

# **Thoughts on a Second Great Depression**

**By M.A. Nystrom, M.B.A.**

**Man on the street in (the Republic of) China**

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## **1. Introduction to the Second Great Depression**

The idea of a second great depression first occurred to me in the summer of 1998, at an empty bookstore in a shiny, modern, deserted mall in Bangkok. It was a year after the Asian financial crisis had devastated the economies of many newly emerging Asian nations, casting a pall over the fantasy of uninterrupted economic growth. Bangkok still bustled, but the city was dotted with brand new malls such as this one, immaculate temples to capitalism, everything 50% off but with no buyers in sight. Some of the older malls were already abandoned, escalators stopped and gathering trash, their upper floors darkened while the lower floors became home to spontaneous traditional markets selling vegetables and household goods from makeshift stalls.

It was in this context that I first picked up Robert Prechter's book "At the Crest of the Tidal Wave," in that deserted bookstore. I devoured the book and all of its charts over the next few days and began to see Bangkok in a different context. It was a glimpse of the future of America: Deserted malls, innumerable cardboard and tin shanties built along the railroad tracks by people without homes of their own, and others -- the sick, the injured, the lame, the living dead -- sleeping in the shadows of gleaming new skyscrapers, the monuments to modern finance capitalism.

This began a long journey into understanding the nature and causes of economic depressions that has turned into something of a scavenger hunt for me, one clue leading to the next in an ever-expanding search for truth.

## **2. Cycles, Cycles, Cycles**

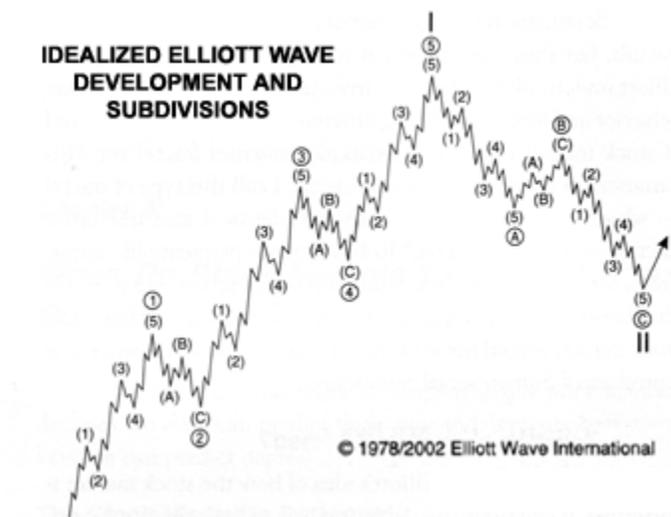
The idea of cycles of prosperity and suffering is nothing new. The Bible tells the story of Pharaoh's dream, which Joseph interpreted as a prediction of seven years of feast, followed by seven years of even greater famine. (The Bible is full of symbols, and seven is not a literal number, but the number of God, symbolizing a divinely ordained period of time.)

Modern man is far removed from his natural roots, and is no longer ruled by mysticism or religion, but it is still possible to see that everything in nature moves in

cycles. The earth spins round once a day, and travels around the sun once a year. Because of this we have seasons that determine when many plants and animals are born and grow, and when they die. Other cycles govern the growth and decline of markets, societies and civilizations.

## 2.1 Elliott Waves

My search for the second great depression began with Prechter and his theory of Elliott Waves, which are clearly identifiable patterns that describe how groups of people behave. They reveal that mass psychology swings from pessimism to optimism and back in a natural sequence. The waves are most clearly seen and measured in financial markets. The patterns are fractals, occurring at all levels of scale, from minutes all the way to years, decades and centuries, rising and falling according to natural rules. From Prechter's analysis, we are just completing a pattern of Grand Supercycle degree, which in short means that after decades of prosperity, we are on the brink of an economic setback that will be larger than the Great Depression (which was a pullback of only Supercycle degree).



Prechter's first forecast for the great market top came in 1995, then again in 2000. Markets did peak in 2000, but the onset of the ensuing depression has been like waiting for a slow train coming.

## 2.2 Technology Long Waves

From an economic standpoint, Soviet economist Kondratieff identified a long wave cycle in capitalist economies of about 60 years that got him banished to Siberia for claiming that capitalism was cyclical, moving through periods of growth, booms and busts but inevitable regeneration. Further study on long waves by Western researchers identified that the process behind long waves is an interaction between 1) new

technology, 2) business opportunities that the new technology creates, and 3) an eventual overbuilding of capital after the technology ages. The stages are:

1. Discoveries in science create a phenomenal base for technological innovation
2. Radical and basic technological innovations create new products
3. These products create new markets and new industries
4. The new industries continue product and process innovation, expanding markets
5. As technology matures, new competitors enter, creating excess capacity
6. Excess capacity decreases profitability and increases business failures and unemployment
7. Subsequent economic turmoil in financial markets leads to depressions
8. New science and new technology provides the basis for new economic expansions. (From *Managing Technology*, by Frederick Betz, National Science Foundation, 1987)

Up to #6, this sounds very much like the internet boom and bust of the 1990's, but as of yet, it has not led to a second great depression.

### 2.3 Concentration of Wealth

Ravi Batra's book "The Great Depression of 1990" has excellent discussions on a number of different cycles that lead to depressions, including social cycles, cycles of monetary growth, government regulation, as well as concentration of wealth. The book is well worth the read, in spite of its title (and very cheap at used book stores because of it). Batra points out that there is a large body of economic literature upholding the theory that *recessions* are caused by unequal distribution of incomes and concentration of wealth.

It works like this: As savings rise, consumption falls. Since the rich save more money than the poor, the concentration of wealth in fewer hands increases savings and decreases consumption. As demand drops, and economic growth fails to keep pace with growth in the labor force, unemployment rises. Classically, this is a self-correcting process; labor costs eventually adjust, excesses are flushed out of the system, and growth begins anew. But in a *depression*, the above process is accompanied by a collapse of the financial system. A recession is a normal, necessary part of the business cycle and will not, in itself, cause a healthy financial system to collapse. However, as wealth becomes concentrated, it has a detrimental effect on the financial system. As Batra goes on to explain, in a sound financial system, banks make loans only to credit-worthy customers who are unlikely to default on their loans. But when wealth becomes concentrated, the number of less affluent people increases, as well as their borrowing needs. These less affluent people, who now make up the majority, have fewer assets and are thus less credit worthy. Even in such an environment, banks cannot afford to be choosy -- they must make loans in order to stay "competitive" with their peers and simply to stay in business. Thus, as the concentration of wealth rises, the number of unhealthy banks with shaky loans also rises in a dangerous spiral, increasing the possibility of systemic failure.

A perverse side effect of the growing wealth disparity is the rise in speculative investments. As a person becomes wealthy, his aversion to risk declines, so the number of risky investments by the rich also increases. Money doesn't mean so much to the rich, so they're willing to take a wild chance on a flyer, if it will double, triple or quadruple their money. As Charles Kindleberger puts it:

The object of speculation may vary from one mania or bubble to the next. It may involve primary products, or goods manufactured for export to distant markets, domestic and foreign securities of various kinds, contracts to buy or sell goods or securities, land in the city or country, houses, office buildings, shopping centers, condominiums, foreign exchange. At a late stage, speculation tends to detach itself from really valuable objects and turn to delusive ones. A larger and larger group of people seeks to become rich without a real understanding of the process involved. Not surprisingly, swindlers and catchpenny schemes flourish.

Sound familiar? We've seen bubbles in each of the securities he mentioned over the last two decades, and the last few years have shown us that even huge, multinational companies such as Enron and WorldCon can also be swindlers and catchpenny artists. Everyone wants to be rich quick and with the minimal amount of effort. In spite of these signs of the times, it has yet to lead to a second great depression.

#### **4. Not if, When**

There are so many factors pointing to a breakdown of the current dollar-based financial system that I have simply lost count. The rich get richer and the poor get poorer and the divide between them grows wider each day. The US government is in more debt than it can every repay. Personal bankruptcies are at an all time high. Home "ownership" is also at an all time high, but much of it is due to risky loans made by audacious banks to unqualified buyers. It is the banks that own the homes, not the people. In fact, banks own just about everything, since most everything these days is purchased on credit. Personal debt is at an all time high. Americans work longer and harder, but wages have stagnated. The number of Americans who are homeless and in jail is at an all time high. These problems are not going away, and they're not getting better. People are falling out of the system at an increasing rate, and it is only a matter of time before that trickle becomes a deluge.

My point is not to convince you of the inevitability of a financial collapse. One need only look at history to understand that the tide of prosperity rises and falls with time. In my mind a second great depression is a foregone conclusion, a *fait accompli*. The storm clouds are gathering and growing darker. We have already felt the first drops of rain. It is not a matter of if, but when.

But depressions do not affect everyone equally. Even during the Great Depression, which left 25% of workers unemployed, it also left **75% *with*** jobs. The

amount of work did not fall -- there is always work to be done and needs to fulfill -- but there was no money to pay the workers. Times of change also produce great opportunities for enterprising individuals. For example, the wildly popular board game Monopoly was born during the depths of the Great Depression, allowing people to fantasize about better times and also learn the skills of capitalism.

Studying the causes and effects of past collapses can help you become psychologically prepared, mitigate personal damage, preserve wealth, and then you can begin taking steps toward building a better, more just and robust system for the future. In the coming environment, will you be one of the 75% with a job, or the 25% or more without? Will you be an entrepreneur, on the lookout for new opportunities for betterment, or will you be waiting for a government handout and a government solution? Will you be caught at the top, holding speculative investments that will eventually become worthless, or will you be picking up bargains at the bottom of the cycle? Will you blame the system or look for ways to help create a better system?

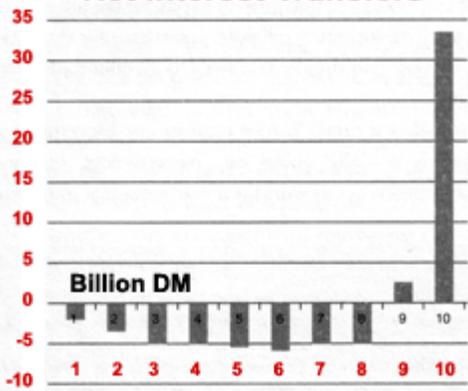
## **5. Purpose of a Second Great Depression**

Since first picking up Prechter's book, my reading over the past several years has covered a wide range of topics beyond just financial markets, and I've come to see that the looming depression is actually a symptom of deeper problems, not a root cause. Unbridled capitalism under a fiat currency system leads to ever greater consumption fueled by debt spending. But if every country (notably the emerging BRIC countries) wants to achieve the American way of life, humanity will suck the earth dry of her resources and pollute the environment with the refuse of our disposable lives. It is already happening, and this also plays a role in the coming depression.

Just as the Great Depression came as the final break in the transformation of the US from an agricultural to an industrial economy, the second great depression can be seen as the line of demarcation between the industrial age and the age of a knowledge based economy. From this perspective, the looming depression should be seen as an opportunity, not a disaster. Humanity must transform and change its course of development away from the path of inevitable destruction through consumption, and seek new ways of living and interacting with each other and its environment. The American economy doesn't manufacture as much as it used to (that seems to be China's job now), but American ideas still power the world, from the automobile to computers to the internet. The world still looks to America for the most innovative ideas. To make our way out of the depression, we're going to have to think our way out. (This is why I encourage you to turn off the TV and think!)

Our current monetary system is a relic of the past that is not equipped to handle current or future needs for humanity. The old saying that money makes the world go around is quite true: Without money, we would never do lots of things that now keep many of us occupied for our entire lives! At its root, our monetary system is flawed, causing us to make fatal choices. Part of the reason for this is that The Federal Reserve has been given the power to create money from nothing. Another part of the reason is the

## Net Interest Transfers



**Systematic wealth transfer from the bottom 80% to the top 20% of society, Germany, 1982.**  
From the book *The Future of Money*, p.54.  
(c) Bernard Lietaer, Radndom House UK, 2001

role that interest plays in systematically transferring wealth from the poor to the rich.

The wealthiest people and organizations own most of the interest bearing assets. They receive an uninterrupted flow of interest from whoever needs to borrow money. This chart shows the impact of the transfer of wealth via interest from one social group to another, based on a study performed in Germany in 1982. Germans were grouped into ten income categories of equal size, and during that year, a total of 270 billion DM in interest was paid and received. The graph clearly shows the systemic transfer of wealth from the bottom 80% of the

population to the top. This transfer of wealth is due exclusively to the monetary system, and is completely independent of the degree of cleverness or industriousness of the participants -- the classic argument to justify large differences in income. As a result of schemes such as these, the top 1% of Americans now have more personal wealth than the bottom 92% combined! (From *The Future of Money*, by Bernard Lietaer, Random House UK 2001) In these modern times, money has lost all connection with value, work and productivity, making a collapse of the system inevitable. Part of the purpose of a second great depression will be to flush away arbitrary, unfair systems such as these.

Under a sound monetary system, the value of a currency is tied to a fixed asset such as gold, so banks and governments can't create money out of thin air, as they do today. This will help to limit the power of government. Other types of fairer monetary systems exist and these can also be created, and I will discuss these in the future. (Please [sign up for updates](http://www.bullnotbull.com) if you'd like to stay informed by visiting <http://www.bullnotbull.com>) These systems will be instrumental in the rebuilding process after the depression, since fiat currencies will be seen for what they truly are -- worthless paper.

## 6. Conclusion

Like a slow train coming, another great depression is on its way. No one knows exactly when that train will arrive, so now is the time to prepare for your safety and do what you can to preserve the wealth you've built. Then you can begin to scan the horizon for opportunities that will inevitably arise, and think about ways you can help people less fortunate than yourself.

Pessimism, cynicism and negativity are for better times; for times like the ones we are approaching, we can't afford them.

I believe the looming second great depression will be a cathartic period of transformation giving us (meaning all of us, collectively) the opportunity to reengineer society into something more just, free and appropriate for the future world that we are living into. Just as we no longer need to spend 16 hours per day slaving on the farm to meet our subsistence needs, in the future we won't need to spend 10 hours per day slaving at the office in order to simply consume more.

The digital information communications revolution is changing the world as much as the industrial revolution did, but in the midst of the current dislocations and confusion, it is difficult to recognize. But since most work -- from farming to manufacturing to many routine services -- can be automated, the question then becomes what will people do with their time? How will people live and interact? The answers to these questions will be decided during the pain, confusion, reflection and search for answers that the second great depression will inevitably bring.

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