DID FDR END THE GREAT DEPRESSION?

LEE OHANIAN

Did President Franklin Roosevelt's New Deal economic policies pull the country out of the Great Depression? My research clearly suggests that the answer, contrary to popular belief, is no. In fact, the New Deal made matters worse.

Let me explain.

The centerpiece of Roosevelt's New Deal plan to fix the economy was the National Industrial Recovery Act, or NIRA, which the President announced with great fanfare in June of 1933.

FDR believed that he could use the government to artificially raise both prices and wages. It would work like this: higher prices would raise profits—that makes business happy; and higher wages would raise income—that makes workers happy.

More profits for business means more money to hire new workers. Higher wages for workers means more money to buy consumer goods. A virtuous cycle is set into motion and the economy improves rapidly.

But here's what FDR missed: Artificially raising wages also raises labor costs. And when labor costs go up, business hires fewer workers or no workers at all, especially in a difficult economic environment. Meanwhile, artificially raising prices reduces demand for the obvious reason that people buy less of something when its price goes higher.

So, why did FDR do this?

FDR based his New Deal policy largely on what happened during World War I, which had ended only 15 years earlier, in 1918. During that war, the government established planning boards to set wages and prices, and economic activity increased. If it worked during wartime, FDR reasoned, it should work during peacetime. But Roosevelt confused the economic activity that was actually the result of inflated war demands as being due to government planning.

The government, Roosevelt concluded, could much better manage the economy in a time of crisis than private enterprise, which, in his worldview, only considered its own selfish interests. Therefore, government guidance—not free enterprise—was Americans' steadfast ally.

Contrary to what you might think, big business, including autos and steel, were happy to go along with FDR's plan—at least, at first. If the government was going to ensure their profits, who were they to complain? So, instead of prohibiting monopolies—something the government is actually supposed to do—the NIRA created monopolies on the condition that these favored industries immediately raised wages significantly and bargained collectively with labor.

Not surprisingly, the Supreme Court declared the NIRA unconstitutional in May, 1935, stating that FDR violated constitutional separation of powers. He had meddled in an area— private business— where he had no constitutional right. But the decision had little practical effect because the government simply ignored it.

Meanwhile, the wage side of the equation rose faster than expected because of the passage of another New Deal Law, the 1935 Wagner Act. The Wagner Act provided unions with new collective bargaining rights. And as the labor unions grew in size and power, so did workers' wages.

The result was that between 1933 and 1939, these government policies— the NIRA and the Wagner Act—increased prices and wages by about 20 percent. These artificial price and wage increases impeded what should have been a strong recovery from the Depression. They prevented the natural forces of competition from pushing prices down and pushing worker productivity up. Instead, artificially high wages led industry to hire few workers, and high prices reduced demand for products.

If these policies had not been adopted, my research, as well as research by other economists, indicates the economy would have returned to its normal level of employment and output by 1936. In other words, the policies that were supposed to restore prosperity actually prolonged the Depression.

I'm Lee Ohanian, Professor of Economics at UCLA for Prager University.