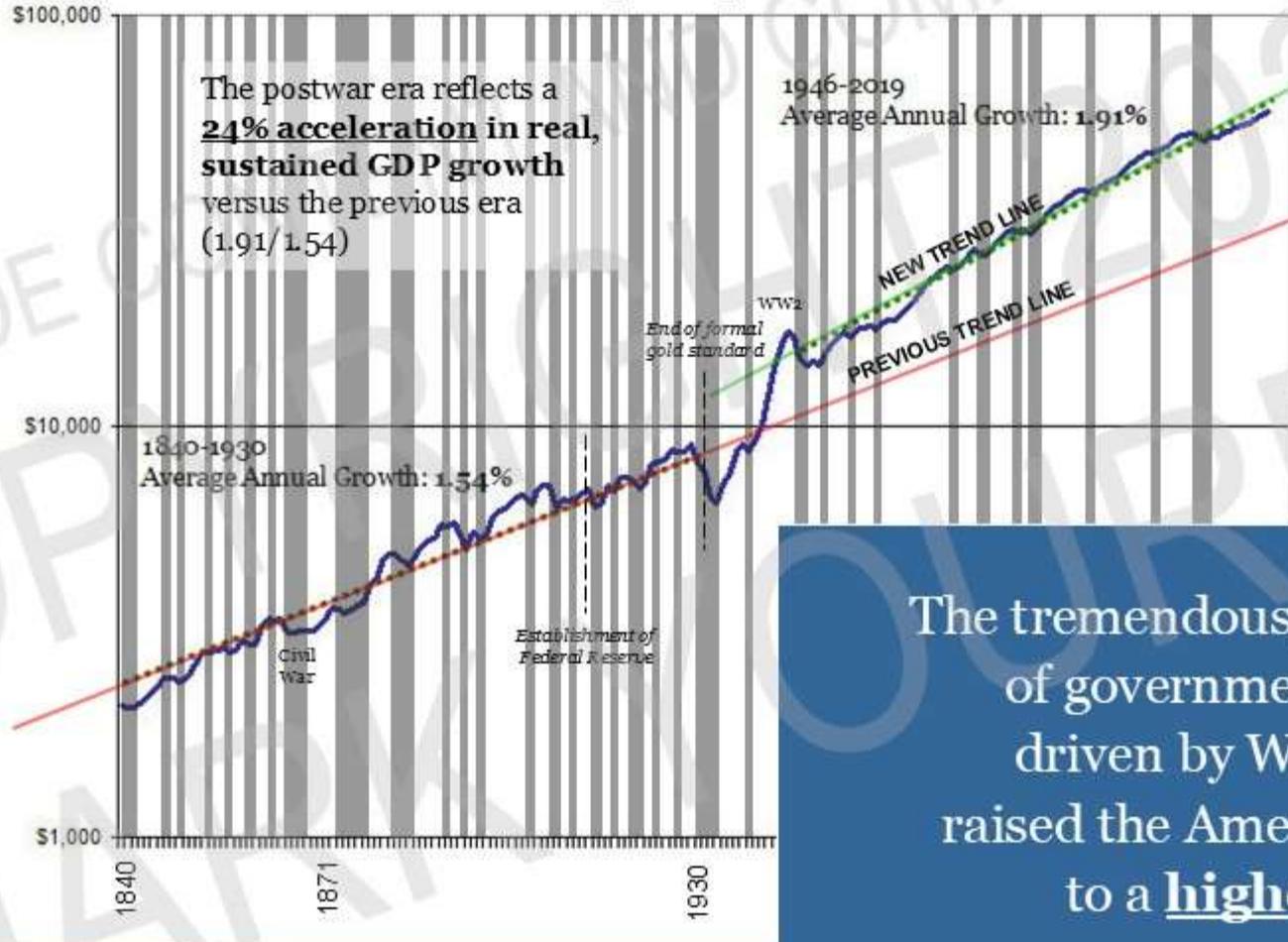
Why is the slope of this line so much straighter than the S&P 500 graph?

US Real GDP per capita 1840-2019



note the new, steeper slope

US Real GDP per capita 1840-2019

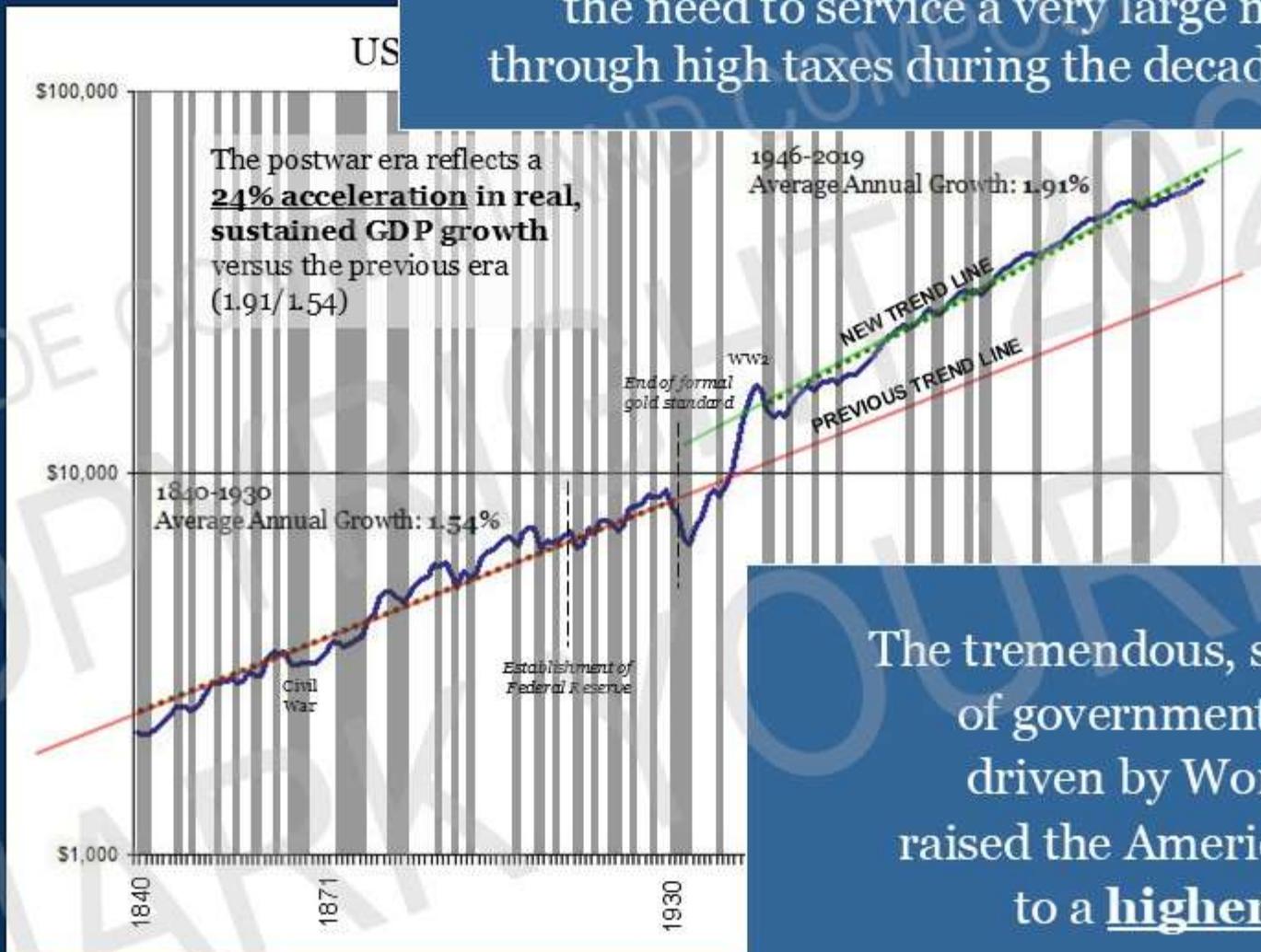


note the new, steeper slope

note the fact that the new, steeper slope is also well above the old long-term trend line

The tremendous, sustained gush of government spending driven by World War II raised the American economy to a higher plane

This higher plane was permanently sustained, along with the increased growth rate, despite the need to service a very large national debt through high taxes during the decades after the war



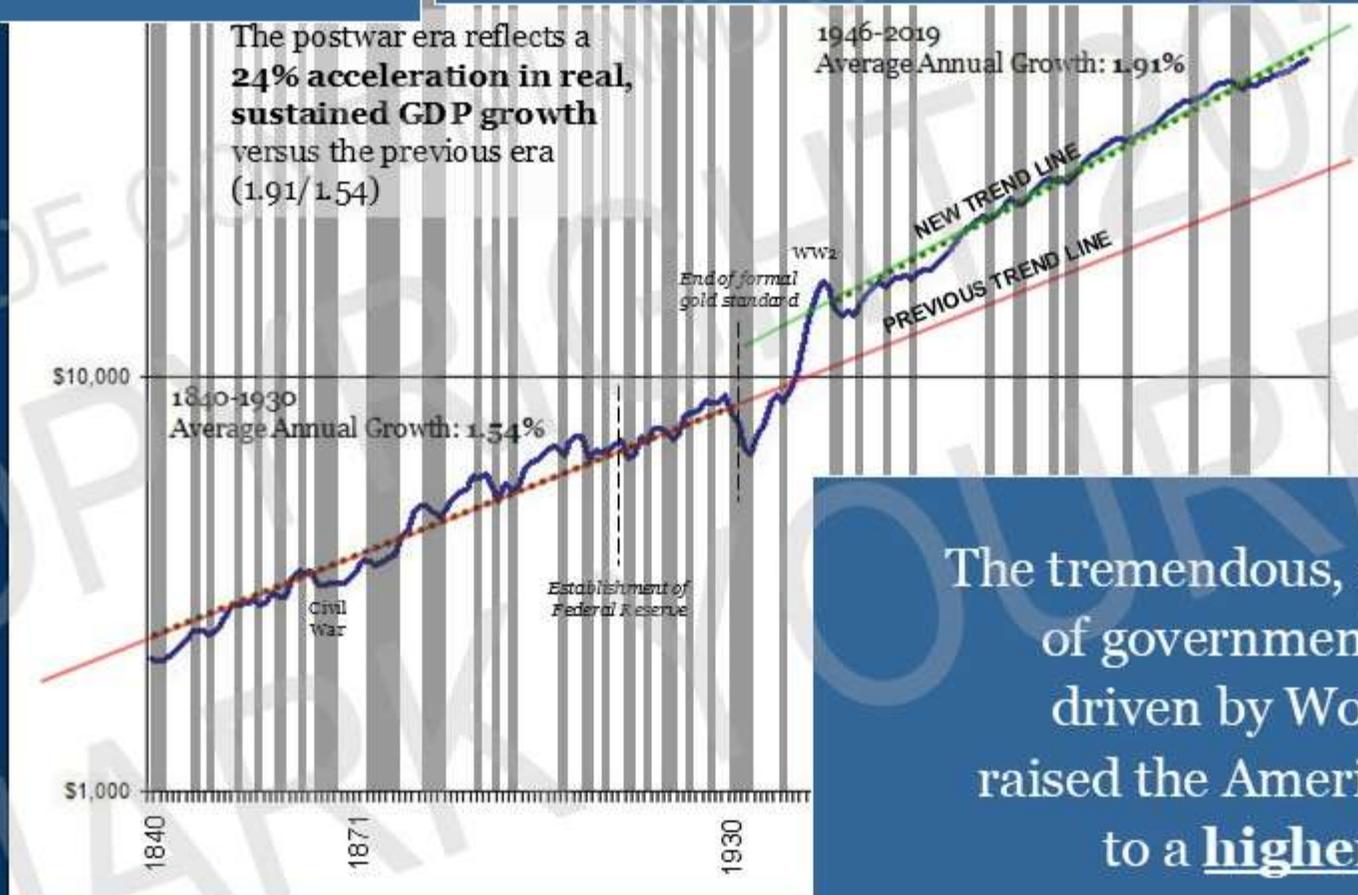
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How did World War II lift real per capita GDP permanently to a higher level?

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The tremendous, sustained gush of government spending driven by World War II raised the American economy to a higher plane

How did World War II lift real per capita GDP permanently to a higher level?

The evidence suggests that this was primarily due to the emergency need for many more workers, mostly in the manufacturing economy

Wartime production pulled a large number of **women** and **non-white men** into the workforce, and into jobs that were *much more productive* than any employment they had had before – highly-productive jobs that they had been **shut out of**, until the war

And after the war, to a significant degree many of these workers **held onto their productivity gains** in all kinds of new capacities, resulting in *permanently-increased GDP per capita*

This higher plane was permanently sustained, along with the **increased growth rate**, despite

We Can Do It!



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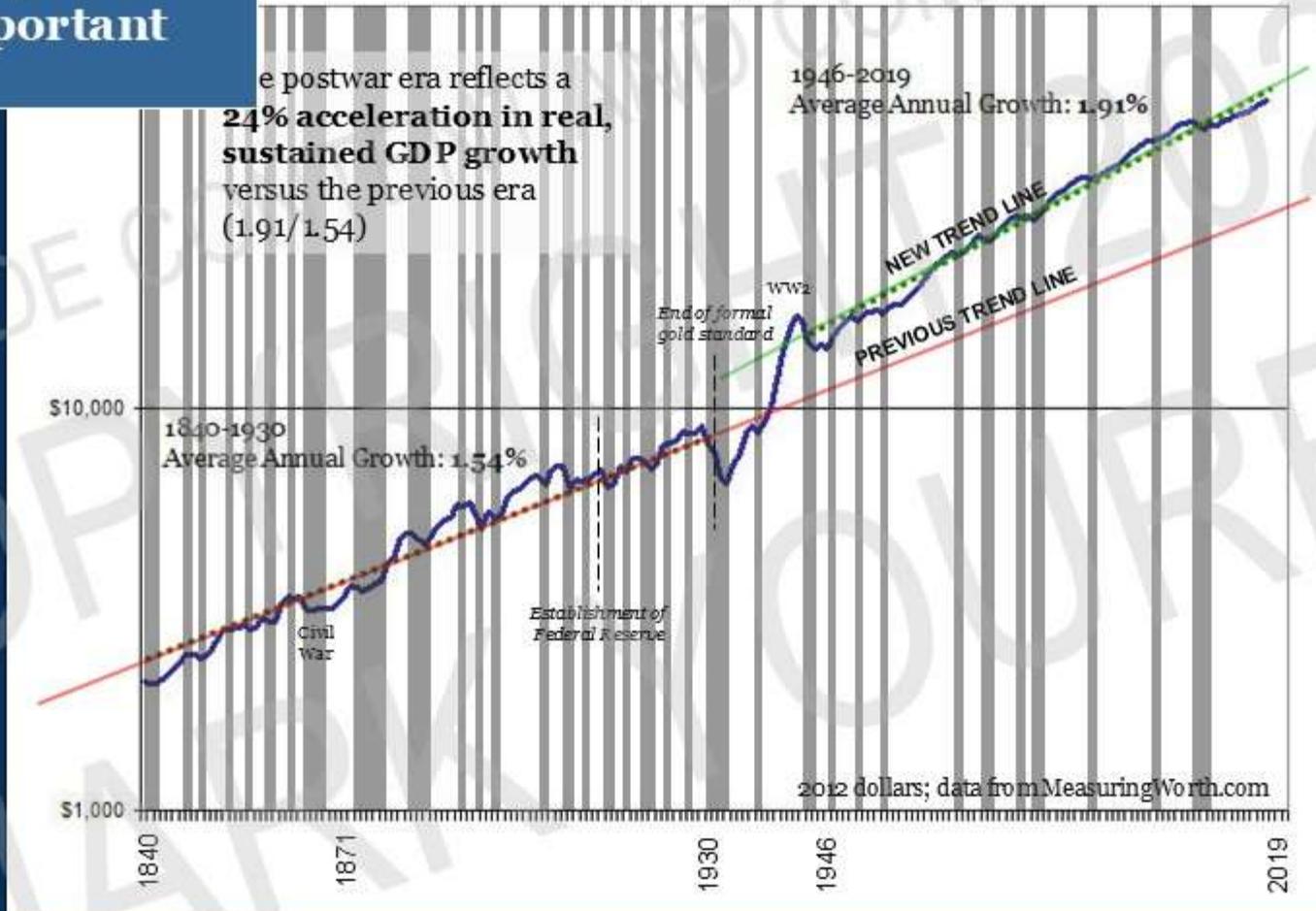
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something else happened
that is **critically important**

US Real GDP per capita 1840-2019

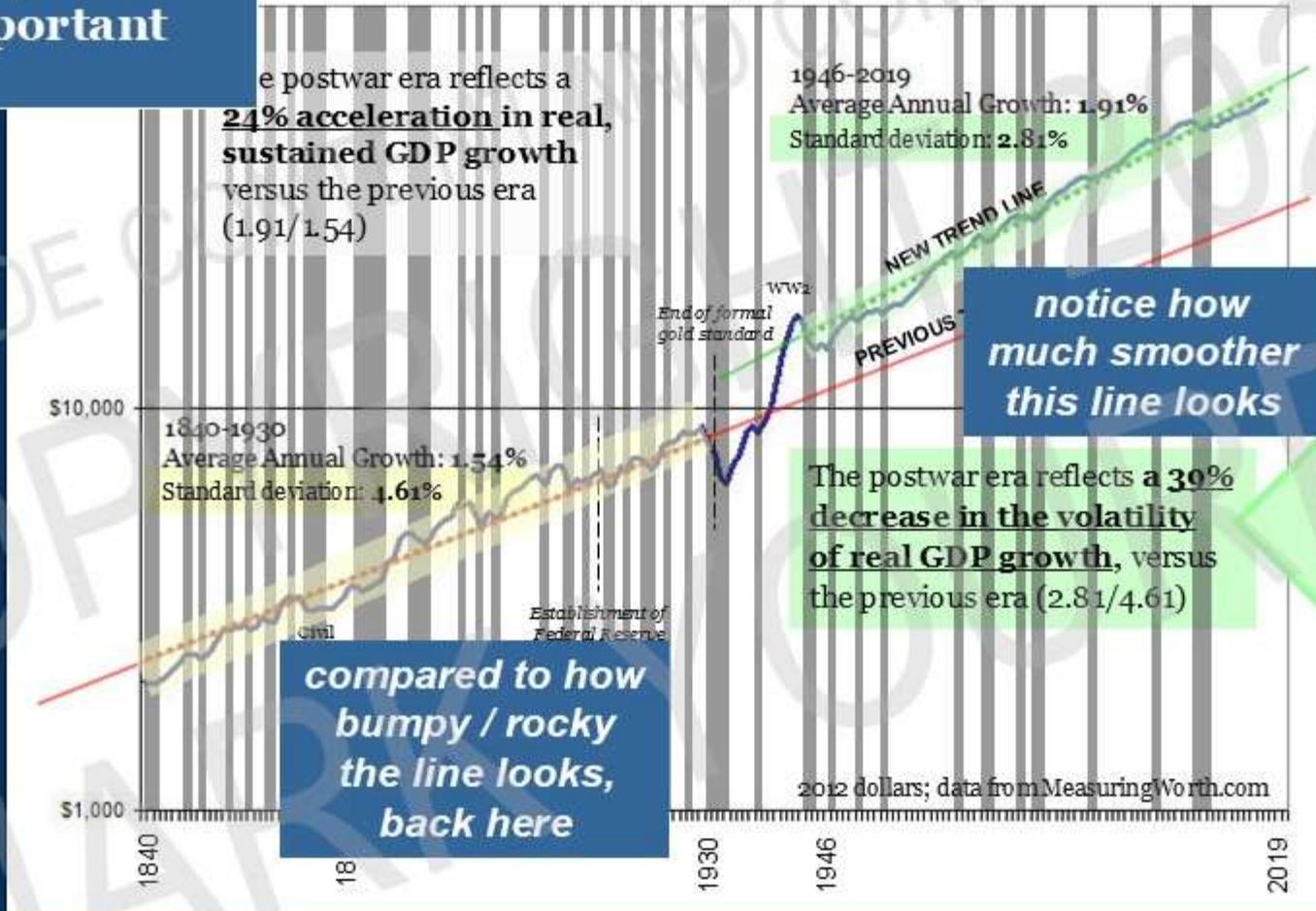


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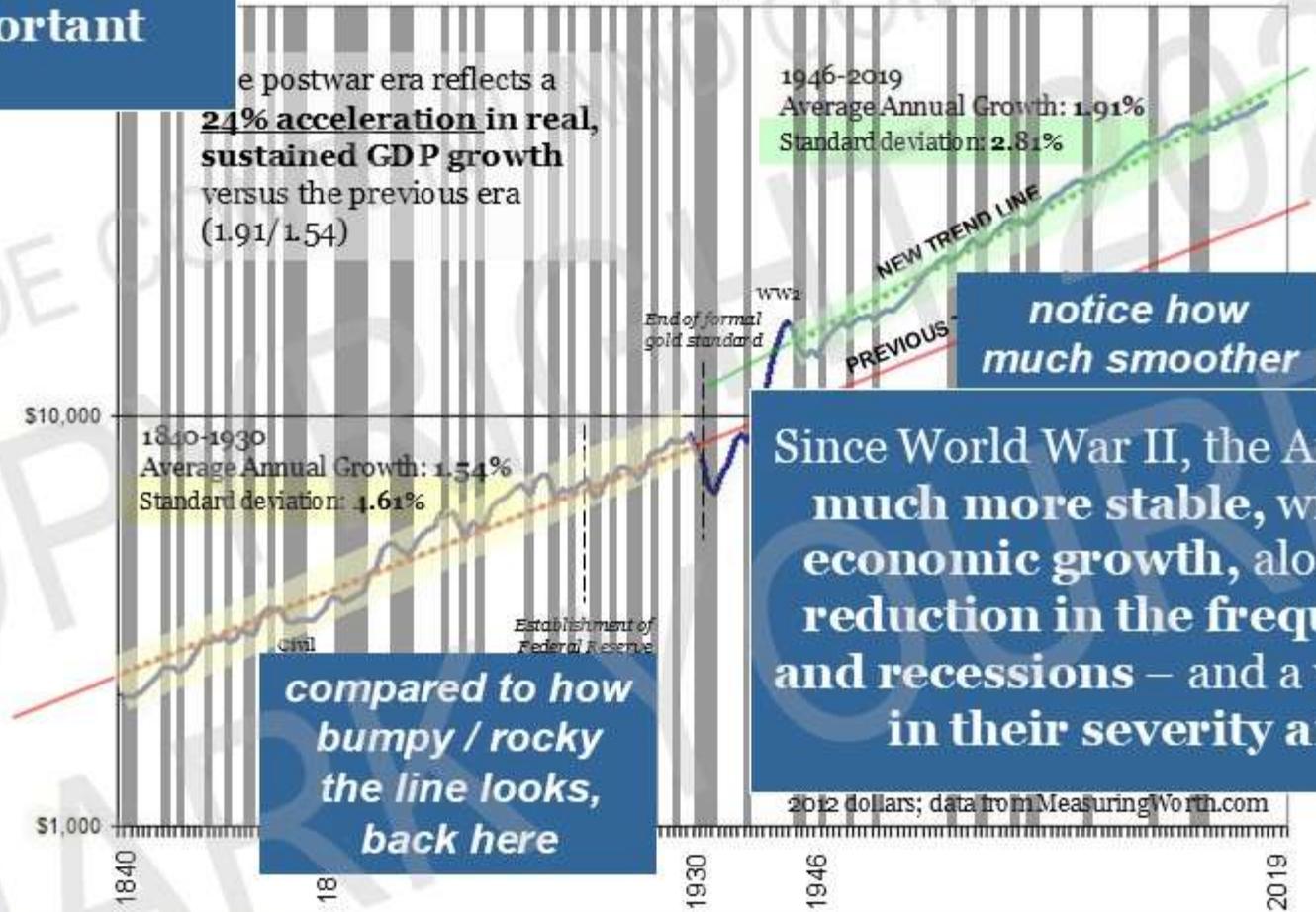


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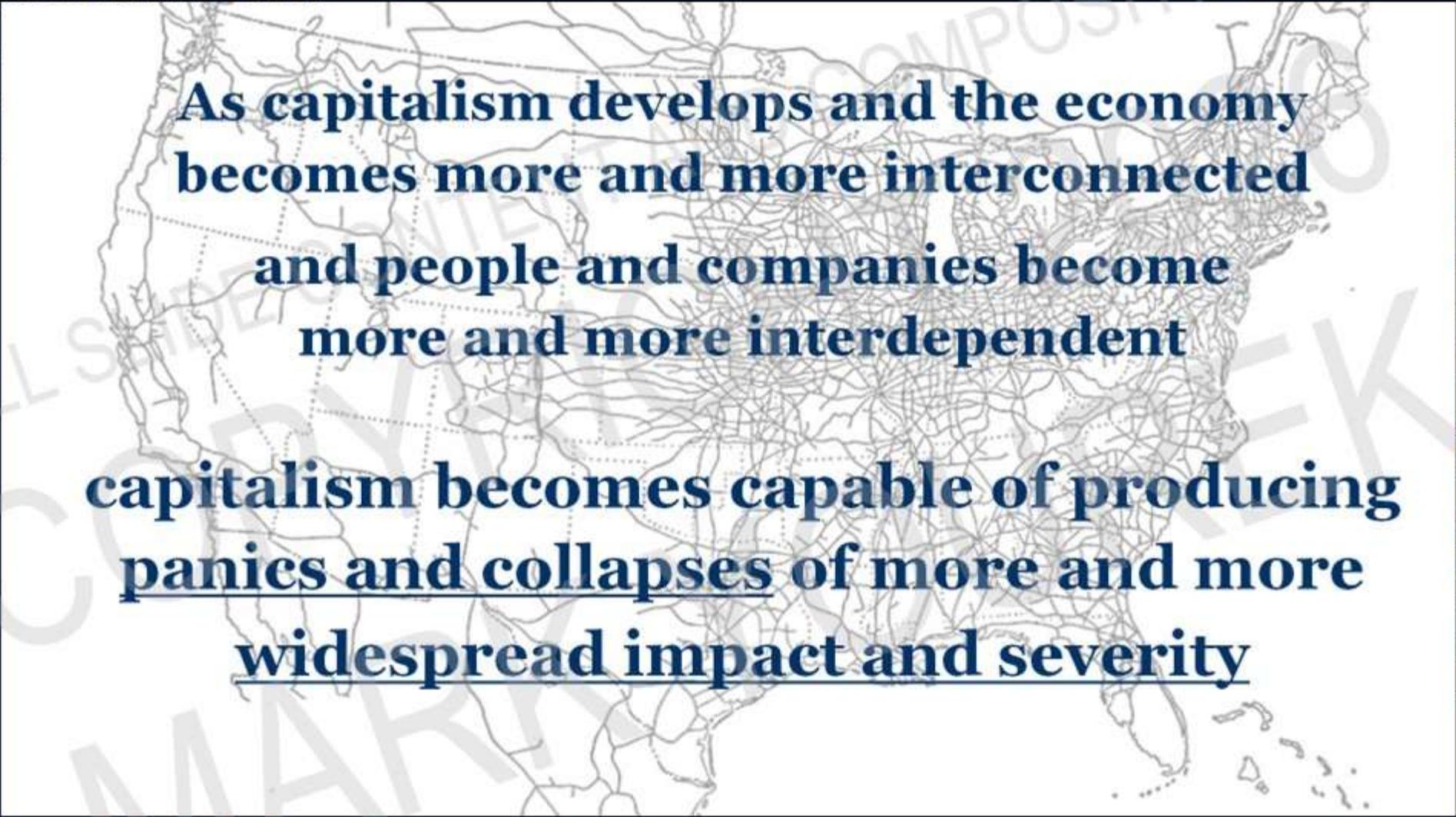
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**As capitalism develops and the economy
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and people and companies become
more and more interdependent**

**capitalism becomes capable of producing
panics and collapses of more and more
widespread impact and severity**

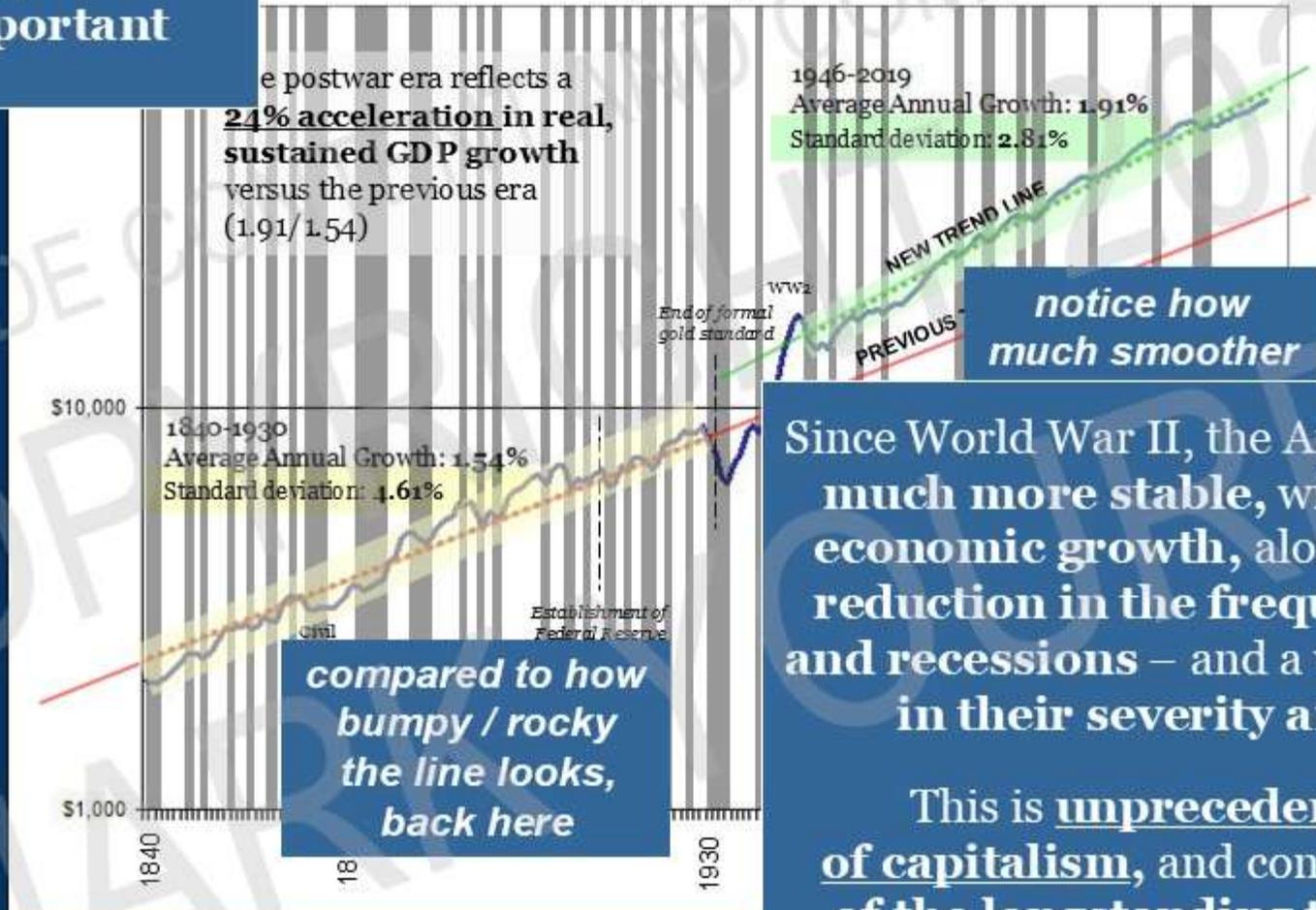
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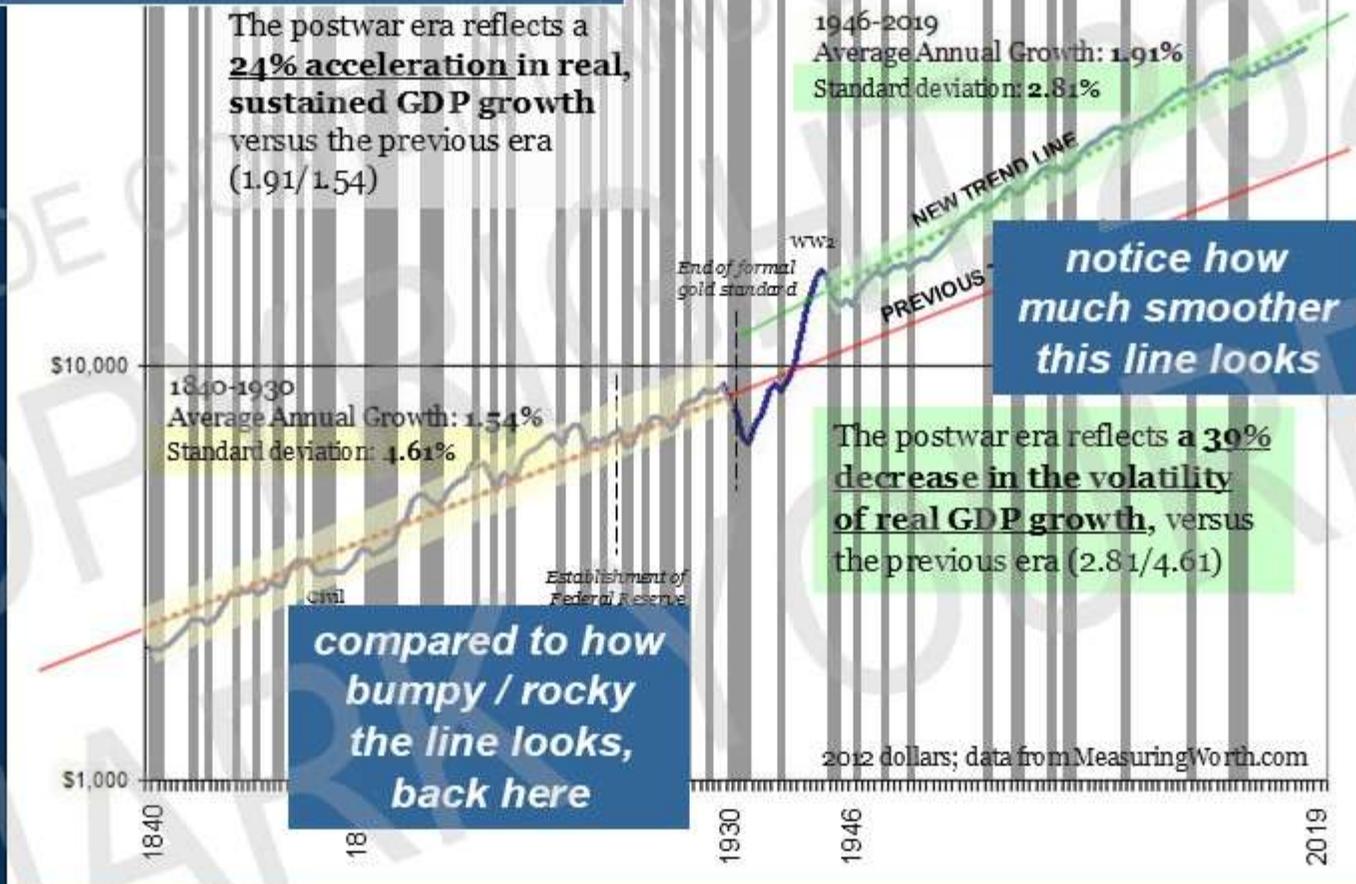
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Since World War II, the American economy has been **much more stable**, with **smoother, steadier economic growth**, along with quite a noticeable **reduction in the frequency of panics, crises and recessions** – and a very significant **reduction in their severity and destructiveness**

This is **unprecedented in the history of capitalism**, and constitutes a **total reversal of the longstanding trend**, which was always towards more and more **severe, widespread and destructive panics and downturns**

Why did real economic growth in the US become much steadier and more stable after World War II?

per capita 1840-2019



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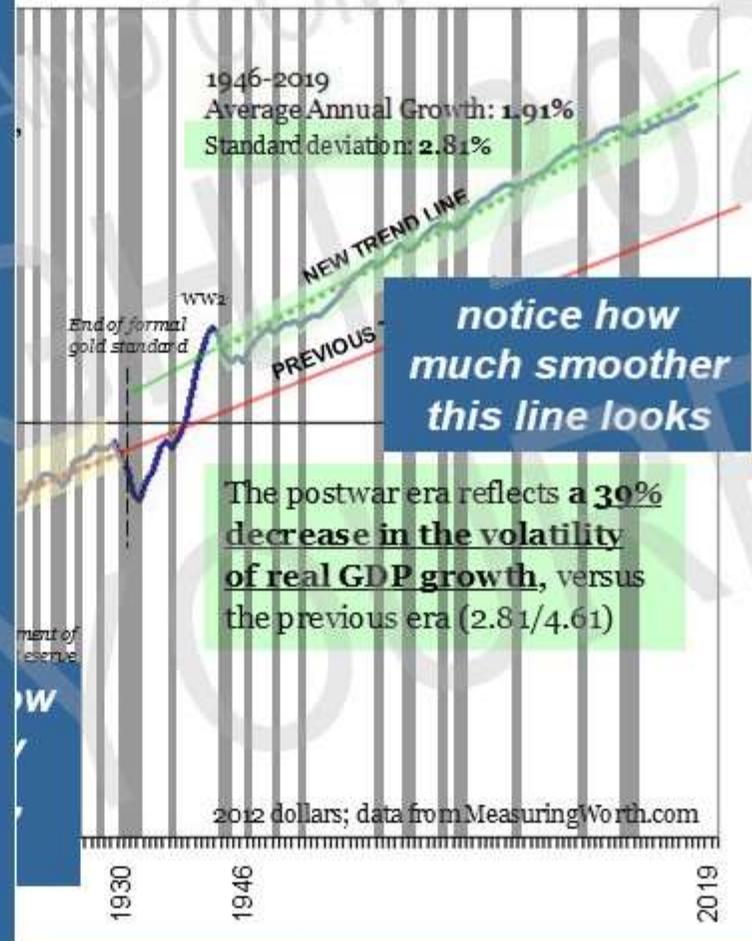
Why did real economic growth in the US become much steadier and more stable after World War II?

The banking reforms of the 1930s, which introduced government-backed deposit insurance, and the formal role of the Federal Reserve as the lender-of-last-resort to banks, have contributed enormously to the **greater economic stability** we have enjoyed in the postwar era

Also critical has been the evolution of economic understanding, and the application of that understanding by a more independent **Federal Reserve**, in executing much more effective monetary policy over time

And there is probably **one more factor in play**, that has contributed to greater economic stability since World War II...

per capita 1840-2019



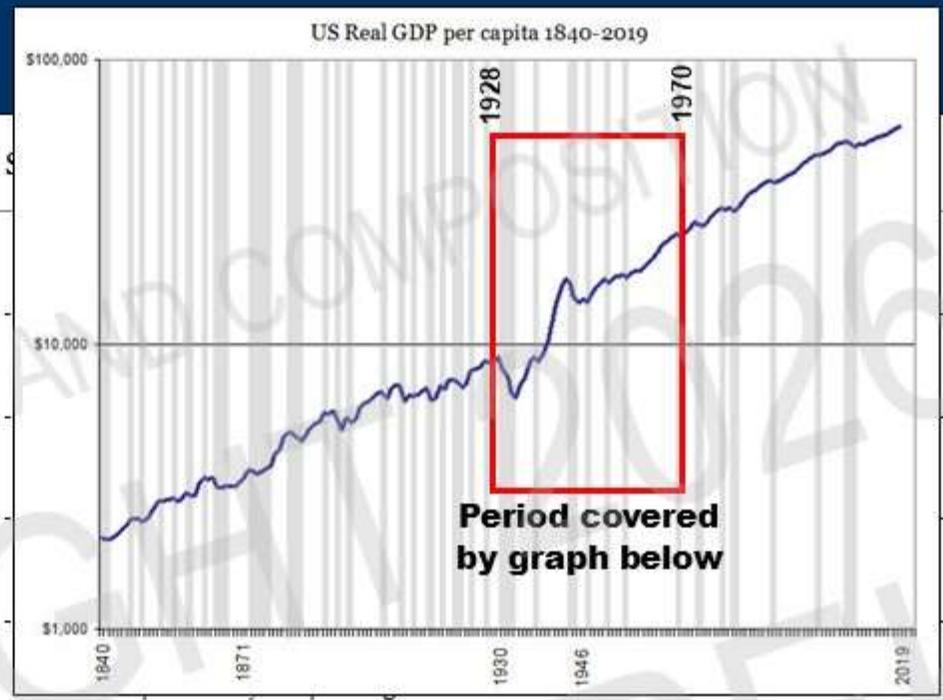
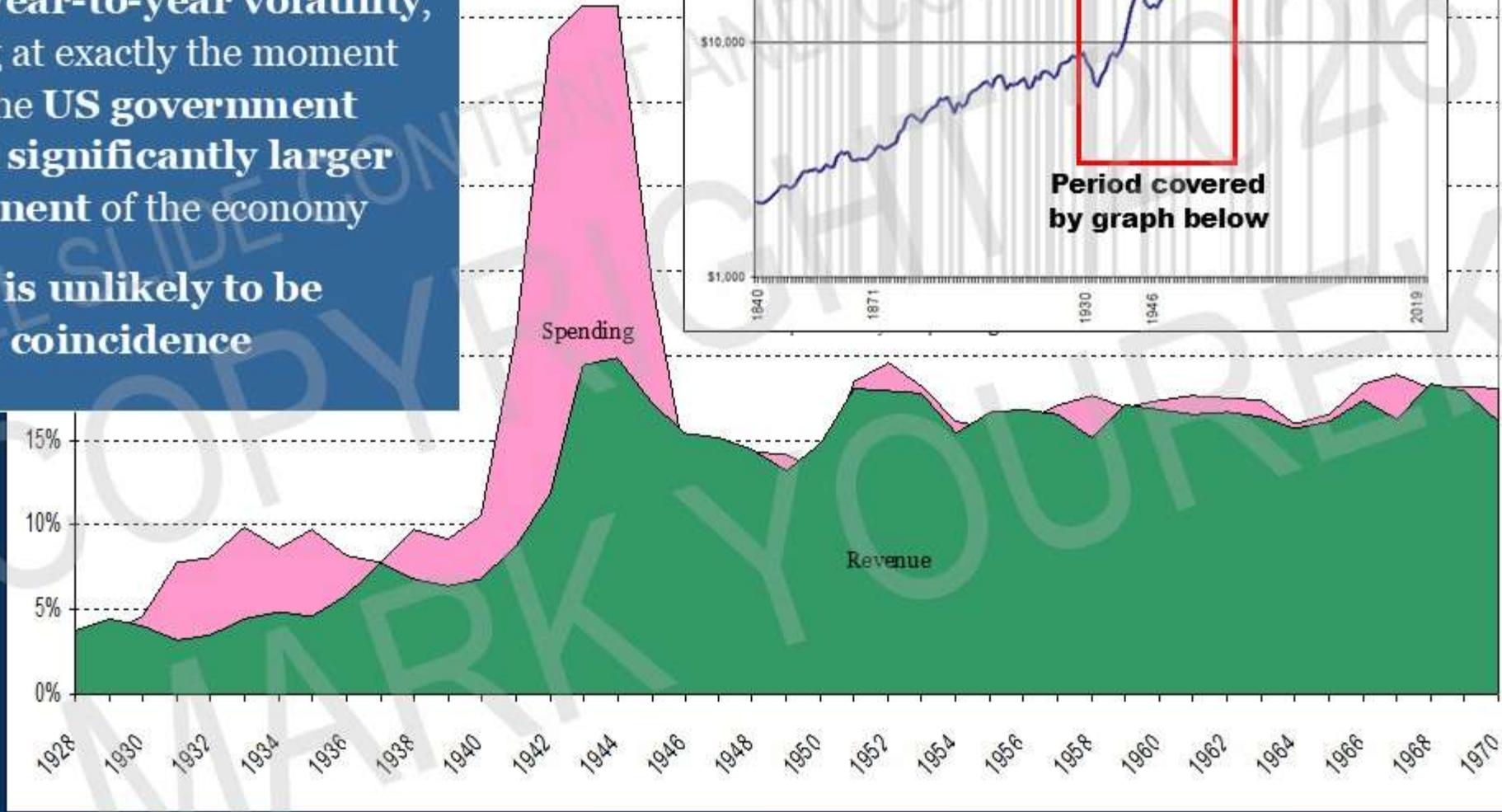
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The economy started to reflect a more consistent growth rate, with less year-to-year volatility, beginning at exactly the moment when the US government became a significantly larger component of the economy

This is unlikely to be a coincidence

Federal Revenue and S



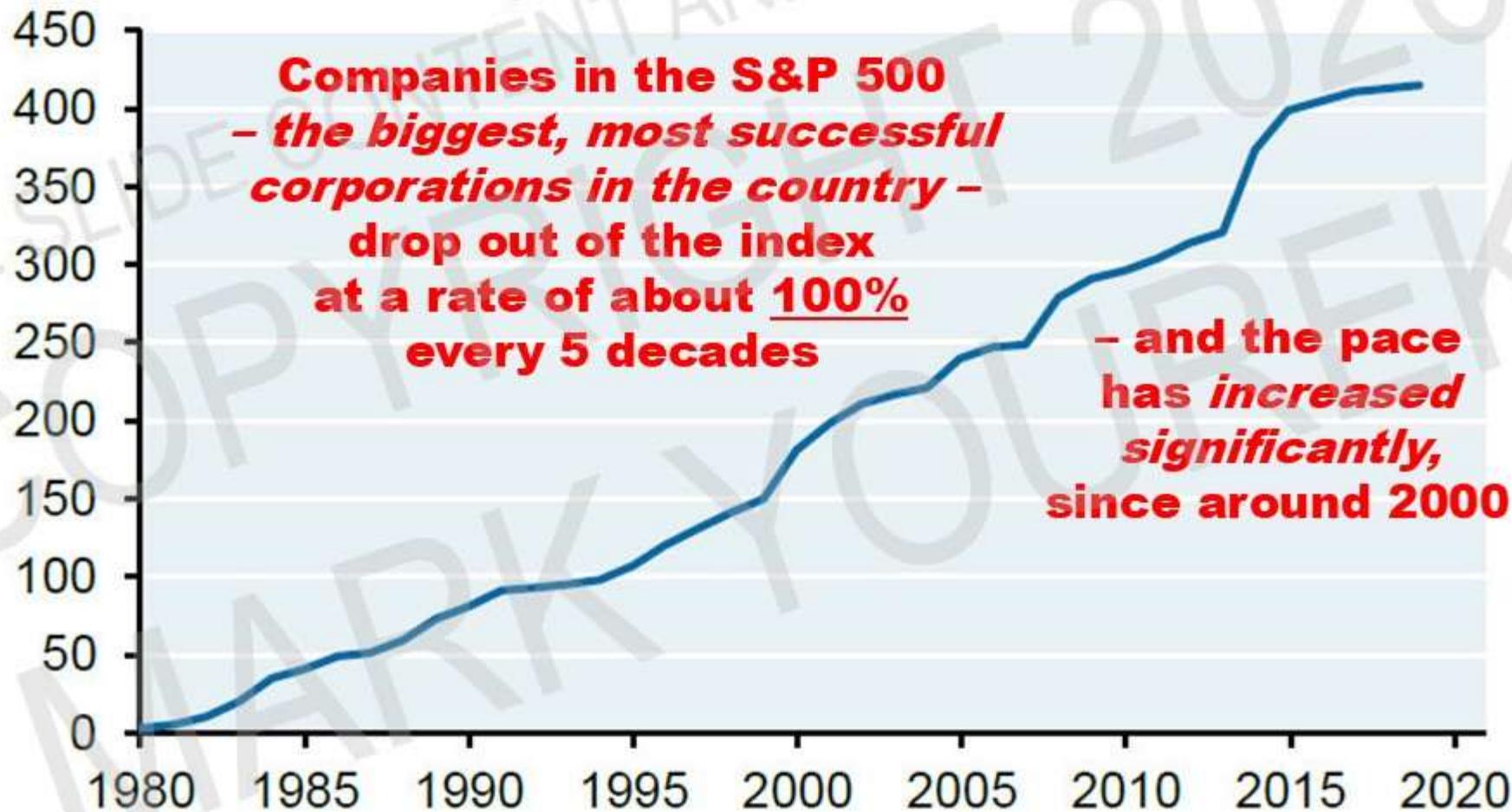
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Capitalism is **bipolar** –
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**Individual companies operating
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Cumulative number of companies removed from the S&P 500 due to distress, 1980-2019



Individual companies operating in the market-capitalist economy are much more unstable than you think

Distribution of excess lifetime returns on individual stocks vs. Russell 3000, 1980-2020

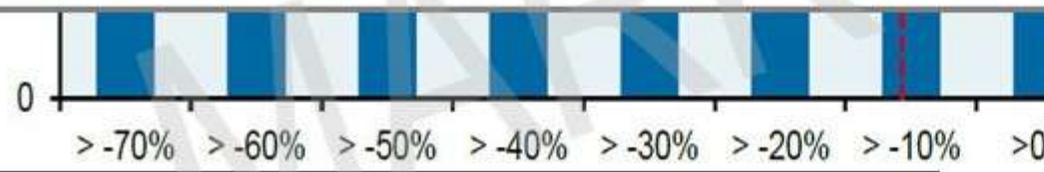
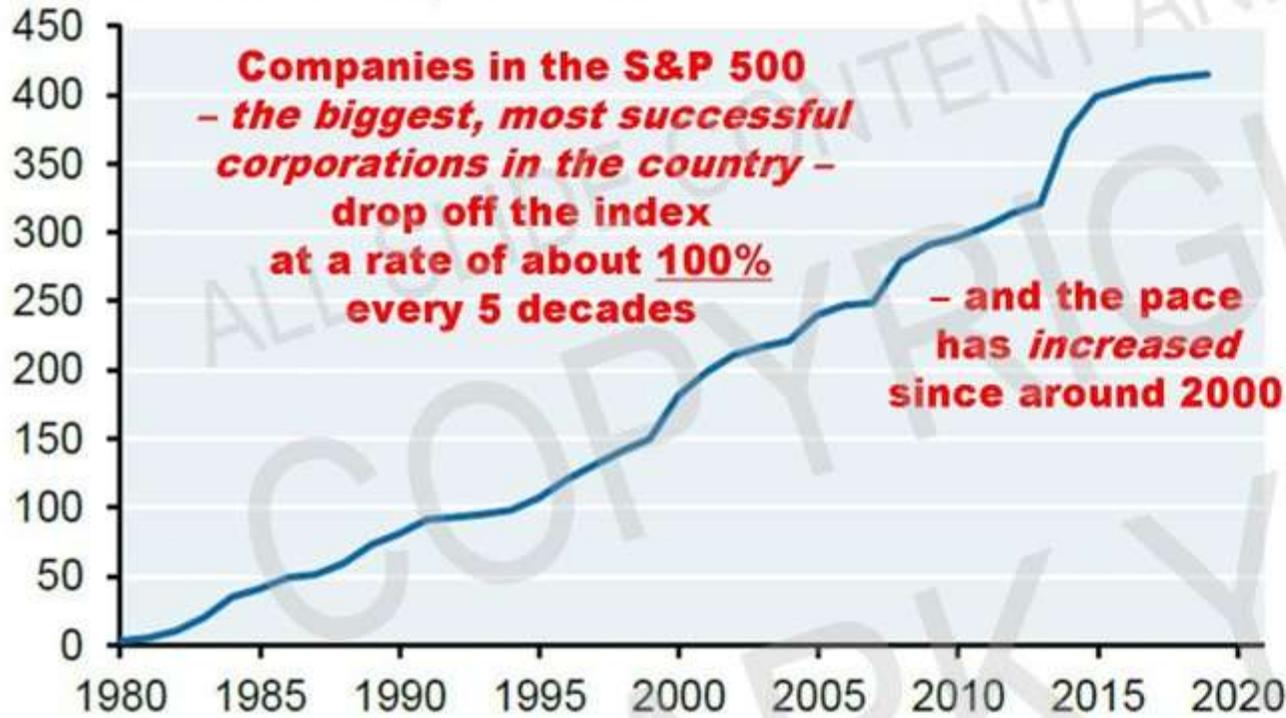


Every one of these companies *had* been successful enough to go public

annualized return on the Russell 3000 Index

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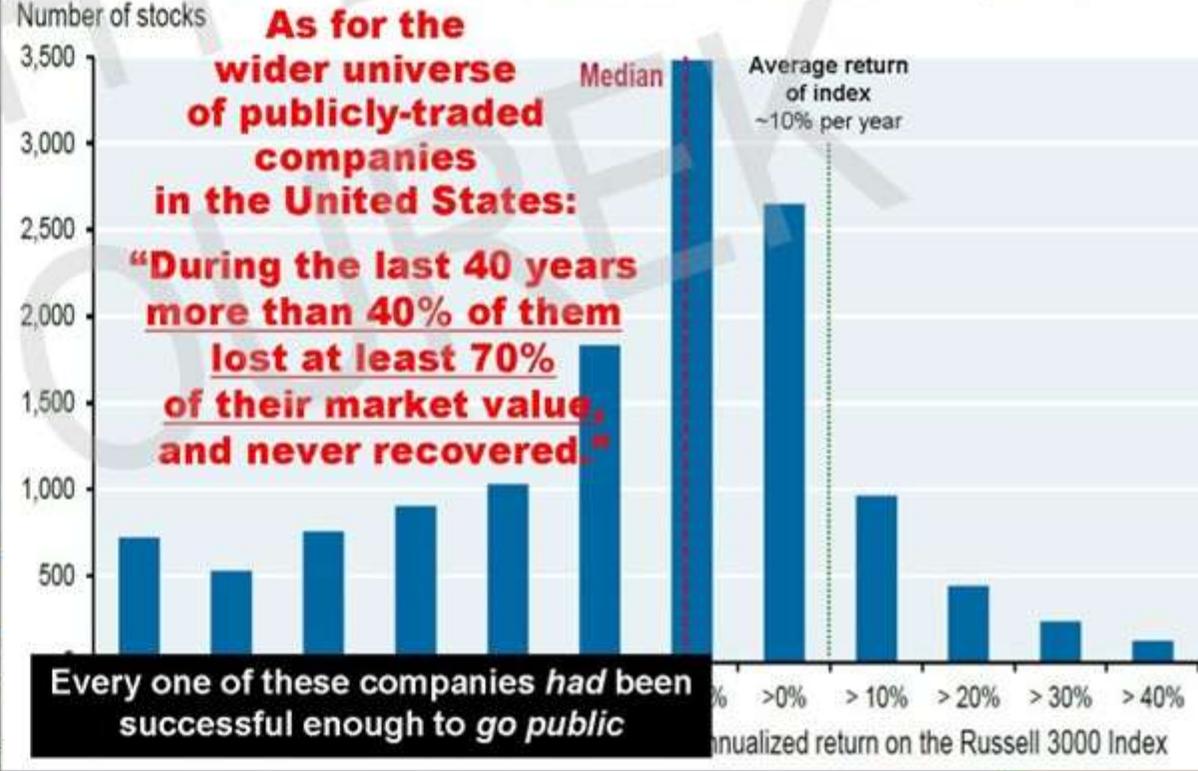


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Russell 3000, 1980-2020

Average return on index per year: ~10%

Distribution of excess lifetime returns on individual stocks vs. Russell 3000, 1980-2020



\$10,000

Why do the two sides of this graph look so different?

There are three specific ways that government has been making the US economy more stable, and with a higher sustained growth rate, since 1940

1.

Monetary policy stabilizing prices and avoiding deflation, and direct crisis intervention and mitigation as executed by the Federal Reserve

2.

Stabilization of the banking sector through government-backed deposit insurance, and the Federal Reserve acting as lender of last resort

3.

The increased size of the Federal government as a share of the economy, which provides a more significant element of overall stability

\$.1

1871 1881 1891 1901 1911 1921 1931 1941 1951 1961 1971 1981 1991 2001 2011

S&P 500 Index

Dividends



For male workers and managers, the sudden influx of new female workers during World War II was often disorienting, confusing, and even threatening



PROBLEMS IN SUPERVISION

SUPERVISING WOMEN WORKERS

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by Herbert Kerkow

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