The Great Monetary Ponzi Scheme

Apologies for the lack of love, Bristlemouthers. I'm finally finished our end of year special reports and, thankfully, have time to think about something other than infrastructure stocks and inflation.

I read a lot of Nobel Prize winning economist Paul Krugman's stuff over the past couple of months, including his recently updated book *The return of depression economics*. This article on Slate, though, really wound me up (if you read it first and then come back, this post will make a lot more sense).

I'm one of the 'intellectually incoherent' who believe that 'the suffering the economy experiences during a recession is a necessary punishment for the excesses of the previous expansion'. And I've got a few answers to questions Krugman claims the incoherent ones don't have an answer to.

Krugman accepts the fact the we have investment booms and that they necessarily lead to busts. But why, he asks 'should the ups and downs of investment demand lead to ups and downs in the economy as a whole?'

Don't say that it's obvious—although investment cycles clearly are associated with economywide recessions and recoveries in practice, a theory is supposed to explain observed correlations, not just assume them. And in fact the key to the Keynesian revolution in economic thought—a revolution that made hangover theory in general and Austrian theory in particular as obsolete as epicycles—was John Maynard Keynes' realization that the crucial question was not why investment demand sometimes declines, but why such declines cause the whole economy to slump.

Well, Paul, the reason is that investment booms and consumption booms go hand in hand. In both your country and mine, consumers have been spending more than they earn for a large part of the past decade. Why? Because the investment boom has enabled them to go on a consumption boom. Not only do they feel wealthier, but they're convinced the 20% returns they're making year on year are going to pay for their retirement.

Yet you're surprised that a collapse in asset prices leads to a collapse in the wider economy? What else do you expect consumers to do when they discover they're not half as rich as they thought they were? They are going to save more and consume less, and that is going to cause a recession.

You go on to say that 'nobody has managed to explain why bad investments in the past require the unemployment of good workers in the present'. The answer to that seems fairly obvious to me as well: the investment boom created capacity and jobs to service an unsustainable level of demand. While we wait for the true demand to catch up, we're going to have surplus capacity.

Of course, your ‘easy way out’ will work. Borrow money, print money, do whatever you need to do, but don’t let that idle capacity remain idle. It worked in the early 1990s, it worked in the 2001 recession and it’s working now.

But my question to you is: where does it end? Interest rates are near zero and consumers’ ratio of debt to disposable income is the highest it’s ever been. When interest rates hit 5% in the US and 7% here, it sent the economy into a tailspin. By the time this rescue package is complete, your government is going to have one of the highest ratios of debt to GDP in the world. At some point, surely, throwing more money at the problem is no longer a viable solution?

Intellectually incoherent perhaps but, to me, your solutions have the smell of one giant ponzi scheme.