Great Myths of the Great Depression*

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Many volumes have been written about the Great Depression and its impact on the lives of millions of Americans. Historians, economists, and politicians have all combed the wreckage searching for the "black box" that will reveal the cause of this legendary tragedy. Sadly, all too many of them decide to abandon their search, finding it easier perhaps to circulate a host of false and harmful conclusions about the events of seven decades ago.

How bad was the Great Depression? Over the four years from 1929 to 1933, production at the nation's factories, mines, and utilities fell by more than half. People's real disposable incomes dropped 28 percent. Stock prices collapsed to one-tenth of their pre-crash height. The number of unemployed Americans rose from 1.6 million in 1929 to 12.8 million in 1933. One of every four workers was out of a job at the Depression's nadir, and ugly rumors of revolt simmered for the first time since the Civil War.

Old myths never die; they just keep showing up in college economics and political science textbooks. Students today are frequently taught that unfettered free enterprise collapsed of its own weight in 1929, paving the way for a decade-long economic depression full of hardship and misery. President Herbert Hoover is presented as an advocate of "hands-off", or laissez-faire, economic policy, while his successor, Franklin Roosevelt, is the economic savior whose policies brought us recovery. This popular account of the Depression belongs in a book of fairy tales and not in a serious discussion of economic history, as a review of the facts demonstrates.

The Great, Great, Great, Great Depression

To properly understand the events of the time, it is appropriate to view the Great Depression as not one, but four consecutive depressions rolled into one. Professor Hans Sennholz has labeled these four "phases" as follows: the business cycle; the disintegration of the world economy; the New Deal; and the Wagner Act.1

The first phase explains why the crash of 1929 happened in the first place; the other three show how government intervention kept the economy in a stupor for over a decade.

Phase I: The Business Cycle

The Great Depression was not the country's first depression, though it proved to be the longest. The common thread woven through the several earlier debacles was disastrous manipulation of the money supply by government. For various reasons, government policies were adopted that ballooned the quantity of money and credit A boom resulted, followed later by a painful day of reckoning. None of America's depressions prior to 1929, however, lasted more than four years and most of them were over in two. The Great Depression lasted for a dozen years because the government compounded its monetary errors with a series of harmful interventions.

Most monetary economists, particularly those of the “Austrian school”, have observed the close relationship between money supply and economic activity. When government inflates the money and credit supply, interest rates at first fall.

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1. Hans F. Sennholz, "The Great Depression". The Freeman, April 1975, p. 205

Businesses invest this "easy money" in new production projects and a boom takes place in capital goods. As the boom matures, business costs rise, interest rates readjust upward, and profits are squeezed. The easy-money effects thus wear off and the monetary authorities, fearing price inflation, slow the growth of or even contract the money supply. In either case, the manipulation is enough to knock out the shaky supports from underneath the economic house of cards.

One of the most thorough and meticulously documented accounts of the Fed's inflationary actions prior to 1929 is America's Great Depression by the late Murray Rothbard. Using a broad measure that includes currency, demand and time deposits, and other ingredients, Rothbard estimated that the Federal Reserve expanded the money supply by more than 60 percent from mid-1921 to mid-1929.1 The flood of easy money drove interest rates down, pushed the stock market to dizzy heights, and gave birth to the "Roaring Twenties".

By early 1929, the Federal Reserve was taking the punch away from the party. It choked off the money supply, raised interest rates, and for the next three years presided over a money supply that shrank by 30 percent. This deflation following the inflation wrenched the economy from tremendous boom to colossal bust.

The "smart" money -the Bernard Baruchs and the Joseph Kennedys who watched things like money supply- saw that the party was ending before most other Americans did. Baruch actually began selling stocks and buying bonds and gold as early as 1928; Kennedy did likewise, commenting, "only a fool holds out for the top dollar".[3]

When the masses of investors eventually sensed the change in Fed policy, the stampede was under-way. The stock market, after nearly two months of moderate decline, plunged on "Black Thursday" -october 24, 1929- as the pessimistic view of large and knowledgeable investors spread.
The stock market crash was only a symptom -not the cause- of the Great Depression: the market rose and fell in near synchronization with what the Fed was doing.

Phase II: Disintegration of the World Economy

If this crash had been like previous ones, the subsequent hard times might have ended in a year or two. But unprecedented political bungling in-stead prolonged the misery for twelve long years.

Unemployment in 1930 averaged a mildly recessionary 8.9 percent, up from 3.2 percent in 1929. It shot up rapidly until peaking out at more than 25 percent in 1933. Until March 1933, these were the years of President Herbert Hoover-the man that anti-capitalists depict as a champion of noninterventionist, laissez-faire economics.

Did Hoover really subscribe to a "hands off the economy", free-market philosophy? His opponent in the 1932 elections, Franklin Roosevelt, didn't think so. During the campaign, Roosevelt blasted Hoover for spending and taxing too much, boosting the national debt, choking off trade, and put-ting millions of people on the dole. He accused the president of "reckless and extravagant" spending, of thinking, "that we ought to center control of everything in Washington as rapidly as possible", and of presiding over "the greatest spending ad-ministration in peacetime in all of history". Roosevelt's running mate, John Nance Garner, charged that Hoover was "leading the country down the path of socialism".4 Contrary to the modern myth about Hoover, Roosevelt and Garner were absolutely right.

The crowning folly of the Hoover administration was the Smoot-Hawley Tariff, passed in June 1930. It came on top of the Fordney-McCumber Tariff of 1922, which had already put American agriculture in a tailspin during the preceding decade. The most protectionist legislation in U.S. history, Smoot-Hawley virtually closed the borders to foreign goods and ignited a vicious international trade war. Professor Barry Poulson notes that not only were 887 tariffs sharply increased, but the act broadened the list of dutiable commodities to 3,218 items as well. [5]

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3. Lindley H. Clark, Jr., "After the Fall", Wall Street Journal, October 26, 1979, p. 18.

4. "FDR's Disputed Legacy", Time, February 1, 1982, p. 23.

5. Barry W. Poulson, *Economic History of the United States* (New York: Macmillan Publishing Co., Inc., 1981), p. 508

Officials in the administration and in Congress believed that raising trade barriers would force Americans to buy more goods made at home, which would solve the nagging unemployment problem. They ignored an important principle of international commerce: trade is ultimately a two-way street; if foreigners cannot sell their goods here, then they cannot earn the dollars they need to buy here.

Foreign companies and their workers were flattened by Smoot-Hawley's steep tariff rates, and foreign governments soon retaliated with trade barriers of their own. With their ability to sell in the American market severely hampered, they cur-tailed their purchases of American goods. American agriculture was particularly hard hit. With a stroke of the presidential pen, farmers in this country lost nearly a third of their markets. Farm prices plummeted and tens of thousands of farmers went bankrupt. With the collapse of agriculture, rural banks failed in record numbers, dragging down hundreds of thousands of their customers.

Hoover dramatically increased government spending for subsidy and relief schemes. In the space of one year alone, from 1930 to 1931, the federal government's share of GNP increased by about one-third.

Hoover's agricultural bureaucracy doled out hundreds of millions of dollars to wheat and cot-ton farmers even as the new tariffs wiped out their markets. His Reconstruction Finance Corporation ladled out billions more in business subsidies. Commenting decades later on Hoover's administration, Rexford Guy Tugwell, one of the architects of Franklin Roosevelt's policies of the 1930s, explained, "We didn't admit it at the time, but practically the whole New Deal was extrapolated from programs that Hoover started". [6]

To compound the folly of high tariffs and huge subsidies, Congress then passed and Hoover signed the Revenue Act of 1932. It doubled the income tax for most Americans; the top bracket more than doubled, going from 24 percent to 63 percent.

6. Paul Johnson, *A History of the American People* (New York: HarperCollins Publishers,, 1977), p. 741.

Exemptions were lowered; the earned income credit was abolished; corporate and estate taxes were raised; new gift, gasoline, and auto taxes were imposed; and postal rates were sharply hiked.

Can any serious scholar observe the Hoover administration's massive economic intervention and, with a straight face, pronounce the inevitably deleterious effects as the fault of free markets?

Phase III: The New Deal

Franklin Delano Roosevelt won the 1932 presidential election in a landslide, collecting 472 electoral votes to just 59 for the incumbent Herbert Hoover. The platform of the Democratic Party whose ticket Roosevelt headed declared, "We believe that a party platform is a covenant with the people to be faithfully kept by the party entrusted with power". It called for a 25 percent reduction in federal spending, a balanced federal budget, a sound gold currency "to be preserved at all hazards", and the removal of government from areas that belonged more appropriately to private enterprise, and an end to the "extravagance" of Hoover's farm programs. This is what candidate Roosevelt promised, but it bears no resemblance to what President Roosevelt actually delivered.

In the first year of the New Deal, Roosevelt proposed spending $10 billion while revenues were only $3 billion. Between 1933 and 1936, government expenditures rose by more than 83 percent. Federal debt skyrocketed by 73 percent.

Roosevelt secured passage of the Agricultural Adjustment Act (AAA), which levied a new tax on agricultural processors and used the revenue supervise the wholesale destruction of valuable crops and cattle. Federal agents oversaw the ugly spectacle of perfectly good fields of cotton, wheat and corn being plowed under. Healthy cattle, sheep, and pigs by the millions were slaughtered and buried in mass graves.

Even if the AAA had helped farmers by curtailing supplies and raising prices, it could have done so only by hurting millions of others who had to pay those prices or make do with less to eat.

Perhaps the most radical aspect of the New Deal was the National Industrial Recovery Act (NIRA), passed in June 1933, which set up the National Recovery Administration (NRA). Under the NIRA, most manufacturing industries were suddenly forced into government-mandated cartels. Codes that regulated prices and terms of sale briefly transformed much of the American economy into a fascist-style arrangement, while the NRA was financed by new taxes on the very industries it controlled. Some economists have estimated that the NRA boosted the cost of doing business by an average of 40 percent-not something a depressed economy needed for recovery.

Like Hoover before him, Roosevelt signed into law steep income tax rate increases for the high brackets and introduced a 5 percent withholding tax on corporate dividends. In fact, tax hikes be-came a favorite policy of the president's for the next ten years, culminating in a top income tax rate of 94 percent during the last year of World War II. His alphabet agency commissars spent the public's tax money like it was so much bilge.

For example, Roosevelt's public relief programs hired actors to give free shows and librarians to catalogue archives. The New Deal even paid re-searchers to study the history of the safety pin, hired 100 Washington workers to patrol the streets with balloons to frighten starlings away from public buildings, and put men on the public payroll to chase tumbleweeds on windy days.

Roosevelt created the Civil Works Administration in November 1933 and ended it in March 1934, though the unfinished projects were transferred to the Federal Emergency Relief Administration. Roosevelt had assured Congress in his State of the Union message that any new such program would be abolished within a year. "The federal government", said the President, "must and shall quit this business of relief. I am not willing that the vitality of our people be further stopped by the giving of cash, of market baskets, of a few bits of weekly work cutting grass, raking leaves, or picking up papers in the public parks".

But in 1935 the Works Progress Administration carne along. It is known today as the very government program that gave rise to the new term, "boondoggle" because it "produced" a lot more than the 77,000 bridges and 116,000 buildings to which its advocates loved to point as evidence of its efficacy[7]. The stupefying roster of wasteful spending generated by these jobs programs represented a diversion of valuable resources to politically motivated and economically counterproductive purposes.

The American economy was soon relieved of the burden of some of the New Deal's excesses when the Supreme Court outlawed the NRA in 1935 and the AAA in 1936, earning Roosevelt's eternal wrath and derision. Recognizing much of what Roosevelt did as unconstitutional, the "nine old men" of the Court also threw out other, minor acts and programs, which hindered recovery.

Freed from the worst of the New Deal, the economy showed some signs of life. Unemployment dropped to 18 percent in 1935, 14 percent in 1936, and even lower in 1937. But by 1938, it was back up to 20 percent as the economy slumped again. The stock market crashed nearly 50 percent between August 1937 and March 1938. The "economic stimulus" of Franklin Roosevelt's New Deal had achieved a real "first": a depression within a depression!

Phase IV: The Wagner Act

The stage was set for the 1937-38 collapse with the passage of the National Labor. Relations Act in 1935-better known as the Wagner Act and organized labor's "Magna Carta". To quote Hans Sennholz again:

> This law revolutionized American labor relations. It took labor disputes out of the courts of law and brought them under a newly created Federal agency, the National Labor Relations Board, which became prosecutor, judge, and jury, all in one. Labor union sympathizers on the Board further perverted this law, which already afforded legal immunities and privileges to labor unions. The U.S. thereby abandoned a great achievement of Western civilization, equality under the law. [8]

7. Martin Morse Wooster, "Bring Back the WPA? It Also Had A Seamy Side", *Wall Street Journal,* September 3, 1986, p. A26.
8. Sennholz, pp. 212-13.

Armed with these sweeping new powers, labor unions went on a militant organizing frenzy. Threats, boycotts, strikes, seizures of plants, and widespread violence pushed productivity down sharply and unemployment up dramatically. Membership in the nation's labor unions soared; by 1941, there were two and a half times as many Americans in unions as in 1935.

From the White House on the heels of the Wagner Act carne a thunderous barrage of insults against business. Businessmen, Roosevelt fumed, were obstacles on the road to recovery. New strictures on the stock market were imposed. A tax on corporate retained earnings, called the "undistributed profits tax", was levied. "These soak-the-rich efforts", writes economist Robert Higgs, "left little doubt that the president and his administration intended to push through Congress everything they could to extract wealth from the high-income earners responsible for making the bulk of the nation's decisions about private investment".[9]

Higgs draws a close connection between the level of private investment and the course of the American economy in the 1930s. The relentless assaults of the Roosevelt administration -in both word and deed- against business, property, and free enterprise guaranteed that the capital needed to jumpstart the economy was either taxed away or forced into hiding. When Roosevelt took America to war in 1941, he eased up on his antibusiness agenda, but a great deal of the nation's capital was diverted into the war effort instead of into plant expansion or consumer goods. Not until both Roosevelt and the war were gone did investors feel confident enough to "set in motion the postwar investment boom that powered the economy's return to sustained prosperity".[10]

9. Robert Higgs, "Regime Uncertainty: Why the Great Depression Lasted So Long and Why Prosperity Resumed After the War", The independent Review, Spring 1977, p. 573.

10. Ibid., p. 564.

Whither Free Enterprise?

On the eve of America's entry into World War II and twelve years after the stock market crash of Black Thursday, ten million Americans were jobless. Roosevelt had pledged in 1932 to end the crisis, but it persisted two presidential terms and countless interventions later.

Along with the horror of World War II came a revival of trade with American's allies. The war's destruction of people and resources did not help the U.S. economy, but this renewed trade did. More important, the Truman administration that followed Roosevelt was decidedly less eager to berate and bludgeon private investors, and as a result, those investors carne back into the economy to fuel a powerful postwar boom.

The genesis of the Great Depression lay in the inflationary monetary policies of the U.S. government in the 1920s. It was prolonged and exacerbated by a litany of political missteps: trade-crushing tariffs, incentive -sapping taxes, mind-numbing controls on production and competition, senseless destruction of crops and cattle, and coercive labor laws, to recount just a few. It was not the free market that produced twelve years of agony; rather, it was political bungling on a scale as grand as there ever was.