

Freedom Matters

An Occasional News & Opinion Paper

Dane County, Wisconsin

Vol. 9, No. 3

Wednesday, April 1, 2009

Our mission is to restore, perfect and maintain our government as a constitutional republic that is dedicated to defending our unalienable rights as individuals to life, liberty and property.

What Caused the 1930s Great Depression

by Bob Bowman

Freedom Matters is reviewing three new books on Franklin Delano Roosevelt (FDR) and the Great Depression of 1929-1945. Our previous issue cited Amity Schlaes' book, *The Forgotten Man*. It is a chronological report in which she gives thumbnail biographies of key people on all sides of the political issues of those times. I was born a year before the stock market crash of 1929 and grew up in the 1930s, and for me, she captures a sense of it.

I was eleven when FDR's Secretary of the Treasury testified to congress as follows (quoted from Burton Folsom Jr's book, *New Deal or Raw Deal*, 2008, p. 2):

"We have never made good on our promises. ... I say after eight years of this administration we have just as much unemployment as when we started. ... And an enormous debt to boot!"

There it is, a candid admission from FDR's close friend, confidante and New Deal loyalist, Henry Morgenthau Jr., that *the Roosevelt administration failed to cure the Great Depression*. Unemployment was near 20% when FDR was elected President in 1932. It dipped to 14% in 1936, but worsened again and was 20% in 1938-9.

Why did FDR fail to cure it? *Because he was wrong about its causes.* In addition, he misled historians who were too busy kissing his feet to look up and attend to actual data. To quote Jim Powell, in his 2003 book, *FDR's Folly*:

"Most books about the Great Depression have repeated the views of FDR and his New Dealers that the Great Depression was caused by wild speculators, crooked bankers, and rich people hoarding their money rather than spending it. These views have continued to appear even in recent history books." Powell then cited such histories published in 1985, 1986, 1990 and 1993.

Specifically, FDR accused businesses of keeping prices high while reducing wages, thus enriching themselves, by which workers could not afford to buy what they produced, and the resulting *underconsumption* caused the economy to collapse. Oh, the intellectual class ate that up, and the unregenerate of them still do. If the rich were thus wrecking the market, then capitalism was failing, and Roosevelt's answer to such *market failures* was for government to step in and *plan* the economy.

FDR got *underconsumption* theory from his "brain trust," and later from the economist John Maynard Keynes. To the contrary of FDR, the data show that in the 1920s

wages went up, prices went down, the consumption portion of the GNP (gross national product) rose, but business profits did not significantly rise. So, **the data consistently reject his underconsumption theory.**

Market failures did *not* cause the Great Depression. *Government* failures did. For one, **the Federal Reserve raised discount interest rates so much that they contracted the nation's money supply by one-third.** Businesses could no longer borrow the money they needed to operate, and had to lay off workers.

Another *government failure* was passage of the Smoot-Hawley Tariff Act under Hoover. That led to retaliatory tariffs by other nations, drying up most of America's foreign trade, thereby tripling the unemployment rate. **Roosevelt kept the Smoot-Hawley act and failed to reduce tariffs enough to restore foreign trade.**

The collapse of thousands of U.S. banks also resulted from a *government failure*: **unit banking laws, whereby bank branch offices were prohibited.** Small banks had lobbied for this in order to suppress competition from large banks. However, the small banks thus were unable to diversify enough to survive contractions of trade and of the money supply. Canada had an equally deep depression at the same time, *but had no unit banking laws*, by which it had not even one bank failure.

There is controversy over whether Roosevelt's banning of the gold standard in favor of printing fiat currency also contributed to the depression, but if it did, that would be another *government failure*.

Contractions of the money supply correlate with economic depressions, as powerfully demonstrated by Milton Friedman and Anna Jacobson Schwartz in their monumental 1963 book, *A Monetary History of the United States, 1867-1960*. The United States had several economic depressions in that time that typically lasted only a year or two before the market spontaneously recovered from them.

However, the 1930s Great Depression lasted 15 years, and it is the first depression in which the government massively interfered with the free market, introducing a crippling measure of uncertainty. The U.S. only recovered economically after Roosevelt died. Likewise, the recent Depression of 2008 is the result of government failures, far more than than it is of market failures. As President Reagan famously said, government is not the solution. It is the problem.

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*** Published by Freedom Matters, Inc., Cross Plains, WI. 53528, Elena Byrne, Editor ***
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