A Brief History of Blaming the Government

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Conservative, libertarian, and business sources have a long history of immediately and aggressively blaming the government when policies that they initially promoted as "free market" (or similar terms) fail.

Introduction

Conservative, libertarian, and business writers, publications and think tanks (such as the *Wall Street Journal* editorial page) have a long history of blaming the government for economic and financial fiascoes that followed the adoption of public policies initially billed as "free market" or "deregulation". Previous examples include the Great Depression, the savings and loan deregulation fiasco of the 1980's, the failure of conservative author George Gilder's high tech investment advice in the 1990's and the California electricity market deregulation fiasco of 2000.

The Great Depression

Several different government scapegoats have been blamed for the Great Depression: allegedly tight monetary policy by the Federal Reserve (famously by Milton Friedman), the Smoot-Hawley tariff, various taxes under Hoover and Coolidge, and the New Deal government programs.

To quote a noted expert on the Great Depression:

However, in 1963, Milton Friedman and Anna J. Schwartz transformed the debate about the Great Depression. That year saw the publication of their now-classic book, A Monetary History of the United States, 1867-1960*. The* Monetary History*, the name by which the book is instantly recognized by any macroeconomist, examined in great detail the relationship between changes in the national money stock--whether determined by conscious policy or by more impersonal forces such as changes in the banking system--and changes in national income and prices. The broader objective of the book was to understand how monetary forces had influenced the U.S. economy over a nearly a century. In the process of pursuing this general objective, however, Friedman and Schwartz offered important new evidence and arguments about the role of monetary factors in the Great Depression. In contradiction to the prevalent view of the time, that money and monetary policy played at most a purely passive role in the Depression, Friedman and Schwartz argued that "the [economic] contraction is in fact a tragic testimonial to the importance of monetary forces" (Friedman and Schwartz, 1963, p. 300).*

To support their view that monetary forces caused the Great Depression, Friedman and Schwartz revisited the historical record and identified a series of errors--errors of both commission and omission--made by the Federal Reserve in the late 1920s and early 1930s. According to Friedman and Schwartz, each of these policy mistakes led to an undesirable tightening of monetary policy, as reflected in sharp declines in the money supply. Drawing on their historical evidence about the effects of money on the economy, Friedman and Schwartz argued that the declines in the money stock generated by Fed actions--or inactions--could account for the drops in prices and output that subsequently occurred.[1]

It is worth noting that the Keynesian interpretation of the Great Depression is the exact opposite. The Keynesian theory is that expansionary monetary policy was tried and failed due to a liquidity trap in which businesses and households refused to borrow even at very low interest rates and saved, rather than spent, any extra funds.

Monetary policy is only one of several government scapegoats for the Great Depression. The Smoot-Hawley tariff is probably the second most popular scapegoat. Here is a recent restatement of the Smoot-Hawley excuse:

The prevailing view in many quarters is that the stock market crash of 1929 was a failure of the free market that led to massive unemployment in the 1930s-- and that it was intervention of Roosevelt's New Deal policies that rescued the economy.

It is such a good story that it seems a pity to spoil it with facts. Yet there is something to be said for not repeating the catastrophes of the past.

Let's start at square one, with the stock market crash in October 1929. Was this what led to massive unemployment?

Official government statistics suggest otherwise. So do new statistics on unemployment by two current scholars, Richard Vedder and Lowell Gallaway, in their book "Out of Work."

The Vedder and Gallaway statistics allow us to follow unemployment month by month. They put the unemployment rate at 5 percent in November 1929, a month after the stock market crash. It hit 9 percent in December-- but then began a generally downward trend, subsiding to 6.3 percent in June 1930.

That was when the Smoot-Hawley tariffs were passed, against the advice of economists across the country, who warned of dire consequences.

Five months after the Smoot-Hawley tariffs, the unemployment rate hit double digits for the first time in the 1930s.

This was more than a year after the stock market crash. Moreover, the unemployment rate rose to even higher levels under both Presidents Herbert Hoover and Franklin D. Roosevelt, both of whom intervened in the economy on an unprecedented scale.[2]

It is worth noting that foreign trade constituted about seven percent (7%) of the total US economy at this time[3]. It is debatable whether shrinking foreign trade whether due to Smoot-Hawley or the widening global slowdown accounts for the Great Depression.

Various tax increases under Presidents Coolidge, Hoover, and Roosevelt have been blamed at times for the Great Depression. This is one of the less common government scapegoats. An example may be found in the Cato Institute Tax & Budget Bulletin No. 23, dated September 2005, “The Government and the Great Depression” by Chris Edwards, Director of Tax Policy, Cato Institute:

***Tax Hikes**. In the early 1920s, Treasury Secretary Andrew Mellon ushered in an economic boom by championing income tax cuts that reduced the top individual rate from 73 to 25 percent. But the lessons of these successful tax cuts were forgotten as the economy headed downwards after 1929. President Hoover signed into law the Revenue Act of 1932, which was the largest peacetime tax increase in U.S. history. The act increased the top individual tax rate from 25 to 63 percent.*

Of course, an alternative interpretation is that the tax cuts and other policies of the Coolidge and Hoover Administration created a short term boom, a bubble, followed by a catastrophic bust as the hidden costs of the policies became visible.

Remarkably, even the New Deal has frequently been blamed for the Great Depression. A recent example is the book *FDR's Folly: How Roosevelt and His New Deal Prolonged the Great Depression* by Jim Powell (Random House, September 2004). Here is a brief review quote from Milton Friedman:

*"Admirers of FDR credit his New Deal with restoring the American economy after the disastrous contraction of 1929—33. Truth to tell–as Powell demonstrates without a shadow of a doubt–the New Deal hampered recovery from the contraction, prolonged and added to unemployment, and set the stage for ever more intrusive and costly government. Powell's analysis is thoroughly documented, relying on an impressive variety of popular and academic literature both contemporary and historical." – **Milton Friedman**, Nobel Laureate, Hoover Institution*

Another recent book with a similar theme is *New Deal or Raw Deal?: How FDR's Economic Legacy Has Damaged America* by Burton W. Folsom Jr. Here is a brief reviews:

"History books and politicians in both parties sing the praises for Franklin Delano Roosevelt's presidency and its measures to get America out of the Great Depression. What goes unappreciated is the fact that many of those measures exacerbated and extended the economic downturn of the 1930s. New Deal or Raw Deal? *is a careful documentation and analysis of those measures that allows us to reach only one conclusion: While President Roosevelt was a great man in some respects, his economic policy was a disaster. What's worse is that public ignorance of those policy failures has lent support for*

similar policies in later years. Professor Burt Folsom has produced a highly readable book and has done a yeoman's job in exposing the New Deal."-- Walter E. Williams, John M. Olin Distinguished Professor of Economics, George Mason University

Another popular source of claims that the government caused the Great Depression is Alan Reynolds article "What Do We Know About the Great Crash" in the November 9, 1979 of the conservative *National Review*.

The New Deal is quite complex with its notorious alphabet soup of agencies and programs. In addition, the New Deal changed direction several times. Although most people don't realize this, the New Deal featured extremely pro-business programs such as the National Recovery Administration (NRA) headed by financier Bernard Baruch in its first few years. The New Deal shifted to the left in 1934 when faced with a revolt by Louisiana Senator Huey P. Long and other earlier supporters who threatened to organize a third party.

The Savings and Loan Fiasco of the 1980's

In the 1980s, the US Savings and Loan industry was "deregulated" with disastrous consequences. This is a case where the putative "deregulation" was, in fact, selective deregulation. After the collapse of most of the savings and loan industry, costing billions, conservative, libertarian, and business sources blamed the government, even citing the fiasco to argue for further "deregulation".

A clear example of this is "Lessons from the Savings and Loan Debacle: The Case for Further Financial Deregulation" by Catherine England (Regulation: The Cato Review of Business & Government, Summer 1992, The Cato Institute). Here is an excerpt:

An April 28, 1992, Washington Post editorial warned, "Over the past decade the country has learned a lot about the limits to deregulation." The savings and loan crisis was, of course, one exhibit called forth: "Deregulation also has its price, as the savings and loan disaster has hideously demonstrated. Deregulation, combined with the Reagan administration's egregious failure to enforce the remaining rules, led to the gigantic costs of cleaning up the failed S&Ls."

Such editorials demonstrate that the S&L fiasco continues to be misdiagnosed. Unfortunately, this misdiagnosis is being applied by *many to the ailing banking industry, and there are those who would introduce the S&L cancer into the insurance market and compound that industry's problems. In the absence of more careful attention to the roots of the S&Ls' problems, taxpayers may face further financial industry bailouts.*

The S&Ls' experience yields three important lessons. First, excessive regulation was the initial cause of the industry's problems. Second, federal deposit insurance was ultimately responsible for the high costs of the debacle. Finally, government-sponsored efforts to protect the industry only invited abuses and increased the ultimate cost of restructuring.

The savings and loan deregulation was a selective deregulation in which price controls, limits on risky investments such as junk bonds, and other precautions from the Depression era were eliminated while government guarantees through the Federal Savings and Loan Insurance Corporation (FSLIC) were increased. This is, of course, the problem with partial or selective deregulation. Prudent regulations often form an interacting network of components like a mechanical clock or similar complex system. Experiences like the S&L fiasco show over and over again that removing some of the regulations can break the system and create disastrous problems. Conservatives, libertarians, and business people routinely promote the idea that deregulation is a simple linear scale where less regulation is always better, *until* the fiasco unfolds. Then, they use the fiasco to argue for further policies labeled as "deregulation", pointing out the selective or partial nature of the "deregulation" that failed.

George Gilder's Investment Advice

During the 1990's conservative author and supply-side economics advocate George Gilder became a prominent high technology stock investment adviser, publisher of the stock market advice newsletter *Gilder Technology Report* and a book *Telecosm*[4]. In particular, Gilder promoted investments in the telecommunications industry such as Global Crossing, one of his famous bad stock picks. Most people who followed Gilder's investment advice, including apparently Gilder, did quite poorly in the long run[5].

When the Internet and telecom stocks and businesses crashed, Gilder blamed the government, most notably in a *Wall Street Journal* commentary published on August 6, 2001 titled "Tumbling into the Telechasm". Here is a brief excerpt.

The Bush economy, unfortunately, not only possesses no such immunity to bad policy, but also is gravely vulnerable to policy mistakes accumulating by the end of the Clinton term. A high-tech depression is under way, driven by a long siege of deflationary monetary policy and obtuse regulation that has shriveled hundreds of debt-laden telecom companies and brought Internet expansion to a halt.

In a nutshell, the Federal Reserve and government regulation caused Gilder's stock picks to go bad. Significantly, Gilder blames deflationary monetary policy. Alan Greenspan and the Fed are now being accused of creating the housing bubble with too loose monetary policy in the wake of the Internet and telecom crash. The only constant is that it is the Federal Reserve, the government's, fault and not business leaders.

There were significant technical problems with Gilder's technology investment advice. He also largely ignored the impact of regulations until his stock picks went bad. Gilder frequently promoted a vision of digital video direct into homes, a vision that is now coming true. It is important to understand that in the 1990's, DSL was not widely available and DSL could only achieve bandwidths of around 384 Kilobits per second to most homes. Laying fiber optic cables into homes would have been extremely difficult and costly. DSL bypasses the need to lay fiber optic cables because DSL uses the existing copper telephone wires. Prior to 2003, usable digital video such as the basic MPEG-1 video compression used in Video CD's and similar 1990's era video systems required one megabit per second. The new MPEG-4 and similar video compression algorithms can achieve almost DVD quality video at bit rates of 275 Kilobits per second, within basic DSL rates. These technical problems do not even begin to address the issue of how to make money from digital video to the home, so-called "video monetization". YouTube, after all, is currently free.

The California Electricity Market Deregulation Fiasco of 2000

In the late 1990's, California "deregulated" its electricity market. The "deregulation" was promoted by conservative, libertarian, and business groups to increase competition and *lower electricity rates*. The putative deregulation culminated in a fiasco with shortages and blackouts in 2000 and sharp increases in electricity rates. This is one of the most notorious failures of ostensible deregulation in recent years. A similar deregulatory fiasco has occurred more recently in Texas[6].

Conservative, libertarian, and business sources blamed the government. Here is an example from Walter Williams May 23, 2001 syndicated article "Orchestrating Energy Disaster":

ONE needn't be a rocket scientist to create California's energy problems. According to the California Energy Commission, from 1996 to 1999 electricity demand, stimulated by a booming economy, grew by 12 percent while supply grew by less than 2 percent.

Here's how California created its supply crunch. It takes two years to build a power plant in business-friendly states but four years in California. Sunlaw Energy Company wants to build a $256 million natural-gas-fired plant in Los Angeles; community activists are stopping it. San Francisco activists killed a proposal to float an electricity-producing barge in the bay, even as the city faced blackouts. Computer software giant Cisco Systems has led the charge against a proposed Silicon Valley power plant.

Conservative, libertarian, and business sources blamed surviving price controls and environmental regulations and environmentalists. The fiasco was cited as evidence for additional policies labeled as "deregulation".

Curiously, although California's electricity market had been regulated for decades and activists had been protesting power plants for decades, actual major shortages only occurred after "deregulation" was enacted.

It is also worth noting that the initial argument for deregulation was that increased competition in the wholesale electricity market would lower costs for the electricity suppliers. Thus, there would be no need to deregulate retail prices, since wholesale costs would drop due to the miracle of the market. In regulated electricity systems, the utilities usually have their own proprietary electric power plant which, for example, is supposed to protect them from someone cornering the "free" wholesale electricity market. The electricity deregulation in California forced utilities to divest their electric power plants. Regulations are often a system of regulations that work together as in electricity markets, so that removing one regulation can have catastrophic consequences.

Conclusion

Conservative, libertarian, and business writers, publications, and think tanks have a long history of blaming the government for economic and financial fiascoes that follow the adoption of policies initially promoted as "deregulation", "free market", or similar terms. Many more examples may be found and detailed with further research (left as an exercise to the reader). Not infrequently the fiasco will actually be cited as evidence for further policies promoted as "deregulation".

It is important to distinguish "true deregulation" from policies labeled as "deregulation," "free market" or something similar. As in some of the examples above, many policies labeled as "deregulation" turn out on close examination to be selective deregulation or even simply changes in regulation that favor certain individuals, companies, or groups. Before the fiasco, conservative, libertarian, and business groups often ignore this, embrace the policies, and tout them. Once the fiasco unfolds, they back away shrieking "it is the government's fault!" and "it wasn't true deregulation!". This astonishing about-face is done quickly and aggressively.

Many historical examples do not answer the question whether "true deregulation" would work as conservative, libertarian, and business sources claim. They do show, over and over again, that policies promoted as "deregulation" or "free market" can be much worse than existing regulations. *Selective deregulation* can be much worse than prudent regulation.

Often policies promoted as "deregulation" or "free market" do not benefit most people, even most business or wealthy people. For example, many businesses in California embraced the electricity market deregulation in the belief that it would lower their corporate electricity bills. Didn't happen. Many conservative, libertarian, and business people lost significant amounts of money following George Gilder's free-market tinged investment advice.

The clear lesson is to beware policies or investments promoted as "deregulation", "free market", or similar terms. Examine the fine print closely and skeptically.

The government is vast with many agencies, departments, laws, regulations, and programs. In a given situation or fiasco, there are often many laws, regulations, policies, and programs that have some relationship to the situation or fiasco. Thus, it is often possible to cite a long list of government scapegoats. Blame the government excuses are difficult to comprehensively rebut for this reason.

Blame the government excuses substitute an abstract concept – "the free market" or "the private sector" – for individual businesses or groups of businesses that may have made substantial mistakes or even engaged in deliberate misconduct. Blame the government excuses enable individual business leaders to escape personal or professional responsibility for their decisions.

About the Author

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