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Canada a local economic buffer

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In My Opinion

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— The Federal Reserve Board has again decreased the interest rate it charges for short-term loans to commercial banks. This is the latest in a series of drops that have been unprecedented, in size and rapidity, for at least a generation. It is natural for North Country residents to wonder what is going on, what might happen next, and how it might affect us.

The Fed has not needed to cope with the current decline in financial-market confidence since the Great Depression. While many now realize that the failure of regulation to keep up with newfangled financial products is at least partly responsible for this current mess, spending too much time on blame doesn't get us any further toward solving it.

Perhaps history can give us some insights. Confidence in financial markets was shaken with the Great Crash of 1929. The immediate effects of that crash on market performance and confidence were only a little larger than what we are seeing today. Over the next three years, though, confidence continued to erode, wiping out almost three quarters of the value of the stock exchange.

What we perhaps ought to understand is why things continued to deteriorate between 1929 and 1932. First, we did not have a well functioning Federal Reserve System that viewed the maintenance of financial stability as perhaps their primary objective. We also had a prevailing philosophy in the Herbert Hoover administration that the market should be left to its own devices. Hoover was monitoring the situation but did not believe the turmoil could last as long as it did. Modern Keynesian macroeconomics now tells us that the economy is well capable of long periods of persistent and dramatic recession or depression, but these studies were in their infancy in 1930. Finally, there was a tradition of lack of government involvement in economic affairs that prevailed throughout the Roaring 20's.

But, while the Fed tried to do whatever it could, without the support and reinforcement by the economic commander-in-chief, the Fed's actions were deemed not credible.

What got the markets back on track was one simple yet powerful speech.

President Franklin Roosevelt's Inaugural Address, on March 4, 1933, almost exactly 75 years ago, began with these words:

"I am certain that my fellow Americans expect that on my induction into the presidency I will address them with a candor and a decision which the present situation of our people impel. This is preeminently the time to speak the truth, the whole truth, frankly and boldly. Nor need we shrink from honestly facing conditions in our country today.

"This great nation will endure as it has endured, will revive and will prosper. So, first of all, let me assert my firm belief that the only thing we have to fear is fear itself -- nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."

The president, in his first day in office, went on to explain to the people how the banking system works, and our role as citizens in maintaining confidence in financial markets. He was also sending a clear message to those who ran financial institutions that they too have a responsibility, and he would ensure they live up to it.

These decisive words, backed by a credible statement to mobilize any federal resource to restore market confidence, had an immediate impact on the banking industry and the markets. The day markets and banks reopened, the stock market experienced its single biggest increase in history, and most deposits withdrawn from banks and hoarded under mattresses were immediately redeposited. Confidence was restored by a simple speech. Words and vision can make a difference.

Will things get as bad this time around? I don't think so. While perhaps we have done far too little far too late, the cries are getting louder and louder. And it has not taken four years for these clarion calls to be heard. My only fear is that the Fed has used almost all its monetary arrows somewhat futilely, given the lack of a concerted fiscal-policy response. There is not much more the Fed will be able to do at this point. So now there is a growing will to go far beyond a small tax rebate.

It is interesting that Canada seems to weather these storms better than the U.S. Perhaps one significant reason is that their Federal Reserve equivalent, the Bank of Canada, and their government work in a more concerted way to conduct economic policy. Also, in the current crisis of the U.S. dollar, assets have fled to commodities, mostly gold and oil, both of which Canada has in abundance. The now strong Canadian dollar means that a region like the North Country is at least partially insulated as Canadian businesses all of a sudden see great opportunities for an affordable U.S. presence. Hopefully, the Canadian-led growth in the North Country will balance the recessionary fears emanating from our South.

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