

# Myths and Facts About the Great Depression

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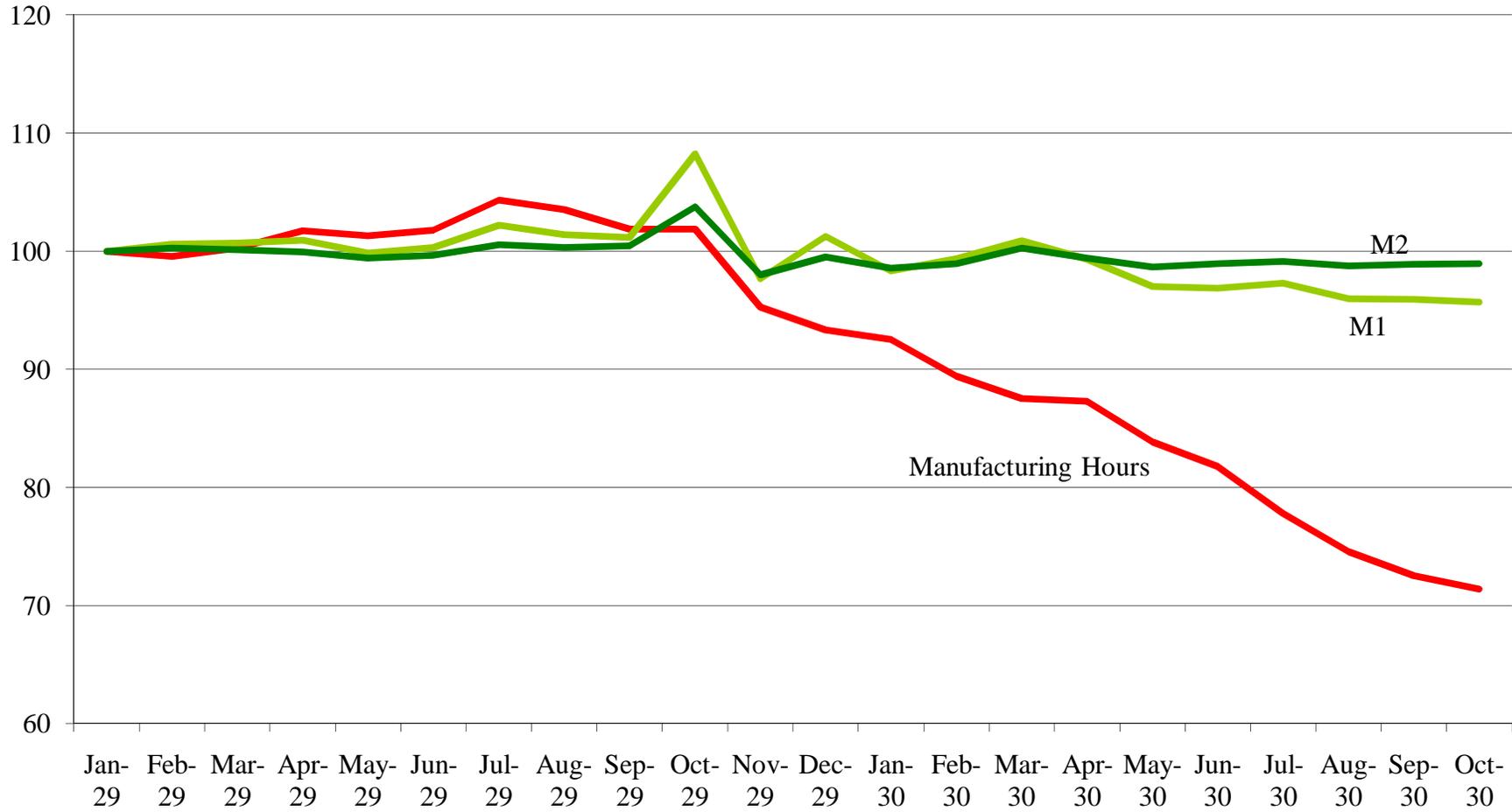
## Textbook View of Great Depression

- Depression began as "garden variety recession"
- Fed policy & banking panics turned it into the Great Depression
- 1/3 of banks exited
- Hoover was a "Laissez-Faire" president
- Recovery due to FDR's policies that restored employment

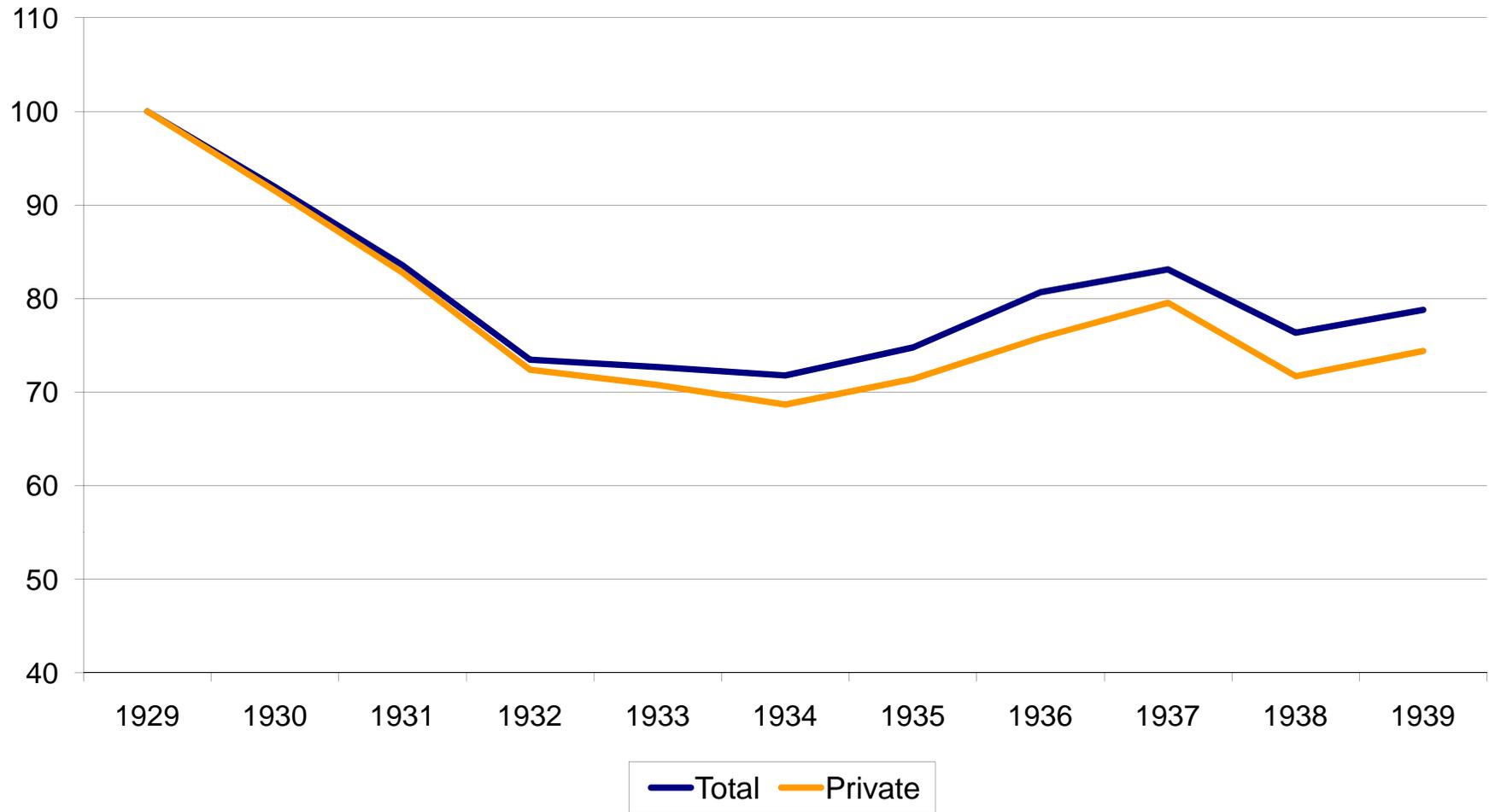
## Myths and Facts

- Depression began as "garden variety recession"
- Fed policy and banking panics made it the Great Depression
  - *No. Depression immediately severe - before panics and money supply decline*
- 1/3 of banks exited
  - *Deposits in failed banks less than 1 percent per year of total deposits*
- After 1933, strong recovery from FDR's policies that restored employment
  - *In 1939, Output and employment more than 20 percent below normal*

Figure 1 - Manufacturing Hours and the Money Supply  
Index (Jan 1929=100)



## Hours Worked Per Capita 1929-39 (1929 = 100)



## What Caused Depression, Why Was Recovery Weak, What was Fed's Role?

- Cartel policies forced wages and prices above normal levels → Depression
- Interfered with normal process of supply and demand
- Accounts for:
  - Why Depression was "one off" event
  - Why monetary contraction was so damaging
  - Why farm sector employment did not fall
  - Why employment didn't recover
- Hoover started policies to foster cartels - FDR doubled-down
  - *Hoover - ".fix the economic wrongs that spring up under the pressure of competition"*
  - *FDR - "A builder of more plants... an organizer of more corporations, will do as much harm as good"*

# Hoover & FDR Believed Market Economy Didn't Work Well

- Both firmly believed competition in markets depressed economy
  - Hoover - *"fix the economic wrongs that spring up under the pressure of competition"*
  - FDR - *"A builder of more plants... an organizer of more corporations, will do as much harm as good"*
- Both believed that artificially raising prices and wages would restore prosperity
- "Higher wages meant workers could buy more, and higher prices meant higher profits"

## Deflation Doesn't Always = Depression

- Deflation of early 1920s more severe than Great Depression
  - 18% deflation in 1921, 7% deflation in 1922
  - GDP fell 3.5 percent in 1921, then rose in 1922
- Private spending increased
- Recession due to lower gov't purchases - end of WWI spending

# Hoover

- Met with CEOs, told them to maintain/raise wages and share work among employees
- Hoover would keep unions at bay - 1928 Supreme Court landmark decision changed labor relations
- Industry agreed - Henry Ford held press conference to advertise he raised wages
- First wholesale episode of government telling business what to do

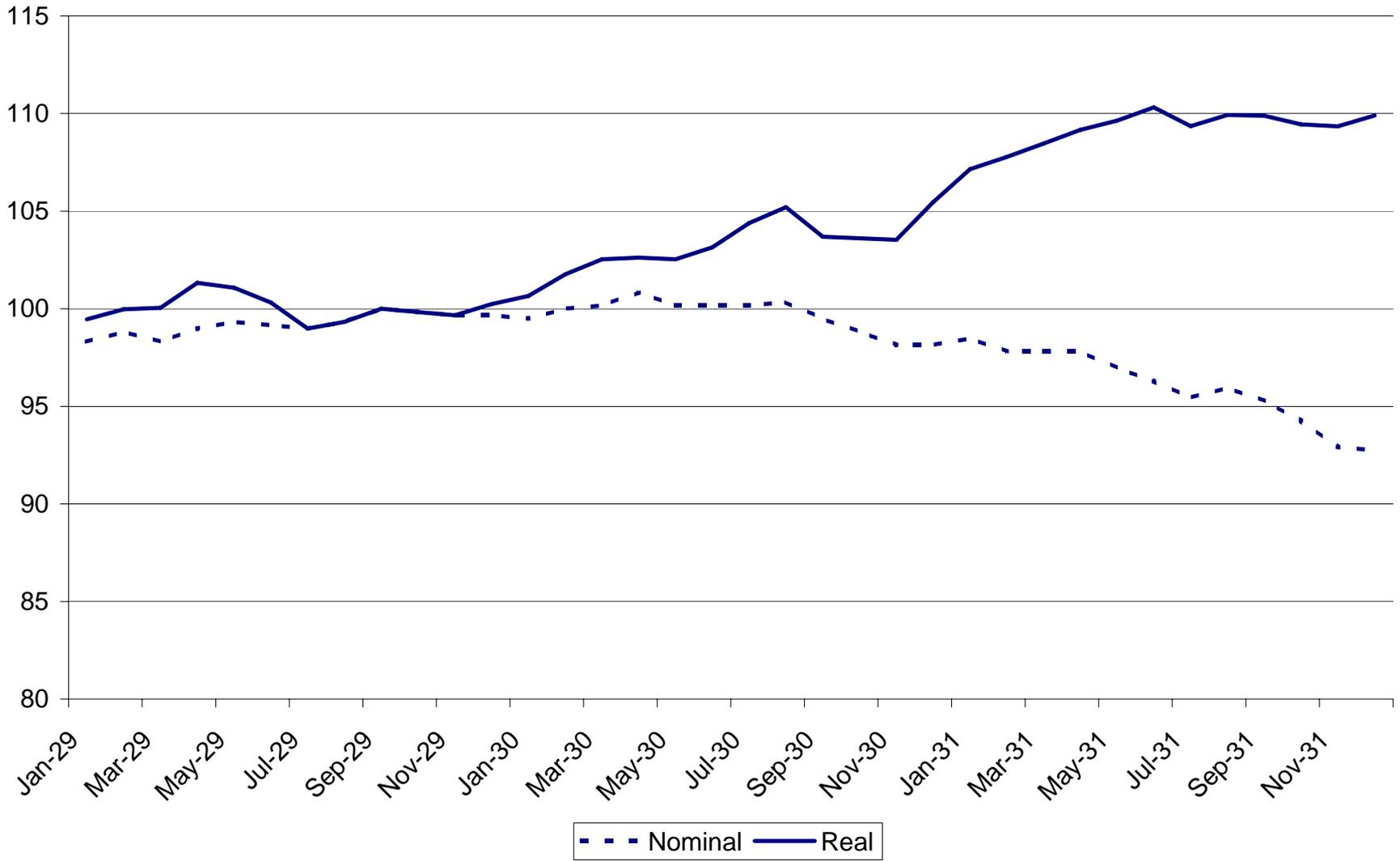
## Consequences of Hoover's Policy

- Labor costs rose substantially as productivity fell and wages were fixed
- Industry asked Hoover to allow wage cuts proportional to deflation
- Hoover declined: "There will be hell to pay with Unions"
- People wanted to work, but couldn't - wages didn't fall
- *Situation Wanted Ads* - people willing to work for 30 percent less than wages paid
- Farm sector not impacted by Hoover policy - employment didn't fall - wages did

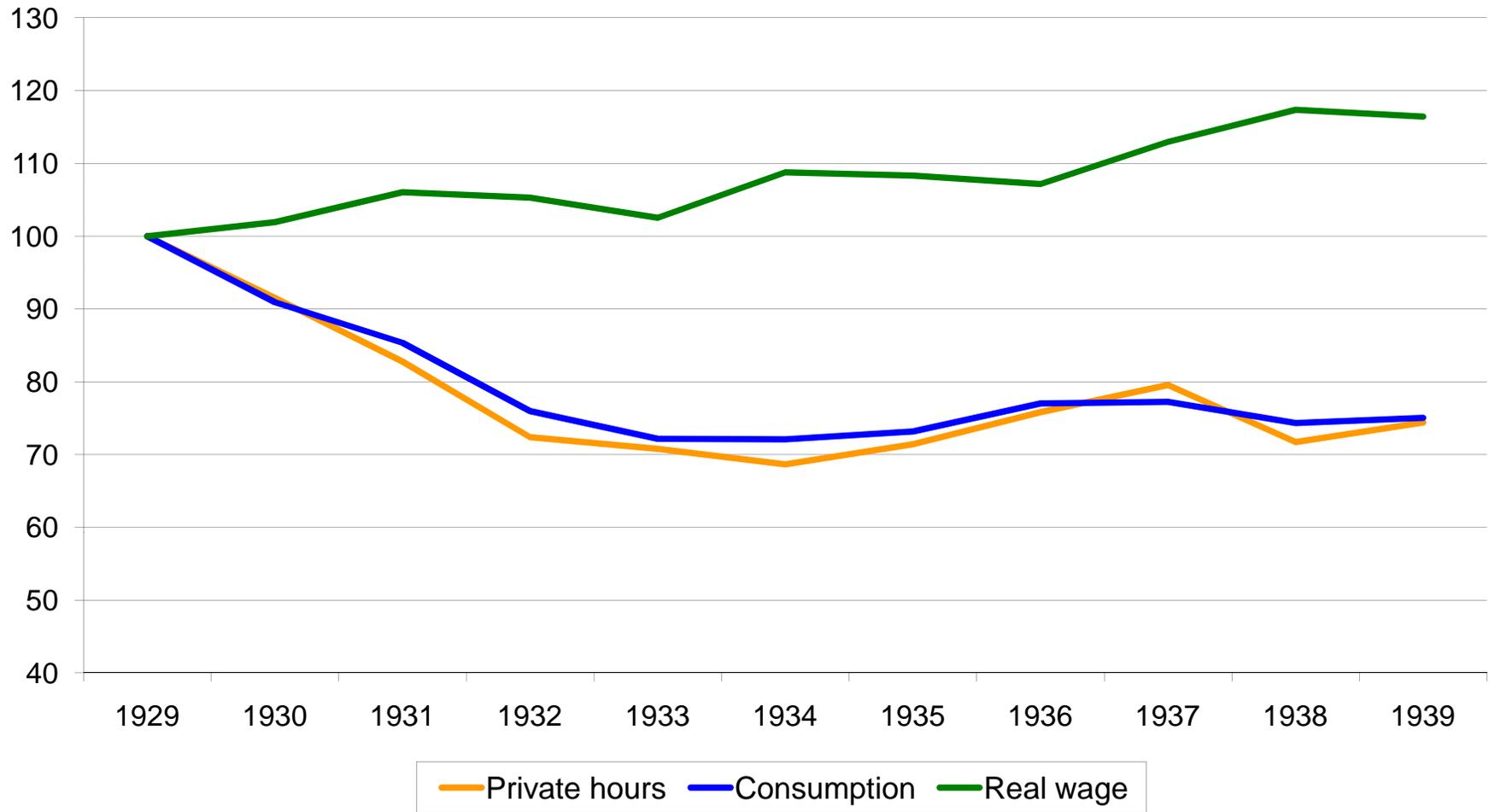
## FDR

- National Industrial Recovery Act - full-scale cartelization of US industry
- Industry collusion provided that they raised wages substantially
- "Codes of Fair Competition" - permitted minimum prices, output restrictions
- Result: wages and industry prices 20 percent above full employment levels
- Depressed employment by 15 percent
- Economy would have recovered to trend by 1937 in absence of cartel policies

**Figure 3 - Manufacturing Wages**  
(Sept 1929 = 100)



**Per Capita Hours and Consumption, and Real Wage 1929-39**  
(1929 = 100)



## Very Different View of Depression

- Depression one-off decade-long event because of wholesale cartel policies
- Fed could have limited damage from Hoover by preventing deflation
- But couldn't have done much to offset FDR policies
- Capitalism wasn't broken...
- Interference with market mechanisms depressed the economy