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Lessons from the New Deal: Did the New Deal Prolong or Worsen the Great Depression?

by

Greg Hannsgen and **Dimitri B. Papadimitriou**
The Levy Economics Institute of Bard College

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GREG HANNSGEN is a research scholar at the Levy Economics Institute. President DIMITRI B. PAPADIMITRIOU is executive vice president and Jerome Levy Professor of Economics at Bard College.

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The Levy Economics Institute
P.O. Box 5000
Annandale-on-Hudson, NY 12504-5000
http://www.levy.org

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ABSTRACT

Since the current recession began in December 2007, New Deal legislation and its effectiveness have been at the center of a lively debate in Washington. This paper emphasizes some key facts about two kinds of policy that were important during the Great Depression and have since become the focus of criticism by *new* New Deal critics: (1) regulatory and labor relations legislation, and (2) government spending and taxation. We argue that initiatives in these policy areas probably did not slow economic growth or worsen the unemployment problem from 1933 to 1939, as claimed by a number of economists in academic papers, in the popular press, and elsewhere. To substantiate our case, we cite some important economic benefits of New Deal–era laws in the two controversial policy areas noted above. In fact, we suggest that the New Deal provided effective medicine for the Depression, though fiscal policy was not sufficiently countercyclical to conquer mass unemployment and prevent the recession of 1937–38; 1933's National Industrial Recovery Act was badly flawed and poorly administered, and the help provided by the National Labor Relations Act of 1935 came too late to have a big effect on the recovery.

Keywords: New Deal; Public Works Projects; NIRA; NLRA; Cartelization; Unions; Labor Relations Policy; Fiscal Policy; Fiscal Stimulus; Unemployment; Great Depression

JEL Classifications: E200, E620, J580, L430, N120

I. THE NEED FOR A NEW LOOK AT THE NEW DEAL

As the nation watches the impact of the recent stimulus bill on job creation and economic growth, a group of many academics has disputed the notion that the fiscal, job-creation, regulatory, and labor-relations programs of the New Deal helped end the Depression. The work of these revisionist scholars has led to a debate in newspapers, magazines, and think-tank conferences. Indirectly at stake in this fracas are the prospects for needed anti-recession measures such as a new stimulus bill, one that emphasizes jobs for the 9.7 percent of the workforce that is currently unemployed, and more ambitious and permanent programs like national health care. Hence, this article looks at some of the most important claims made by the New Deal critics of the past 20 years. In a short article, we obviously cannot do justice to the academic literature on this subject, though we provide some references to this work. Our purpose is to respond to echoes of some academic work that are currently resonating in public forums (e.g., Barro 2009; Ohanian 2009a; Reynolds 2009).

II. THE GREAT DEPRESSION AND ROOSEVELT'S POLICY RESPONSE

When Roosevelt took office, the country's economic outlook was dismal. The unemployment rate had reached 25 percent. Modern economist Nancy E. Rose describes the dire conditions of the 1930s:

> The unemployed are selling apples on street corners to make a few pennies or standing in line at soup kitchens, while food is rotting in the fields because the farmers cannot sell it for enough to make it worth harvesting. Houses are boarded up and farms foreclosed as the owners fail to meet their mortgage payments, and apartments are scarce since people have no money for rent. The growing numbers of homeless are building ramshackle temporary housing out of cardboard and wood on the outskirts of cities across the country. Panicked depositors are withdrawing their money from banks, which are failing one after the other, while barter is replacing cash transactions. Rising unemployment and falling incomes are leading to declining tax revenues, and in many towns teachers are out of work and children are out of school. (Rose 1994: 16–17)

It is hard to imagine any program that could have quickly and inexpensively solved these problems. On the other hand, the period from the Great Crash in 1929 to the beginning of Roosevelt's first term in 1933 offered little evidence that the economy could recover on its own, a hope even now held out by many economists, businessmen, and others. Economic historian Peter Temin (1976: 138–168) of MIT has presented a particularly convincing account of the failure of the economy to recover spontaneously in the early 1930s and of the strong economic headwinds faced by the newly elected Roosevelt and Congress in 1933.

Until recently, the legislation that followed was widely seen as benign and innovative, though of varying potency. As recently as 1980, Michael M. Weinstein stated that "most of the those who have considered the macroeconomic impacts of the [National Industrial Recovery Act (NIRA) of 1933] codes have either dismissed their importance or considered them to have been weakly salutary" (1980: 267). Most discussion of policy aimed at ending the Depression revolved around fiscal and monetary policy.

This view has lately been challenged by a wave of revisionist research claiming to show that New Deal legislation slowed the recovery from the Depression in the period from 1933 to 1939. Amity Shlaes, in her controversial 2007 bestseller, *The Forgotten Man,* writes that rules written under NIRA "were so stringent that they perversely hurt businesses. They frightened away capital, and they discouraged employers from hiring workers" (2007: 8). Also, Shlaes blames continuing high unemployment in the mid- and late-1930s partly on strikes that were made possible by National Labor Relations Act (NLRA) (9). Moreover, she criticizes Roosevelt's spending programs for focusing on consumers to the detriment of producers and for their excessive orientation toward short-term economic gains (11). After describing a number of other supposedly harmful programs, Shlaes states that "government intervention helped to make the Depression Great" (9), a claim that she repeated in *Forbes* and *Time* this year (Shlaes 2009a and 2009b).

Many of these arguments have been aired in recent hearings held by the Economic Policy Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs (Romer 2009; Galbraith 2009; DeLong 2009b; Winkler 2009; Ohanian

2009b). In March, the New Deal came under fire at a symposium at the Council on Foreign Relations in New York (Council on Foreign Relations). Even at a Hyde Park, NY exhibit in honor of 75th anniversary of the "first 100 days" of Roosevelt's presidency, the revisionists' theories about NIRA were mentioned. Eric Rauchway (2008b) and Benjamin Friedman (2007) helpfully argued in defense of NIRA, NLRA, and the rest of the New Deal in articles in *The American Prospect* and *The New York Review of Books*. Of course, the participants in this fracas have cited technical economics articles on this subject.

III. NIRA AND THE NLRA: UNLIKELY CULPRITS

Some of the articles about the purported effects of anti-competitive New Deal legislation on the speed of the economic rebound include Cole and Ohanian (1999); Prescott (1999); Bordo, Erceg, and Evans (2000); Chari, Kehoe, and McGrattan (2002); and Cole and Ohanian (2004). Ohanian has argued in *Forbes* that "the Depression lasted far longer than it should have," and that "government policies that restricted competition" such as NIRA and NLRA appear to be the "main culprit" (Ohanian 2009d: 1; Ohanian 2009a). We next consider Shlaes's and Cole and Ohanian's claim that NIRA and NLRA were important drag on economic performance from 1933 until 1939.

A. The Intent behind the Bills

When he sent the recovery bill to Congress, Roosevelt stated its goals: "to obtain wide re-employment, to shorten the workweek, to pay a decent wage for the shorter week, and to prevent unfair competition and disastrous overproduction" (Roos 1971: 41). The bill included some public works projects, but critics have focused on Title I, which provided for the drafting of industrial codes. The president was authorized to "approve codes drawn up by trade or industrial groups providing that he found such codes to be equitable, truly representative, and not designed to promote monopolistic practices. He might also make any necessary additions or deletions; and in an industry where no agreement could be reached, he might impose a code" (Hawley 1966: 31–32). Hawley explains that the bill

> said little about the type of provisions that should be included in the codes. The only specific instructions, in fact, were those dealing with labor standards. Each code, according to Section 7, had to contain an acceptable provision for maximum hours, minimum wages, and desirable working conditions. In addition, it had to include a prescribed Section 7a, which outlawed yellow dog contracts [which forbid workers who sign them from joining unions] and guaranteed the right of laborers to organize and bargain collectively though representatives of their own choosing. Aside from these labor clauses, the only other guide was the declaration of policy contained in Section 1, a declaration that was couched in terms of broad, general goals rather than specific instructions. The act, it stated, was designed to promote cooperative action, eliminate unfair practices, increase purchasing power, expand production, reduce unemployment, and conserve natural resources; but there was little to indicate the type of code provisions that might be used to achieve these laudable objectives. (Hawley 1966: 32)

The critics of NIRA have found fault with the law because it had the effect of allowing firms to work together to set prices, which, according to economic theory, would result in lower output. This belief might seem unjustified in light of the fact that while the law prohibited codes that permitted collusion, another clause exempted the new codes from the antitrust laws, one of many contradictory parts (Bellush 1975: 29). Many historians and economists believe that in practice the bill increased the monopoly power of large firms. The New Deal critics also fault NIRA's minimum wage and collective bargaining provisions on the grounds that they increased wages above competitive levels, reducing employment.

A look at the economic thought of the time may explain what led politicians, in the midst of the Depression, to support measures that most economists now regard as anti-growth. First, at the time, many economists and others believed that the root cause of the Depression was overproduction (Wolfskill 1969: 62–63; Weinstein 1980: 3). As the quote at the beginning of this section suggests, Roosevelt was also concerned about overproduction at the time the bill was sent to Congress. As many policymakers of the time saw it, the modern economy produced more goods than consumers were able to purchase, leading to "cutthroat competition." As a result, prices were falling, and firms were drastically cutting wages and payrolls in an effort to stay in business. The new codes would deal with this situation by preventing sales at below cost and other unfair

trade practices (Wolfskill 1969: 62–63; Weinstein 1980: 3). Some businessmen and trade associations foresaw an opportunity to set explicit limits on output. Also, the bill would shorten workweeks so as to spread work hours among more workers and boost the purchasing power of workers by raising wages. While NIRA was designed to speed recovery, as its title suggests, the portion of the bill calling for industrial codes was not envisioned by NIRA's supporters mainly as a stimulus to economic growth. Moreover, the bill, like many other parts of the New Deal, was intended to address social issues, such as child labor and exploitative employment, not just to fight the Depression. Surely, these too are laudable objectives.

The administration and others also had in mind the idea that the U.S. economy had reached a "mature" phase in which significant, sustained growth was no longer possible, and other policy objectives became more relevant (Wolfskill 1969: 62–63). This view led Roosevelt in 1932 to describe the role of government in a depressed economy much differently than modern economists:

> Clearly, all this calls for a reappraisal of values. A mere builder of more industrial plants, a creator of more railroad systems, an organizer of more corporations, is as likely to be a danger as a help….Our task is not discovery, or exploitation of natural resources, or necessarily producing more goods. It is the soberer, less dramatic business of administering resources and plants already in hand, of seeking to reestablish foreign markets for our surplus production, of meeting the problem of underconsumption, of adjusting production to consumption, of distributing wealth and products more equitably, of adapting existing economic organizations to the service of the people. (Roosevelt, quoted in Kennedy [1999: 373])

B. The Cartelization Hypothesis and the Great Depression

The economists who regard NIRA and NLRA as significant hindrances to recovery have a much different view of the performance of an unfettered capitalist economy. Edward Prescott, for example, has very optimistic beliefs about what happens when an economy is not burdened by laws such as NIRA:

> The capitalistic economy is stable, and absent some change in technology or the rules of the economic game, the economy converges to a constant growth path with the standard of living doubling every 40 years. (Prescott 1999: 28)

The economists who have recently attempted to calculate the effects of NIRA and NLRA use models that predict this kind of consistent and rapid economic growth for an unregulated economy. NIRA and other government programs, they say, constitute changes in the rules of the economic game and are one reason why the economy's performance fell short of their usual model's predictions during the recovery from the Depression (Prescott 1999: 28).

The academic articles cited in the introduction argue that NIRA and/or NLRA impeded economic recovery in a number of different ways. Our analysis addresses the *cartelization* hypothesis, which is considered in academic work by Cole and Ohanian (2004) and popularized in Congressional testimony and magazine articles by Ohanian (2009a, 2009b, 2009c, and 2009d). The term cartelization arises because economists often think of the industry groups and unions formed under NIRA and NLRA as cartels. Some of the arguments below would apply with equal force to other critiques of NIRA and NLRA.

Cole and Ohanian (2004: 779–781) begin by describing what they regard as a subpar recovery after the economic collapse of 1929–33. Despite some favorable "shocks" to the money supply, productivity, and the banking system, real GDP per adult was still 27 percent below trend in 1939. The total number of hours worked by U.S. workers was also well below trend as late as 1939. Cole and Ohanian find, using a standard macroeconomic model, that, in the absence of some interference with the "competitive" economic system, output and employment would have returned to trend by the late 1930s.

Some economists have taken exception to the claim that recovery proceeded slowly between 1933 and 1937. Friedman (2007) has called into question Shlaes's statements to this effect. Romer notes that "between 1933 and 1937 real GNP in the United States grew at an average rate of over 8 percent per year; between 1938 and 1941 it grew over 10 percent per year. These rates of growth are spectacular, even for an economy pulling out of a severe recession" (1992: 757).

Cole and Ohanian do not agree with this last claim. Their paper is devoted to an exercise to see if a model with cartels can account for the gap between actual growth and employment and the predictions of their competitive model. The model is intended to capture certain key effects of NIRA and NLRA: a suspension of the antitrust laws that permitted collusion (essentially cooperation among firms aimed at maintaining high prices) in many industries; and provisions that promoted collective bargaining, which allegedly caused unemployment by raising wages in some industries above competitive levels. Cole and Ohanian (2004: 781) find that "cartelization policies" account for about 60 percent of the gap between actual and potential GDP.

Models broadly similar to Cole and Ohanian's are now the norm in mainstream academic macroeconomics and they have shortcomings, but a detailed analysis is beyond the scope of this article. Lately, however, they have been faulted by some economists for their apparent failure to meet the challenge of the current crisis (Buiter 2009; De Grauwe 2009). One defect of this particular model is a lack of involuntary unemployment. The "unemployed" workers in the model are merely searching for jobs that pay more than positions in the competitive sector, which are readily available—a scenario not corroborated by contemporary observers (Terkel 1970). From this point forward, our evaluation of the case against NIRA and the NLRA addresses the present-day implications of cartelization hypothesis, the applicability of Cole and Ohanian's model to the Depression era, and some aspects of the New Deal neglected by the critics. In other words, we challenge a key historical claim of the revisionists, one that is not necessarily tied to any particular modeling methodology.

C. Does the Cartelization Hypothesis Account for the Length and Depth of the Depression?

The cartelization hypothesis, as advanced by Cole and Ohanian, depends on the claim that in the absence of NIRA and NLRA, perfect competition would have prevailed in all markets, while instead these laws strengthened the monopoly power of firms and resulted in an increase in the number of workers represented by unions. Also, the article relies on the theory that these effects could be expected to reduce economic growth. This section addresses how well the critics' story fits the political and institutional facts of the period

following the passage of NIRA. First, it discusses the product-market aspects of NIRA, and then it deals with the putative labor-market effects of NIRA and NLRA. Readers may be surprised at the somewhat unflattering picture of NIRA painted in what follows, but acknowledging certain flaws in the law and its execution will help show that it probably did not have the negative effects described by its critics, or hogtie business as Shlaes (2007: 151) implies.

Many historians believe that NIRA indeed allowed "the large corporations which dominated the code authorities [to use] their powers to stifle competition, cut back production, and reap profits from price-raising rather than business expansion" (Leuchtenberg 1963: 69). Cole and Ohanian measure such effects of NIRA against a baseline model with perfect competition. It is of course impossible to ascertain the counterfactual of whether industry would have been perfectly competitive in the relevant period if Roosevelt's legislation had not been signed into law. However, one way of making some inferences about what would have happened is to compare the 1930s with the 1920s. If monopoly power was already widespread in the 1920s, it would be unlikely that perfect competition would have existed in 1933–39 in the event that NIRA and NLRA had not been passed.

Indeed, some empirical studies at least raise the possibility that there was no significant decrease in competition in the 1930s, compared to 1900–30 (Stigler 1950: 46–59; Cox 1981: 181). As an example, in 1927, five years before Roosevelt's election, the U.S. Steel Corporation produced over 53 percent of the total U.S. output of steel rails. Its mines and factories accounted for more than 36 percent of the output of nine other major steel-related products (Chandler 1990: 138). Throughout the 1920s, large businesses, with the cooperation and help of the federal government, were forming "trade associations," which had the effect of diminishing competition. There was

> a rapid burgeoning of trade associations, a rationale that justified their anticompetitive activities, and a public policy under which such agencies as the Department of Commerce and the Federal Trade Commission helped these associations to standardize their products, expand their functions, and formulate codes of proper practices, codes that generally regarded a price cutter as a "chiseler" and price competition as immoral. (Hawley 1966: 10; see also Himmelberg [1976])

When the Depression began, cooperation among firms began to break down amid pressure to cut prices. Also, antitrust officials began to challenge many of the codes (Hawley 1966: 39). Business looked to the government to help shore up their system of collusion. The new NIRA codes were mostly initiated by existing trade associations and were "largely a direct offshoot of the trade-association system" (Bellush 1975: 44; see also Himmelberg [1976]). Hence, NIRA cannot be seen as a government imposition of cartels on a purely competitive system. This fact alone does not prejudice Cole and Ohanian's analysis of how the codes affected the economy, but it does mean that it is wrong to blame the codes and their anti-competitive impact solely on the New Deal.

In addition to the industrial cartels, Cole and Ohanian's model includes bargaining between industry and unions. This aspect of the model is meant to represent the effects of the section 7(a) of NIRA and NLRA, both of which sought to establish American workers' rights to join unions and bargain collectively. In essence, the paper uses the idea that unions act as "monopolies" for workers, raising wages and causing unemployment. They find that labor's newfound bargaining power accounts for a large portion of the negative effect of New Deal anti-competitive legislation on GDP. One example is a scenario in which output in the "cartel model" is 94 percent of output in a hypothetical competitive economy, but this figure would rise to 97 percent if labor's negotiating power was reduced to zero (Cole and Ohanian 2004: 805). Along similar lines, Shlaes (2007: 9) argues that excessive wages and strikes brought on by New Deal legislation increased unemployment.

However, while the New Deal collective-bargaining laws were a crucial step forward for the union movement in the United States, their immediate effect was rather weak, largely because the National Recovery Administration (NRA, the agency charged with implementing the codes) had a pro-business bias (Hawley 1966 ; Bellush 1975; Biles 1994: 83–102; Leuchtenberg 1963: 69–70). Less than 10 percent of the authorities that administered and enforced the codes had some labor representation (Bellush 1975: 47). Conkin reports that "many corporations evaded the labor codes (bargaining rights, wage-hour protection, prevention of child labor) required by Section 7(a) of the NIRA, either by establishing company unions or by deliberate refusals to recognize legitimate unions" (1975: 33). Bellush's (1975: 85–135) account of the effects of Section 7(a)

shows that business still had the upper hand in the fight with organized labor. Labor rights fell far short of the rules set forth in section 7(a), which mandated that workers have the right to organize and bargain collectively "free from the interference, restraint, or coercion" (Weinstein 1980: 19) of their employers.

Labor's fortunes did change somewhat in 1935 after the passage of NLRA and the Supreme Court's ruling that NIRA was unconstitutional. Cole and Ohanian state that "union membership rose from about 13 percent of employment in 1935 to about 29 percent of employment in 1939" (2004: 785). Labor won some crucial organizing victories soon after NLRA was signed into law in 1935 (Leuchtenberg 1963: 239–242). Conkin (1975: 62) points out that the new labor rights act proved far more effective than NIRA in providing protection for unions. Hence, Cole and Ohanian's assumption that union negotiating power was elevated by the New Deal is more plausible for the period from July 1935 to 1939 than for 1933 to July 1935. Nevertheless, even after 1935, the union movement advanced gradually and with strong opposition. As DeLong puts it, "NLRA came too late to be blamed for the Great Depression. The most you can do is blame it for the 1937–38 recession" (2009a:17). The latter claim probably founders on the much more logical explanation that fiscal policy tightened sharply before that recession, a proposition discussed below.

Cole and Ohanian clearly do not pretend to engage in a thorough evaluation of the social costs and benefits of unions. Instead, they focus on "monopoly" function of unions during the 1930s. However, economists have studied many other effects of unions, ranging from increased productivity in some firms to industrial democracy to improved working conditions for many nonunion workers (Freeman and Medoff 1984: 5). Even some chairmen of large corporations have seen the union tactics that disrupted the economy during the New Deal as a part of a beneficial movement, as evidenced by a quote from Thomas Murphy of General Motors:

> The UAW may have introduced the sit-down strike to America, but in its relationship with GM management it has also helped introduce…mutually beneficial cooperation…. What comes to my mind is the progress we have made, by working together, in such directions as providing greater safety and health protection, in decreasing alcoholism and drug addiction, in improving the quality of work life. (quoted in Freeman and Medoff [1984]: 4)

In light of the radical movements on the ascendancy during the Depression, corporate leaders may have known that widespread unionization also helped save capitalism. To the extent that NLRA helped the unions organize more workplaces, it produced benefits not just for union members, but for American business and society. There were certainly costs, too, but these probably did not include increased unemployment: DeLong (2009a: 17) points out that unemployment was low in the 1950s, despite the fact that unions were even stronger in that decade than in the 1930s. In fact, an argument can be made that unions help create jobs in nonunionized industries by enlarging the working-class market. These facts put into context Shlaes's statement that Roosevelt "systematized interest-group politics….ministered to those groups [including "labor" and "unionized workers"], and was rewarded with votes" (2007: 11). More than Shlaes acknowledges, Roosevelt and Robert Wagner, the Senate sponsor of NLRA, had the whole country's best interests at heart in their efforts to pass the bill.

A defense of this law and its less effective predecessor can be summed up as follows. Cole and Ohanian base their assertions on results from a careful and precise modeling exercise that says little about the overall economic effects of NIRA and NLRA. Monopoly power may have hurt consumers in the 1930s by raising prices and reducing output, but NIRA cannot be blamed entirely for cartels and monopolies that dated to the 1920s and earlier. Section 7(a) of NIRA and NLRA were major steps in the rise of the union movement, but these laws probably had not made unions strong enough in the early- and mid-1930s to have much effect on economic growth. Even if labor's bargaining power was somewhat increased, it is important to avoid the impression that Democratic "interest groups" such as labor were running rampant in an economically counterproductive manner. Moreover, while the "insider-outsider" labor-market models of the type employed by Cole and Ohanian are certainly not intrinsically worthless, such models cannot possibly offer a comprehensive assessment of the costs and benefits of the pro-labor legislation of the New Deal. One would be needed to justify a conclusion that section 7(a) of NIRA and NLRA reduced economic growth, let alone that they were bad legislation.

IV. SOME OTHER "FORGOTTEN MEN"?

The title of Shlaes's book is *The Forgotten Man.* This phrase is remembered in connection with the New Deal because of a speech in which Roosevelt appealed to his audience on behalf of "the forgotten man at the bottom of the economic pyramid" (quoted in Shlaes [2007: 12]). Shlaes sees her book in part as the story of many other forgotten men. She traces the phrase back to William Graham Sumner, a social scientist born in 1840, who "warned that well-intentioned social progressives often coerced unwitting average citizens into funding dubious social projects" (12). Shlaes goes on to cite numerous examples of men apparently forgotten in the New Deal era, ranging from the "the fellow that is trying to get along without public relief" to Andrew Mellon, the wealthy banker who was Treasury secretary under three Republican administrations (13).

After our discussion of NIRA and the NLRA, it seems appropriate to ask who, if anyone, was forgotten in these acts and their implementation. Shlaes takes up the case of Martin Schechter and his family, the famous butchers who were prosecuted for violating National Recovery Act (NRA) codes and ultimately prevailed in the Supreme Court. More generally, she counts the consumer and small businesses among those who were forgotten by the NRA (Shlaes 2007: 226–227). One scholarly account argues that "NIRA represented a triumph of big over small business is accurate only in a limited and special sense" (Himmelberg 1976: 221). Nonetheless, there is some merit to the claim that NIRA often helped large corporations at the expense of the consumer and small enterprises.

On the other hand, Shlaes mentions many of the problems experienced by African Americans during Roosevelt's presidency, but does not point out that they suffered unfair treatment under NIRA. In the drives to organize more workplaces following the passage of NIRA, many unions excluded African-American workers, who were "rarely found in the ranks of organized labor during the early years of the New Deal" (Bellush 1975; 76–77). Many African Americans were forced out of skilled jobs when the AFL organized their workplaces (81). Biles reports that "NRA codes exempted from coverage agricultural laborers and domestics, two categories that accounted for approximately three-fourths of southern black workers" (1994: 111–112). Some codes for mainly African-American regions and occupations imposed wages that were lower than pre-

NIRA levels (Bellush 1975: 75–81). The local compliance boards responsible for enforcing the codes often ignored complaints by African Americans (Bellush 1975: 75–81; Biles 1994: 111).

African-American leaders and intellectuals spoke out strongly against NIRA, which proved to be a setback in Roosevelt's ultimately successful effort to bring African-American voters into the Democratic party (Leuchtenberg 1963: 185–187). Once Roosevelt declared before a Howard University audience in 1936 that there would be "no forgotten men and no forgotten races" (quoted in Shlaes [2007: 282]), many officials, departments, and other programs in the federal government contributed to a liberal presidential record on race by the standards of the day (though NLRA, enacted in 1935, replicated some of the inequities in NIRA). To mention racial disparities in NRA codes is not to criticize *The Forgotten Man,* but it helps round out Shlaes's reckoning of the impact of early New Deal legislation, not to mention our very favorable view of Roosevelt's "first 100 days." Of course, African Americans were only one of a number of groups treated unfairly by certain New Deal programs and regulations. Moreover, these governmental initiatives were born of conflicts between different factions in Congress and within Roosevelt's administration, in a perilous era when social attitudes were different from those of today.

V. WHAT IS LEFT OUT OF THE COLE AND OHANIAN MODEL?

Cole and Ohanian have included in their model one of the most flawed, least effective, and weakly enforced pieces of New Deal legislation, NIRA. The discussion above points out that the codes required by this law were not intended primarily to boost economic growth. It seems fair to ask what would happen if Cole and Ohanian's model were modified to take into account all of the major New Deal laws, or at least those thought of by liberal economists as pro-growth. It would be well-nigh impossible to build such a model, but there are many reasons to think that it would show that the New Deal greatly improved growth in the 1930s and even later.

Many historians and others have written about what the New Deal accomplished (for example, see Kennedy [1999: 363–380]; Rauchway [2008a]). In the South,

agricultural programs provided money for the mechanization of agriculture, perhaps helping to bring an end to the exploitative and inefficient sharecropping system (Biles 1994: 56–57). New Deal public works programs yielded not only paychecks, but national parks, roads, bridges, and post offices—investments that no doubt yielded large economic dividends (Leighninger 2007). Federal deposit insurance all but eliminated old-fashioned bank runs, helping financial institutions to perform more reliably their economically important functions. Social Security remains perhaps the most popular federal program, helping many seniors avoid poverty. The economic effects of the New Deal were vast and far-reaching. A demonstration that NIRA and NLRA inhibited economic recovery does not amount to an argument that the *New Deal* slowed recovery or failed to increase output over the long run (Rauchway 2008b: 2).

This is why New Deal laws other than NIRA and the NLRA deserve some attention in a article oriented toward policy in 2009. Of course, judging from the current discussion of ways to fight the recession, a very large number of economists would say that Roosevelt's public works, relief, and other spending programs were an appropriate part of his attempt to bring about a recovery. The debate over the effectiveness of fiscal policy is relatively familiar to students of economics, but the New Deal is an interesting case study in budgetary policy in the worst times of all.

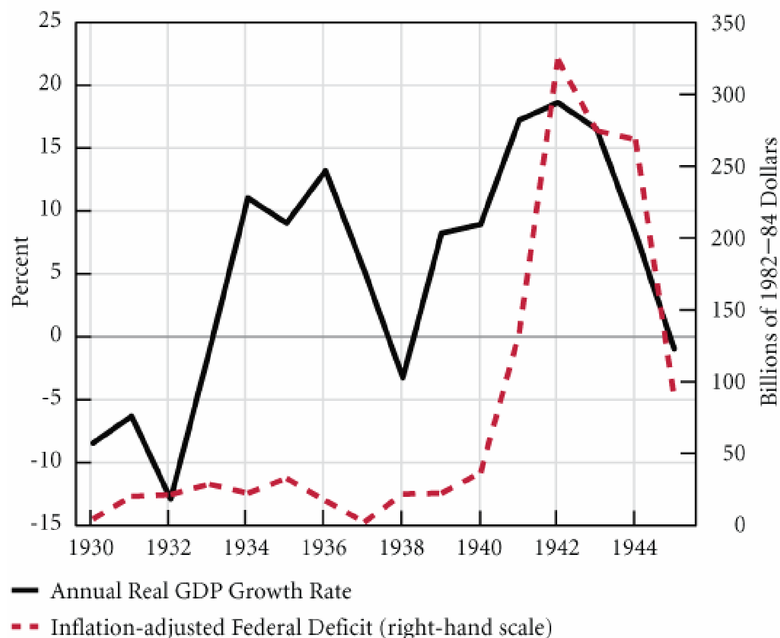
VI. THE NEW DEAL FISCAL STIMULUS: INEFFECTUAL OR JUST NOT BIG ENOUGH?

Roosevelt's jobs programs were massive and ambitious, but the intensity of these efforts varied over time. Roosevelt has been called "a decidedly reluctant and an exceedingly moderate Keynesian" (Kennedy 1999: 361), an apt description for a president who called for a balanced budget in his first national campaign. Roosevelt's Economy Act, passed in the first days of his administration, reduced veterans' benefits and federal employees' salaries by $500 million (Leuchtenburg 1963: 45). (This is a large amount, considering that total federal outlays were $4.6 billion that year [GPO Access]). In 1937, Treasury Secretary Henry Morgenthau III dismayed Keynesians in the White House by calling for spending cuts and "progress toward a balance of the budget" (Shlaes 2007: 342).

Moreover, even as the federal government sharply increased spending from 1933 to 1936, tax-revenue shortfalls were forcing state and local governments to cut their expenditures on roads and other projects. (There are similar problems right now at the state and local levels, and the resulting fiscal undertow is partially offsetting an admittedly strong fiscal push from Washington.)

It is interesting to trace the path of the federal budget deficit and GDP growth starting in the year of the Great Crash, through the New Deal period, and to 1945, the last year of World War II. Figure 1 shows the unsteady path of fiscal policy (broken line), which is measured on the right axis as the federal government deficit deflated by the Consumer Price Index (CPI). (The CPI equaled approximately 1 in July 1983.)

Figure 1 Budget Deficits and Growth, 1930–45



Sources: Authors' calculations; Bureau of Economic Analysis; Office of Management and Budget; and Bureau of Labor Statistics. All data accessed through FRED databank, www.stlouisfed.gov.

By comparison, the inflation-adjusted deficit for fiscal year 2008, which does not appear on the figure, was $218 billion. The deficit had already been rising for at least two years when the New Deal began. Its rise was interrupted in 1934 and, more sharply, in 1936–37, around the time Morgenthau spoke out against Keynesianism. The 1930s deficits

caused great concern, but were soon overshadowed by those of the World War II years. It is hard to find an unambiguous association between the deficit and real GDP growth (depicted in the figure by a solid line), but the resurgence in growth from 1933 to 1937 followed a rapid rise in the deficit. Similarly, the recession of 1937–38 occurred after the deficit fell by half in 1936 and nearly to zero in 1937. As the deficit rebounded from this experiment, growth returned and soon reached nearly 20 percent per year.

Of course, sometimes government deficits occur because households report less taxable income, etc., rather than because policymakers intentionally stimulate the economy. Hence, there have been efforts by economists to measure the true strength of the push provided by fiscal policy. One classic study by E. Carey Brown (1956) found that the net contribution to the demand for goods and services of fiscal policy at all levels of government substantially exceeded 1929 levels in 1931 and 1936, but not in any other year of the decade. This observation led Brown to write: "Fiscal policy, then, seems to have been an unsuccessful recovery device in the 'thirties—not because it didn't work, but because it was not tried" (863–866). According to Brown, spending increased, but the overall stimulus was small owing to "the sharp increase in tax structures enacted at all levels of government" (867). The surge in growth early in Roosevelt's presidency is now viewed by Barry Eichengreen (1992) and many other economic historians as a result of the abandonment of the gold standard and other nonfiscal factors, though few would deny that the New Deal deficits were of some help. Brown (1956: 869) himself concluded that only the much greater economic jolt provided by World War II military expenditures allowed the economy to realize the full potential of fiscal policy.

Perhaps more important than the size of the fiscal stimulus was the number of jobs created by the Works Progress Administration and other federal agencies. An official study by John Kenneth Galbraith (1975 [1940]: 109) found that from 1934 to 1938, employment in federal public works programs equaled 13–15 percent of the total number of unemployed workers, with work relief construction employment amounting to an additional 18–21 percent of that number. These figures are far from comprehensive, as they do not include, for example, jobs outside of construction or the "multiplier" effects generated when federal workers spent their paychecks at private businesses. On the other hand, these numbers show that the persistence of mass unemployment throughout the

1930s should be blamed mostly on the enormity of the task at hand and Roosevelt's reluctance to run deficits. (Some misleading employment statistics from the era, which leave out large numbers of public sector workers, have led a number of scholars to understate the success of the governmental effort to reduce unemployment.)

VII. THE FISCAL-POLICY SKEPTICS

Since debates about stimulus packages began last year, there has been a flurry of polemics on the effects of fiscal policy in blogs and newspapers (for an example, see Barro [2009]). Some economists argue that when the government increases deficits or hires new workers, businesses cut production. Often, these arguments depend on the idea of Ricardian equivalence—that taxpayers put aside substantially more money for future tax payments when the government deficit-spends. To show that this effect completely offsets the effects of higher government deficits requires assumptions that seem unrealistic. Also, some analyses implicitly or explicitly assume that there are no unemployed resources in the economy, so that government cannot hire workers or borrow money without reducing the amount of these "inputs" available to private industry.

In an effort to overcome the limitations of such theories, Keynes tried in his book *The General Theory of Employment, Interest, and Money* (1936) to develop a new kind of macroeconomics that would be useful when significant numbers of people were unemployed and machines were idle. He developed an argument that public spending (and monetary policy) could alleviate such conditions. Looking at the issue from a more pragmatic standpoint, numerous empirical studies done over the years show that fiscal stimulus does matter, though perhaps less than Keynes and many of his contemporaries hoped. Critics point out that a large portion of tax cuts and transfers to consumers are not spent, but with many households' "balance sheets" in bad shape, money set aside to rebuild savings accounts and pay off household debt is perhaps just as beneficial to households and the economy. The account above suggests that the experience of the New Deal era only strengthens the case for fiscal policies and jobs programs.

VIII. NEARLY TWO YEARS INTO THE GREAT RECESSION: TIME TO LOOK TO KEYNES AGAIN

While many economic indicators hint that the economy is growing once again, Paul Krugman (2009), Nouriel Roubini (2009), and others have been arguing convincingly that a very sluggish recovery or double-dip recession is likely. At this point, renewed and sustained economic growth can hardly be taken for granted, but the most important need is to deal with unemployment. Consider just how serious this problem is. The U.S. Department of Labor's broadest measure of civilian unemployment includes part-time workers who "want and are available for" full-time work and people "who currently are neither working nor looking for work, but indicate that they want and are available for a job and have looked for work sometime in the recent past." This group now makes up 16.5 percent of the labor force (Bureau of Labor Statistics [BLS] b). Over one-half of workers who were unemployed in August by the traditional federal definition had been out of work for 15 weeks or more (BLS a). It is next to impossible to find work when there are 6.0 job seekers per opening, as there were by the most recent count (Shierholz 2009).

In spite of the stimulus packages and other large outlays, the economy remains far from the barrier of full employment, so Keynes's general theory of an economy that often has unemployed resources is still apropos. Moreover, there is good reason to think that what worked in the Great Depression would work again today, though again the task at hand is enormous. However, we lament that many Keynesian commentators focus almost exclusively on the amount of stimulus needed. Some types of stimulus would be more effective than others in creating jobs. In particular, a permanent employer-of-last-resort program, as proposed by Hyman P. Minsky (1965; 2008 [1986]: 308–313), would provide cost-effective and noninflationary insurance against unemployment and allow the government to cut spending on some other safety-net programs. (Papadimitriou [1999] makes the case for an ELR program.) The Levy Institute has proposed other "high-quality" forms of fiscal stimulus in past publications (e.g., Papadimitiou and Wray 2001a and 2001b).

Congress, the White House, pundits, and the press are riveted on the all-important health care debate, but we worry that they are also distracted by skirmishes over economic theory and history, while millions wait for a new chance to do meaningful work, and imperfect but effective policy tools are readily at hand.

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