



David Stockman on Keynes and the GOP

Guest: David Stockman

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David Stockman, a former U.S. congressman, served as director of the Office of Management and Budget under Ronald Reagan, from 1981 to 1985. His most recent book is *The Great Deformation: The Corruption of Capitalism in America*. He blogs at DavidStockmansContraCorner.com.

WOODS: One of the columns you sent me had something to do with Mitt Romney—who, oddly enough, in a poll a few weeks ago was found to be leading all possible GOP presidential contenders for 2016. He doesn't even want to run. They have learned nothing. But what I found interesting was that your observation during the financial crisis was exactly the same as mine: here we are faced with the aftermath of a bubble that has the Fed's fingerprints all over it, and all the GOP could think to do was repeat talking points from 1983.

STOCKMAN: Yeah, you know, I agree, and the reason I posted that blog is that in my book, I had a chapter called "Willard M. Romney and the Truman Show of Bubble Finance," and of course everyone remembers *The Truman Show* and Jim Carrey, and the fact he was in an artificial world and didn't realize until the end what was happening. I believe that much of the Republican Party and the mainstream leadership like Romney have been in exactly that kind of bubble. We got to this disaster we are in because we have been allowing the Fed to basically take over and run the entire U.S. GDP, to peg, manipulate, medicate and manhandle the entire financial system. There's not an honest interest rate left, from the overnight market to the 30-year bond. There are all these constant bailouts and puts and safety nets under the market, which create a huge distortion because you need two-way markets and you need the ability to succeed and fail and to be responsible for bad bets and investment. All of that is missing, and so we have the Fed seriously printing money, still at a \$55-billion-a-month rate—which is crazy, given that we're in the fifth year of a so-called recovery. That is not helping the Main Street economy one bit, because the Main Street economy of households and businesses has way too much debt already, and we can go into some of those numbers. Essentially it gives free overnight money to the carry trade to speculate in anything that might have a yield bigger than zero or might have some appreciation.

So what we've done is we've ruined the heart of capitalism, which is honest financial markets. We've turned it into a gambling casino, and we have left the nation bereft of any leadership from the so-called conservative party that could possibly stop this. Romney, to finish this off, is a perfect example of the , because his number-one economic advisor during the 2012 campaign was none other than the chairman of the business school at Columbia, who opined that Bernanke had done a great job and deserved consideration for reappointment. Now, if the conservative party is getting that kind of advice, and the conservative party is being told to put an out-and-out crazy, Keynesian money printer back into the Fed, then I think we've got some gigantic problems in this country, and it's one of the reasons I've gotten very active with this blog called "David Stockman's Contra Corner," where I am trying to post not only my own thoughts but the thoughts of a lot of other people who can see the lunacy of all this, and want to provide good analysis and insights on a day-to-day basis.

WOODS: Now of course, because so much of the natural constituency of the GOP—and I don't mean people in Iowa who want to ban abortion; I am talking about the natural constituency being the one percent (they are the constituency of both parties, but the Republicans are more openly catering to them half the time),

it's no surprise that they are going to give us a diagnosis that has nothing to do with the Fed. Romney's whole career involves windfalls that came to him by means of the crazy economy to which the Fed gave rise. Now, if the Right is going to have these half-Keynesian, three-quarter Keynesian economists, and then the Left has the full-blown Keynesian economist and that's our choice, well, we're going to have to deal with the consequences. Romney himself said that if Ron Paul got his way, getting rid of a trillion dollars of spending, this would hurt the economy and lead us into a depression. If he is going to accept that, then he's got to accept the Keynesian medicine, the Keynesian full-throttle logic coming from Krugman, which you critiqued in a column just the other day on your site. You quote Krugman as saying that we've got to quit the alleged austerity, we've got to turn it around and really get fiscal and monetary growth going again. How do you respond to something like that?

STOCKMAN: It's almost impossible to respond except to recognize that maybe we're in the final intellectual death throes of the Keynesian case. When you get to the point where Krugman is saying we need four percent inflation, when there's not an iota of evidence anywhere that inflation at a four percent rate is going to help anything except undermine the living standard of people on fixed incomes or people who can't get wage increases to keep up. You know, I think you've reached a point where the whole crude mythology of Keynesianism is being exposed, and so that's why I took that on. But the larger point I want to make is that bubble finance is insidious, because after a period of time it corrupts and co-opts the natural opposition. Let me say it this way. In my book I go back all the way to 1914 and survey the 100 years of how we got into this gigantic mess that we're in today. But one of the points that I make is that in the '50s and '60s and early '70s there was still an understanding of sound monetary policy and fiscal rectitude and of what free markets really required, and there was leadership who came to power in the Republican Party that implemented those principles.

One of the heroes of my book is George Humphreys, who was Secretary of the Treasury under Eisenhower. He was a great businessman—ran one of the big mining companies out of the Midwest. He insisted on balancing the budget, shrinking the government, non-inflationary finance, keeping the dollar as good as gold, and all the rest of it. Then I used as another case, Bill Simon, who was a ferocious opponent of crony capitalism and bailouts during the Ford administration in the mid-'70s. My point is that today, when a Republican administration comes to power, they get a guy from Columbia University who has been basically consulting and shilling for the savings and loan industry, and that whole mess, and they appoint people like Hank Paulson, who was Secretary of the Treasury and came right out of the casino on Wall Street that had been created by bubble finance under Greenspan and Bernanke for so many years.

So therefore there's no intellectual integrity left. The understanding of sound money, fiscal rectitude and free markets has been lost. So the leadership from the financial community and even corporate America is now all about doing what it takes by the day, week, and quarter to keep the bubble going, and so therefore we're badly misgoverned because there is no opposition left that has a credible intellectual foundation for what it's doing in either party. We have two free-lunch parties. They compete for who can put the biggest money printers on the Fed and who can do the most so-called, stimulate the economy through tax credits and gimmicks or spending increases as advocated by the White House. But all of that is just taking us deeper into the soup, and unfortunately that's the big breakdown today. It's not simply capitalism, but it's also democracy, because we are now in a regime of crony capitalism where both sides are piling on, using the tools of the state, the budget and the central bank to accomplish ends that would not be remotely reasonable or feasible or likely in an honest, free market.

WOODS: Now David, I know you had only a brief amount of time with us and that you have to run. I hope I can ask a tiny, tiny question even though it's a huge question. But when I was looking at your piece on this subject, I was reminded of how different our analysis of the Great Depression is from that of so many other so-called right-wing economists, who really don't see any problem with the economy in the '20s or before. They think the problem came when there was a stock market crash and the president helped to raise tariffs, and the Fed didn't do enough to save failing banks. That's their analysis. But your analysis is completely different from that.

STOCKMAN: Yeah, I believe that the Great Depression was merely a delayed hangover from the insanity of

the Great War of 1914-1918. It was that war and its unprecedented scale and the monumental carnage that caused the bankruptcy of the entire world international order. It caused the destruction of the pre-war international gold standard that worked, and left the whole world, other than the United States, massively in debt from printing money during the war and from issuing government debt. The debt of England, for instance, went up by 15 times during the war. So what the '20s was about was an effort to dig out from under the disaster, the financial disaster of World War I, recreate some semblance of the gold standard system, liberal, international economics in trade and capital flows that worked. But unfortunately, they didn't get there. They had a lot of jerry-built attempts and there was some decent motivation, but at the end of the day, the world had a mini-boom because the Fed in the United States in the 1920s massively fueled the growth in Wall Street of a foreign bond market that allowed everybody from Brazil to Hamburg to borrow hand over fist, use the proceeds that they raised on Wall Street to buy goods and services from the U.S. economy. We had an export boom. Everything got dramatically bloated and inflated. When the market crashed finally in 1929, the foreign bond market died, the export market died, the U.S. economy was vastly overbuilt, over-capacitated. It went through a huge liquidation, and that was the effect of the Great War. It was not an inherent failure of capitalism. It didn't help, of course, that Hoover signed Smoot-Hawley; that wasn't a good thing. But it certainly wasn't what Friedman said and Bernanke after him, that the Fed didn't print enough money and buy bonds hand over fist in 1930 to 1932. That isn't the cause at all. And so therefore, here's the deal. That was a one-time, historical tragedy that came out of a series of events from 1914 to 1929 that had nothing to do with the modern world, nothing to do with the idea that Keynesian fiscal stimulus and money printing at the central bank is the only way to solve the inherent depression propensities of a capitalist economy. None of that is true. That's the great urban legend that came out of the '30s and we're still struggling with it every day. The Republicans are totally buffaloed. They don't know why the 1930s happened. When Bernanke came running around Washington in September 2008 and said Great Depression 2.0 is around the corner, half of the Republicans believed him, including the clueless guy sitting in the White House and his Wall Street Secretary of the Treasury, and as a result of that we have basically followed really bad policies based on fighting a war, so to speak, an economic war from the 1930s that is both misdirected and aimed at circumstances that never even existed.

WOODS: David, I know you have to run. I am sorry about the time thing. Got to have you back on to talk about this other issue, this fantastic presentation you gave on the Fed and war because as I say, my listeners will eat that up. I want to generate as much traffic for your blog as I can because it's hard to get people to change their Internet viewing habits. People have five or ten places they go to. I want people to realize that this is worth changing your habits for. DavidStockmansContraCorner.com has got to be visited. Thanks for your time today. We'll get you back soon, I hope.

STOCKMAN: Well, I will certainly do that, Tom, and great to talk to you.