the New Deal Economist

Did the New Deal Actually Prolong the Great Depression?

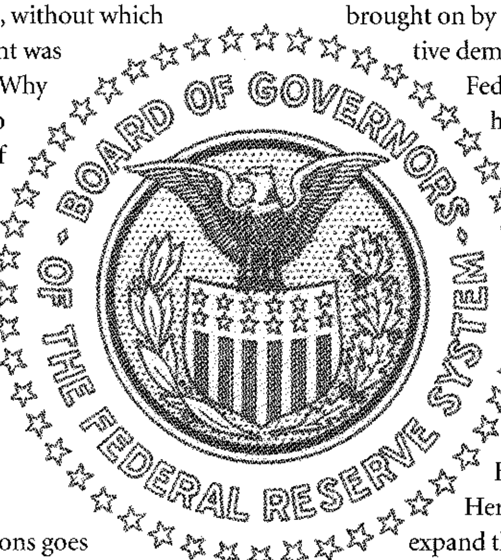
By Jim Powell

The Great Depression was the most important economic event in twentieth-century American history, yet we know surprisingly little about it. Though the popular impression is that Franklin D. Roosevelt's New Deal policies brought about recovery, economic research developed in recent decades suggests the New Deal prolonged the Depression.

The most troubling issue is the persistence of high unemployment throughout the New Deal period: At no point during the 1930s did unemployment go below 14 percent. Living standards remained depressed until after World War II. Stanford University's David Kennedy seems to be the only major political historian to mention any of the research about the effects of New Deal policies. In the Pulitzer Prize-winning *Freedom from Fear* published in 1999, Kennedy concluded flatly that the New Deal "was not a recovery program, or at any rate not an effective one."

It's true the Great Depression was an international phenomenon. But compared to the United States, as economic historian Lester V. Chandler observed, "in most countries the depression was less deep and prolonged." While the U.S. made a modest recovery between 1933 and 1937, the 1937 peak was still lower than our previous economic peak in 1929, a highly unusual occurrence.

Scholarly investigators have raised some provocative questions about this. Why did New Dealers make it more expensive for employers to hire people? Why did New Deal policies discourage private investment, without which private employment was unlikely to revive? Why so many policies to push up the cost of living? To what extent did New Deal labor laws penalize blacks? Why was so much New Deal relief spending channeled *away* from the poorest people? The list of provocative questions goes on and on. And when researchers try to answer them, considerable evidence emerges that New Deal policies actually prolonged high unemployment.



During the 1930s, the Great Depression was widely blamed on stock market speculation, reckless banking practices, and a concentration of wealth in too few hands. The New Deal laws were drafted accordingly. Subsequent investigations, however, have convinced most economists that the Depression had little to do with any of those things. The most influential single work is *A Monetary History of the United States, 1867-1960*, published in 1963 by Milton Friedman and Anna Jacobson Schwartz, which documented the catastrophic one-third contraction of the money supply between 1929 and 1933. Princeton University economist Paul Krugman remarks that, "Nowadays, practically the whole spectrum of economists, from Milton Friedman leftward, agrees that the Great Depression was brought on by a collapse of effective demand, and that the Federal Reserve should have fought the slump with large injections of money."

Yet the Roosevelt administration didn't address Fed mistakes until FDR signed into law the Banking Act of 1935. Here the idea was to expand the power of the Federal Reserve Board in Washington, which meant that Fed mistakes could have an even bigger impact on the economy. The new Federal Reserve Board's first bad call came soon. Concerned about what appeared to be excess bank reserves which might lead to a surge of lending and inflation, the Fed doubled bank reserve requirements between August 15, 1936 and May 1, 1937. The strategy backfired: In an effort to rebuild excess reserves, banks cut their lending, contributing to the severe recession of 1938.

Nor did FDR do anything about unit banking laws that had doomed thousands of rural banks to failure in bad times. These laws limited banks to a single office, preventing them from diversifying their loan portfolios and their source of funds. When local depositors withdrew their funds, and local borrowers defaulted on their loans, the banks collapsed. Because Canada didn't have unit banking laws, even rural banks were able to diversify, and there weren't any bank failures in Canada during the Great Depression.

What FDR did, of course, was support federal deposit insurance. This has involved charging reckless banks the same premiums as prudent banks. Federal deposit insurance subsidizes reckless banks and passes the resulting losses to taxpayers—during the 1980s, the tab exceeded $500 billion.

Another of FDR's major banking reforms, the second Glass-Steagall Act, actually weakened the banking system by breaking up the strongest banks in order to separate commercial banking from investment banking. Universal banks (which served depositors *and* did securities underwriting) were much stronger than banks pursuing only one of these activities. Very few universal banks failed, and securities underwritten by universal banks were less risky. Why did Congress break them up? Two of the biggest lobbyists for Glass-Steagall were the Investment Company Institute and the Securities Industry Association—representing competitors of commercial banks who would benefit from having banks banned from their own business field.

FDR's tax increases also did much to prolong the Great Depression. Federal taxes more than doubled from $1.6 billion in 1933 to $5.3 billion in 1940. FDR raised personal income taxes, corporate income taxes, excise taxes, estate taxes, gift taxes, and liquor duties, and he introduced Social Security payroll taxes (Social Security taxes began in 1937, but Social Security benefits didn't begun until 1940). All these levies meant there was less capital for businesses to create jobs, and consumers had less money in their pockets.

Black people were among the major victims of the New Deal. Large numbers of blacks were unskilled and held entry-level jobs, and when New Deal policies forced wage rates above market levels, hundreds of thousands of these jobs were destroyed. Above-market wage rates encouraged employers to mechanize and in other ways cut total labor costs.

Government spending was touted as a cure for the Depression, but it didn't work.

At a time when millions of people had little money, New Deal policies made practically everything more expensive. In 1933, the worst point of the Depression, FDR pushed through Congress the National Industrial Recovery Act which promoted cartels in over 700 industries, aimed at maintaining consumer prices above market levels. People were jailed for discounting! Then came the Robinson-Patman Act, the Retail Price Maintenance Act, and the Civil Aeronautics Act, which maintained prices of thousands of products and services above market levels.

Perhaps the worst of the New Deal laws, from a consumer's point of view, were those like the Agricultural Adjustment Act which aimed to raise farm incomes by destroying food and forcing up food prices. These laws mainly enriched big farmers since New Deal farm subsidies were based on the amount of land one had. The laws displaced poor sharecroppers and tenant farmers. High farm foreclosure rates persisted during the New Deal, indicating that the Act did almost nothing for the poorest farmers.

While FDR authorized the spending of billions for relief and public works projects, a disproportionate amount of this money went not to the poorest states such as in the South, but to Western states where people were better off—apparently because these were "swing" states which could yield FDR more votes in the next election. The South was already solidly Democratic, so there wasn't much to be gained by buying support there.

Government spending was touted as a cure for the Depression, but it didn't work. In 1933, federal government outlays were $4.5 billion, and by 1940 had more than doubled to $9.4 billion. Unemployment remained stubbornly high.

Despite his charismatic personality and comforting "Fireside Chats," FDR failed to make the recovery of private, productive employment his top priority. Along with advisors like Louis Brandeis, Felix Frankfurter, Rexford Tugwell, and Thomas Corcoran, FDR viewed business as the *cause* of the Great Depression, and he did everything he could to restrict business. His goal was "reform," not recovery. Leading newspaper columnist Walter Lippmann observed at the time that New Dealers would "rather not have recovery if the revival of private initiative means a resumption of private control in the management of corporate business.... The essence of the New Deal is the reduction of private corporate control by collective bargaining and labor legislation, on the one side, and by restrictive, competitive, and deterrent government action on the other side."

Recent economic research on the effects of New Deal policies strongly suggests that the best way to promote a speedy recovery from depression is to let people keep more of their money, remove obstacles to productive enterprise, let markets rather than regulators make decisions, and provide stable money and a political climate where investors feel that it's safe to invest for the future.

Historian and Cato Institute fellow Jim Powell is working on a book about the effects of the New Deal.

Hollywood Report

Vietnam, With Less Angst and Alienation

There is a scene in the script for the upcoming Vietnam War movie *We Were Soldiers* in which Mel Gibson's character, preparing to depart for Southeast Asia, learns that his regiment number is seven. "The *Seventh*?" he asks. "The same regiment as...Custer?"

Ultimately—and this news won't spoil the film—Gibson and his troops fare better than the general and his soldiers did at Little Big Horn. But that's not to say they have an easy go of it. *We Were Soldiers* is about one of the bloodiest battles in all of Vietnam, an engagement in which more than 200 Americans died, more than were killed in any regiment at Gettysburg.

Most of *We Were Soldiers*, scheduled for March release, is set in late 1965 in the Ia Drang Valley, or as it came to be known, the Valley of Death. It was the first location to see the entry of U.S. combat troops in significant numbers, and the carnage there nudged President Johnson toward his view that the war was unwinnable.

The battle was chronicled in stark detail in the 1992 book *We Were Soldiers Once...And Young* written by Hal Moore, an Army lieutenant general who was in the middle of it, and Joe Galloway, the UPI correspondent assigned to the 1st Battalion, 7th Cavalry. The commandant of the Marines selected it as the book of the year for the Corps when it was published. In the film, Moore is played by Gibson, and Galloway by Barry Pepper (the sniper in *Saving Private Ryan*).

Last fall, in the private Washington, D.C. screening room of Motion Picture Association chairman Jack Valenti, Moore and Galloway got to see Hollywood's version of the story. Sitting just a few seats over were Gibson and the picture's writer and director, Randall Wallace (the scriptwriter for *Braveheart*). President Bush's political advisor Karl Rove was also present.

For the most part, Moore tells *TAE*, he was pleased. This is a man who, in his book, rebuked Hollywood's traditional treatment of the war with the words: "We knew what Vietnam had been like, and...Hollywood got it wrong every damned time, whetting twisted political knives on the bones of our dead brothers."

Writer Wallace had his eye on Moore's story for years. Both the 120-page script and early reports from those who've seen the film, indicate that Wallace remained faithful to the book's key elements. *We Were Soldiers* shows in vivid detail how the enemy drew Americans into battle as a kind of training and dress rehearsal for engagements.

Viewers get a clear sense of how treacherous Ia Drang really was. At one point, the 450 men of Moore's battalion have more than 2,000 North Vietnamese arrayed against them. "Remember that intense 20-minute opening scene in *Saving Private Ryan*?" asks Moore. "Well, three fourths of this entire film is like that."

Moore suggests that Wallace's concentration on men in the front ranks—"how we fought for each other, and died for each other"—will go a long way toward elevating the standing of the Vietnam veteran. "It's a movie that will show that it's okay to hate war but love the American warrior," he says.

© Paramount Pictures

Mel Gibson in a scene from *We Were Soldiers*.

Toward the end of the picture, there is a scene with Moore, Defense Secretary Robert McNamara, and General William Westmoreland, meant to send the book's message that Americans fought a "worthy enemy." McNamara and Westmoreland seem confident that U.S. troops will eventually "run the little bastards back home."

"If I were the leader of the other side, I would have been proud of them," says Gibson, as Moore. "They pushed 2,000 men through artillery and napalm.... They ran right at the muzzles of our guns. We took them hand to hand. And we won. But they didn't go away. They just backed up and came again. We won't run the little bastards home, sir. They are home."

It's all an embellishment; no such conversation ever took place. But that seems to bother General Moore only a little. "Randy Wallace told me, 'Hal, it's not a documentary on the History Channel.'" But at least it's not the low fraud of *Apocalypse Now* or *Full Metal Jacket*, either.

—John Meroney