Friday, July 26, 2002

The U.S. Economy Is Not Depression-Proof

by William L. Anderson

[Posted July 26, 2002]

One of the enduring myths about government is the notion that successful governments are those entities that "provide prosperity" for those who are governed. The real issues involve who receives the blame for causing the calamity --and who benefits from it. Thus, Herbert Hoover is identified (correctly) with causing the Great Depression, while Franklin D. Roosevelt wrongly receives credit for pulling the United States out of the depression.

Republicans are still apologizing for Hoover; FDR created the modern Democratic Party, which was able to seize the political opportunities created by the depression to permanently expand the U.S. state.

As the economy now teeters on the brink of another recession, it is instructive to look back at the policies of both the Hoover and the Roosevelt administrations to understand why the Great Depression occurred, and why the government today is poised to repeat the patterns set out by presidents and legislators during the 1930s. Furthermore, we need to understand what *did not* create the conditions under which the depression flourished and to point out what *should* be done to end this current scourge.

In a recent appearance before Congress, Alan Greenspan declared that the recent "scandals" in American business were the result of "infectious greed" --something that made headlines around the country, as Greenspan's adoring press corps could say that the great Federal Reserve chairman was making the same observations as their leftist editorial writers. Thus, we are told by the media, by Greenspan, and by the political classes that what the economy needs are "tough new laws" to "clamp down on corporate crooks," along with easy money from the Fed.

An unfortunate legacy of Milton Friedman's *Monetary History of the United States* is the enduring myth that the Great Depression happened because the Federal Reserve System did not pump enough new money into the economy. Therefore, we are told that in order to prevent the economy from going into the tank, all that is needed is for the Fed to follow an expansionist policy. It has become a public truism that once a recession occurs, if the Fed lowers interest rates and engages in aggressive open market operations, the influx of new money will turn things around. To use a favorite quotation (ironically) from Friedman, nothing could be further from the truth.

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Leftist and Keynesians on the other hand, stress that an explosion of government spending is needed to help jolt the economy out of the doldrums. Thus, the economic mainstream holds that if a government follows both expansionist monetary policies and aggressive "fiscal" policies, there is no way the economy can stay in a funk. [i]

To understand, however, why the U.S. economy is quite vulnerable to a serious recession--or even a depression--we need to know why the Great Depression occurred and what the government *should* have done to prevent it, as opposed to what the government actually did. Furthermore, understanding real causes of the Great Depression also reveals that the political classes gained power from this economic calamity. If anyone believes that most intellectuals, politicians, and bureaucrats are not hoping and praying for a repeat of the 1930s, I have a bridge that connects Manhattan and Brooklyn I would like to sell you.

Myth #1: *The Great Depression occurred because the Federal Reserve followed a tight money policy from 1930 to 1933, thus causing bank failures and contracting the economy*.

Answer: Contrary to popular belief, the cause of the initial stock market crash in 1929 was basically the same cause of the bursting of the recent bubbles in the stock market, that being the loose money policies of the Fed. During the 1920s, as Murray N. Rothbard documented in his classic *America's Great Depression*, the Fed--led by Benjamin Strong (the Alan Greenspan of his day), chairman of the New York Federal Reserve Bank (which basically set Fed policy at that time) --suppressed interest rates and aggressively pursued open market operations to vastly increase bank reserves. [ii]

Following the 1929 crash, the Fed at first reacted by loosening credit to "provide liquidity" to the system, something which Rothbard authoritatively explains in his book. Bank failures occurred, not so much because the Fed refused to stop bank runs, but rather because banks had overextended themselves during the unsustainable boom of the late 1920s.

Even had they propped up banks in the manner that Friedman says they should have, the U.S. economy still would have been foundering in a serious downturn as the malinvested capital created and sustained by the boom had to be liquidated. Friedman, ironically, is correct in stating that the Fed played a major role in causing the Great Depression, but he fails to point out the real damage caused by the central bank.

Myth #2: *The Great Depression occurred because wages failed to keep up with growing productivity in the U.S. economy. Thus, income "inequality" increased, and the growing numbers of impoverished workers were unable to "buy back" the goods they had created, which caused a glut of goods and commodities to appear, creating layoffs and unemployment*.

Answer: This one should be laughable on its face, but it remains the favorite explanation of the left, which declares that recessions are the inevitable result of the "internal contradictions" of the capitalist economy. For this one to be believed, one must be convinced that the creation of increasing numbers of goods and services actually causes poverty. This is like saying an abundance of food causes hunger, a logical absurdity.

While U.S. productivity grew faster than increases in income in the 1920s, prices for many goods fell dramatically during this period. [iii] As is always the case during a boom, the standard of living for most Americans increased in that decade;

unemployment and poverty increased only after the crash and after a number of policy blunders by the Hoover administration, some of which will be described below.

Myth #3: *The U.S. economy slid into depression because Hoover, a believer in "rugged individualism," stood back and did nothing*.

Answer: This is the standard explanation that one reads in U.S. history textbooks, but it is utterly false. First, Hoover was anything but a believer in free enterprise, as is evident not only from his actions as president but also from his actions, statements, and affiliations before he became president of the United States in 1929.

Hoover was very much a "progressive" and believed that government should intervene in economic affairs on a regular basis. In fact, a number of well-known socialists/progressives such as Jane Addams supported his bid for the presidency. (Both Democrats and Republicans courted Hoover; unfortunately for the Republicans, Hoover chose their party. History might have taken an interesting turn had Hoover cast his lot with the Democrats.)

In the wake of the crash and the subsequent liquidity crisis that occurred soon afterward as margin calls escalated after the stock market downturn, Hoover urged business and labor leaders to keep wages and prices high and not let them fall, believing that a "high wage" strategy would win the day. As banks began to fail and the amount of money in circulation began to fall, it became obvious just how dangerous Hoover's strategy really was, since it prevented the necessary adjustment of prices for labor, capital, and commodities.

Hoover also signed the disastrous Smoot-Hawley Tariff in 1930, one of the highest tariffs in the nation's history, despite the fact that 1,000 economists signed a letter begging him not to do so. The effects of the tariff were swift: in the year after Hoover signed the Republican-led tariff, the nation's unemployment level quickly climbed into double digits.

In 1932, the Hoover administration, alarmed that the federal budget deficit was growing, pushed through a huge series of tax increases. Top income tax rates were raised from 24 percent to near 70 percent, while taxes on other items were nearly doubled. Not surprisingly, the federal deficit grew even more after the passage of these punitive tax measures.

Rothbard also points out that Hoover attacked business leaders and the stock market, much in the same way that President George W. Bush and his amen corner in Congress and the media have been doing. Like the present media and political classes, Hoover sought to blame business leaders themselves for the economic downturn.

Myth #4: *Franklin D. Roosevelt's New Deal brought the U.S. economy out of the Great Depression*.

Answer: Roosevelt's New Deal, which Rothbard says was basically a continuation of the the Hoover programs, had the opposite results from what his adoring press claims. When Roosevelt took office in March 1933, the nation's rate of unemployment stood at 25 percent. After falling to about 15 percent by 1935, unemployment rose to nearly 20 percent in 1938--a depression within a depression--and stayed in double digits until near the end of 1941, when the United States entered World War II.

Actually, there were two New Deals, the first of which involved attempts to restrict

production, force up prices and wages, and organize the entire U.S. economy into a series of agricultural, industrial, and retail cartels. The two mainstays of the first New Deal were the National Industrial Recovery Act and the Agricultural Adjustment Act, both of which were declared unconstitutional by the U.S. Supreme Court in 1935.

Roosevelt's second New Deal centered on aiding labor unions in organizing the workplace, aggressive antitrust policies, raising taxes on higher-income Americans in order to further transfer wealth. The centerpieces of the second New Deal were the creation of Social Security and passage of the National Labor Relations Act in 1935. The first has created literally trillions of dollars of unfunded liability, while the second has led to untold increases in business costs and lost productivity.

On top of raising costs on businesses, the Roosevelt administration also was the source of white-hot anti-enterprise rhetoric. It is no wonder that private investment--and especially long-term investment--fell to extremely low levels during the 1930s, as business owners found themselves facing uncertain fates from a hostile government that was blaming them for the unemployment and the economic crisis.

Myth #5: *The U.S. entry into World War II actually ended the Great Depression in this country*.

Fact: As Robert Higgs so aptly noted, World War II did not end the economic hardships Americans faced. Although U.S. unemployment rates fell to record low levels during the war, rationing and shortages dominated economic life. People had money in their pockets, but few places to spend it, since virtually all investment was for war goods.

Furthermore, much of the drop in the nation's unemployment rate was due to the fact that millions of American men were conscripted into the armed forces. To put it mildly, while people had jobs and paychecks, they still were poor. War might have provided jobs, but it did not bring prosperity.

In modern times, many economists have declared that the U.S. economy is depre ssion depression-proof, since both Congress and the Federal Reserve stand ready to engage in the fraud of "monetary and fiscal" policies. Japan's sorry example of following the advice of both Keynesians and monetarists has demonstrated the total bankruptcy of such policies, but it seems that once an ideological position becomes a "fact"--no matter how much evidence exists that it is wrongheaded--nothing is permitted to stand in the way of those who wish to impose these policies upon others.

What makes the current situation so dicey is that, on top of all the other bad economic news, politicians of both political parties are leading a "race to the bottom" to see who can be the most outraged at business owners and executives. The Democrats have already announced that they are going to run their political platforms on anti-business themes, or at least on demands that businesses be regulated to death. Republicans, on the other hand, have touted their own "tough new laws" that are aimed at throwing as many executives in prison as the justice system can spare.

There is a way out of this current economic mess: Stop the government merry-go-round. As Rothbard writes in *America's Great Depression,* once the economic bust has begun, the burdens of government must be lifted. Malinvested resources must be permitted to be liquidated, government spending must be cut back, and the central bank must not try to "reflate" the currency. Within a short time, business owners and managers will make the necessary adjustments, and the economy will recover.

Unfortunately, like the politicians and intellectuals in the early 1930s, our present "leaders" are following the opposite path. One hopes that they will not repeat the horrible errors of Hoover and Roosevelt, but I must admit that I am pessimistic. In 1930, no one believed the economy would collapse; one hopes that today's optimists are as right as the optimists 70 years ago were wrong.

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[i] That the government of Japan has followed both easy money and high spending policies since 1992--all in a vain attempt to curb a decade-long recession--does not seem to register with mainstream economists. The Japanese "experiment" has been a total failure, leaving the Japanese now with even higher rates of employment and a large public debt.

[ii] Rothbard points out that one of Strong's goals was to prop up the overpriced British pound at its pre-World War I exchange rate with the U.S. dollar, something that could only be accomplished by inflating the dollar.

[iii] One of the criticisms of Rothbard's thesis that the Fed inflated the dollar during the 1920s is that the overall price level fell during that period. If one defines inflation as an increase in prices, then the criticism is valid. However, Austrian economists define inflation as a decrease in the value of money relative to the goods and services it produces. By expanding the money supply, the Fed ensured that prices were higher than they otherwise would have been had the monetary expansion not occurred. Thus, according to Austrians, any increase in the overall supply of money--and especially when that expansion occurs within the parameters of central banking--is what one calls inflation. Austrians say that rising prices occur as a result of inflation.

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