

# Management *Insights*

## WORSE THAN HOOVER

BY MARSHALL AUERBACK, CORPORATE SPOKESPERSON, PINETREE CAPITAL LTD.

It's actually a bit over the top and unfair to compare Barack Obama with Herbert Hoover – unfair that is, to the memory of Herbert Hoover. The received image of the latter is the dour, technocrat who looked on with indifference while the country went to pieces. This is actually an exaggeration. As Kevin Baker convincingly argued in his Harper's Magazine piece, "Barack Hoover Obama", President Hoover did try to organize national, voluntary efforts to hire the unemployed, provide charity, and sought to create a private banking pool. When these efforts collapsed or fell short, he started a dozen Home Loan Discount Banks to help individuals refinance their mortgages and save their homes. Indeed, the Reconstruction Finance Corporation, which became famous for its exploits under FDR and Jesse Jones, was actually created by Hoover. Often tarred with the liquidationist philosophy of his Treasury Secretary, the establishment of the RFC was, as Baker suggested, "a direct rebuttal to Andrew Mellon's prescription of creative destruction. Rather than liquidating banks, railroads, and agricultural cooperatives, the RFC would lend them money to stay afloat."

Hoover's tragedy lay in the fact that whilst he recognized the deficiencies of the prevailing neo-classical laissez-faire nostrums of his day, he could not ultimately break with them and accept that the economic tenets which he had grown up with were deficient in terms of dealing with the huge unemployment challenges posed by the Great Depression. By contrast, Roosevelt was himself instinctively a fiscal conservative throughout much of the early stages of his political career (and campaigned as a gold standard man during the election of 1932), but ultimately had the vision (or, at least, excellent political instincts) to recognize the need to cut himself off from the dogma of the past and try something new in a persistent spirit of experimentation. Not everything FDR did worked, but his lack of rigid ideology and his bold spirit of economic experimentation ultimately did much to reduce the scourge of unemployment, even though such policies brought him into significant conflict with the economic royalists of his day.

Barack Obama's style of governing largely reflects an acceptance of the status quo. His "economic experts" also reflects this preference. As Baker argued, "it's as if, after winning election in 1932, FDR had brought Andrew Mellon back to the Treasury."

To the extent that he displays any kind of radicalism, it is to roll back the frontiers of the New Deal and Great Society, in effect gutting the Democratic Party of its core social legacy. This assertion will no doubt inflame the diminishing Obama supporters, who insist the president would never cut Social Security or Medicare, that he's merely been exploring every possible route to a deal with the GOP. But the evidence increasingly suggests otherwise.

Perhaps, as Salon.com's Joan Walsh suggests, the president sincerely believes that the intense polarization of American politics isn't merely a symptom of our problems but a problem in itself – "and thus compromise is not just a means to an end but an end in itself, to try to create a safe harbor for people to reach some new common ground". One finds further support for this view within Barack Obama's own writings. A major theme of his 2006 book *The Audacity of Hope* is impatience with "the smallness of our politics" and its "partisanship and acrimony." He expresses frustration at how "the tumult of the sixties and the subsequent backlash continues to drive our political discourse."

There appears little question, then, that the President values compromise, indeed appears to enshrine it as the apex of all great Presidencies (ironically citing Lincoln's compromise on slavery as a perfect illustration of this ideal). But the problem with Walsh's

supposition is that the President's accommodation with his political enemies, his apparent infatuation with a "third way", suggests that he is being forced to compromise on a particular set of ideals and principles which he has hitherto embraced dearly.

But what is this President's ideal? The only time in our national discussions where Mr. Obama has evinced any kind of passion has been during the debt ceiling negotiations. He has, since the inception of his presidency, elevated budget deficit reductions and the "reform" of entitlements as major transformational goals of his Presidency (rather than seeing deficit reduction as a by-product of economic growth). As early as January 2009, before his inauguration (but after the election, of course), then President-elect Obama pledged to shape a new Social Security and Medicare "bargain" with the American people, saying that the nation's long-term economic recovery could not be attained unless the government finally got control over its most costly entitlement programs (<http://www.washingtonpost.com/wp-dyn/content/article/2009/01/15/AR2009011504114.html>)

In other words, Obama has been on about this since the inception of his Presidency. Recall that it was Barack Obama, NOT the GOP, who first raised the issue of cutting entitlements via the Simpson-Bowles Commission. The President has also parroted the line of most Wall Street economists as he has persistently characterized our budget deficits and government spending as "fiscally unsustainable" without ever seeking to define what that meant. One of his earliest pledges was to cut the deficit in half by the end of his first term, in effect paying no heed to the economic context when he made that ridiculous assertion.

In essence, the debt ceiling dispute is not forcing a compromise on this President, but is instead is viewed by him as a golden opportunity to do what he's always wanted to do. That also explains why he won't ask for a clean vote on the debt ceiling, why he has ignored the coin seignorage option, and why he has persistently avoided the gambit of challenging its constitutionality via the 14th amendment, even though his Democrat predecessor has already suggested that this is precisely what he would do: Bill Clinton asserted last week that he would use the constitutional option to raise the debt ceiling and dare Congress to stop him (<http://www.nationalmemo.com/article/exclusive-former-president-bill-clinton-says-he-would-use-constitutional-option-raise-debt>).

It also explains why President Obama remains infatuated by bigger and bigger "grand bargains", which seem to take us further away from averting the immediate economic catastrophe potentially at hand, which is to say national default. The Administration, then, is not going for a bipartisan compromise, but going for broke on something which the President apparent holds sacrosanct. In reality, true compromise would start with the notion of a clean vote on the debt ceiling or, at the very least, a minimal series of spending cuts that would avert the immediate risk of a default, whilst creating less deflationary pressures.

Have you actually seen the President ever get angrier than he was at his press conference announcing the collapse of the negotiations on the debt ceiling extension? Not even on health care "reform" can we ever recall seeing Obama this engaged, and manifesting something close to real emotion as he has here. That does suggest something beyond mere political calculation; it hints at core beliefs.

And to what end? Neither he, nor the Congress appear to recognize the downward acceleration in GDP triggered when the spending limits are reached if the automatic stabilizers are disabled because they are no longer funded as a consequence of the debt ceiling limitations (again, a LEGAL, rather than operational constraint – the debt ceiling reflects an UNWILLINGNESS to pay, rather than an INABILITY to pay).

So spending will be further cut, debt deflation dynamics will intensify, sales will go down more, more jobs will be lost, and tax revenues will collapse even further. Which will set the whole process off again: more spending is cut, sales go down more, more jobs are lost, and tax revenues fall more, etc. etc. etc. until no one is left working. All are radically underestimating the speed and extent of the subsequent damage.

Unlike President Hoover, who inherited the foundations of a huge credit bubble from the 1920s and found himself overwhelmed by it, this President is worse. He is, through his actions, creating the conditions for a second Great Depression because of his misconceived belief that too much government spending "crowds out" private investment, and takes dollars out of the economy when it borrows. And therefore, goes the perverse logic, when the government stops borrowing to spend, the economy will have those dollars to replace the lost federal spending.

And so after the initial fall, Obama believes, it will all come back that much stronger.

Except, that as my friend Warren Mosler insists, he is dead wrong, and therefore we are all dead ducks.

As Warren notes, have you ever heard anybody say ‘I wish they’d pay off those Tsy bonds so I could get my money back and go buy something.’?

Of course not! Notes Warren:

“Treasury borrowing gives dollars people have already decided to save a place to go. Dollars that came from deficit spending-dollars spent but not taxed. If they were spent and taxed, they’d be gone, not saved.

Treasury bonds provide a resting place for voluntary savings. They are bought voluntarily. They don’t ‘take’ anything away from anyone.

For example, imagine two people, each with \$1 million. One pays a \$1 million tax. The other doesn’t get taxed and decides to buy \$1 million in Treasury bonds. Pretty obvious who’s better off, and who’s still solvent and consuming.”

Someone please explain this basic economic tenet to the President so that he can effect a genuine compromise, not a destructive “grand bargain” which will suck trillions of demand out of a still fragile economy. The predictable result is of his current stance is that, even as he claims to recognize the interlocking nature of the problems facing us and vows to “solve the problem” once and for all via a “grand bargain”, Obama is in fact tearing apart most of the foundations which were tentatively initiated under Hoover, but which came to full fruition under FDR. If he continues down this ruinous path, \$150 billion/month in spending will be cut. Such economic thinking isn’t worthy of Mellon, let alone Herbert Hoover.

## Marshall Auerback, Corporate Spokesperson

As company Corporate Spokesperson, Mr. Auerback is a member of Pinetree’s Board of Directors and has some 28 years of global experience in financial markets worldwide. Mr. Auerback plays a key role in the formulation and articulation of Pinetree’s investment strategy. Currently, Mr. Auerback is a Senior Fellow at the Roosevelt Institute, a research associate for the Levy Institute and a fellow for the Economists for Peace and Security. He has previously served as an advisor to a number of fund management organizations, such as PIMCO, the world’s largest bond fund management group, RAB Capital and David W. Tice & Associates. Mr. Auerback graduated magna cum laude from Queen’s University in 1981 and received a law degree from Corpus Christi College, Oxford University in 1983.



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