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Why America (and Canada) Doesn't Need Another New Deal

It IS a New Deal

BY ROHIT GUPTA

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The Frontier Centre for Public Policy is an independent, non-profit organization that undertakes research and education in support of economic growth and social outcomes that will enhance the quality of life in our communities. Through a variety of publications and public forums, the Centre explores policy innovations required to make the eastern prairies region a winner in the open economy. It also provides new insights into solving important issues facing our cities, towns and provinces. These include improving the performance of public expenditures in important areas like local government, education, health and social policy. The author of this study has worked independently and the opinions expressed are therefore his own, and do not necessarily reflect the opinions of the board of the Frontier Centre for Public Policy.

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Executive Summary

- In recent months and weeks, a significant amount of hyperbole is reminiscent of the Great Depression of 1929-1939. In fact, most senior politicians and policy makers, including the Chairman of the U.S. Federal Reserve Board, Ben Bernanke, have made frequent comparisons between the current economic downturn and the Great Depression.
- However, the data show there is a significant difference between the economic situation today and that of the Great Depression.
- Further, given the social support measures and automatic counter-cyclical "stabilizers" built into government spending today (e.g., welfare, unemployment benefits, public pensions and numerous other social assistance measures), it is virtually impossible that an economy could shrink and human suffering and dislocation could be experienced to the same degree as during the Great Depression.
- Importantly, today's policy makers must be clear about both good and bad policy enacted during the 1930s. Poor policy included anti-business measures that ultimately exacerbated the economic downturn. For example:
- The National Recovery Administration (NRA), created in 1933, created cartels in 500 industries to limit competition. It compelled businesses to reduce production and to increase prices and wages during a severe economic downturn when people could not afford to buy the most basic of necessities.
- The Agricultural Adjustment Administration (AAA) also implemented a collection of harmful programs. The AAA, in the name of raising prices to battle what Roosevelt perceived to be the country's biggest economic ill — deflation — forced farmers to cut production by essentially destroying excess crops (mostly cotton) and livestock. In 1933, 6-million piglets and 220,000 pregnant cows were slaughtered and many cotton farmers ploughed under one-quarter of their acreage.
- Many of Roosevelt's policies worsened the Depression contributed to a "double-dip depression." The unemployment rate, which fell gradually from 1934 through 1937 and reached a low of 14.3 per cent, increased again to 19 per cent by 1938. By the end of the decade even Roosevelt's own Treasury Secretary, Henry Morgenthau Jr., began to have his doubts about FDR's economic policies.
- Today's stimulus funding must not be used to implement the types of questionable New Deal planned-economy equivalents in today's world (in particular with respect to the financial sector). Massive government spending and attempts at demand-side management are where the similarities between current economic policy and the New Deal must stop.

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It appears that sometime over the last six months the world went mad or we stepped into an alternate universe where down is up, bad is good, and profligate, out-of-control, unprecedented government spending is a "necessary fiscal stimulus."

Examine the declarations and comments that emerged from the G-20 leaders' emergency summit last November in Washington, D.C. and one could be excused for thinking we were reading comments made from a bygone era of economic history:

> "[The world economy requires] a coordinated and concerted stimulus through the use of budgetary measures to support demand and the increase of financial assistance to emerging and developing countries."
>
> – French government communiqué, November 15, 2008[1]

> "Those of you who have followed my career know that I'm a free market person — until you're told that if you don't take decisive measures then it's conceivable that our country could go into a depression greater than the Great Depression's.
>
> So my administration has taken significant measures to deal with a credit crisis."
>
> – U.S. President George W. Bush, November 15, 2008[2]

> "[Leaders discussed] whether all nations should move together to enact government spending plans to stimulate their economies …. The leaders supported the benefits of such a plan …"[3]
>
> – reported by PBS, November 15, 2008[4]

Surprisingly, these declarations and comments that argued for the need for more spending came soon after a succession of government bailout and spending packages were approved around the world (all figures in US $):

United States, $750-billion last fall (plus the recently approved $787-billion);
European Union, $250-billion; and
China, $580-billion.

Recently, some G-20 leaders gave even more unequivocal statements supporting further government spending:

The Associated Press reported in December 2008 that President Nicolas Sarkozy, "planned to spend his way out of recession…"[5]

Additionally, just a few days before Barack Obama took over the United States presidency, he said, "At this particular moment, only government can provide the short-term boost necessary to lift us from a recession this deep and severe… Only government can break the vicious cycles that are crippling our economy."[6]

All this panic and hyperbole are reminiscent of the days in and around the Great Depression of 1929-1939. In fact, most senior politicians and policy makers, including the Chairman of the U.S. Federal Reserve Board, Ben Bernanke, have made frequent comparisons between the current economic downturn and the Great Depression. However, the data show there is a significant difference between the economic situation today and that of the Great Depression. (See the Simply the Facts table on page 11.) Further, given the social support measures and automatic counter-cyclical "stabilizers" built into government spending today (e.g., welfare, unemployment benefits, public pensions and numerous other social assistance measures), it is virtually impossible that an economy could shrink and human suffering and dislocation could be experienced to

the same degree as during the Great Depression.

The depression comparisons seem to be complete with a renewed desire for a modern-day version of former U.S. president Franklin Delano Roosevelt's (FDR's) New Deal.

On this point, if we examine the comments made by today's leaders and the statements made by FDR in support of the New Deal, we can see that today's leaders are fashioning themselves as contemporary New Dealers. For example:

- In one of Roosevelt's fireside chats in 1938, he said it was up to the government to "create an economic upturn" by making "additions to the purchasing power of the nation," effectively saying that the government would spend where the private sector would not.[7]
- France's President Sarkozy has on many occasions referred to "France [needing to] spend its way out of recession."[8]
- President Obama states, "Only government can provide the short-term boost necessary to lift us from a recession."[9]

Based on these comments and others made by European leaders, it seems that FDR's philosophy of "priming the pump" and of governments stepping in to fill the void when the business cycle ebbs has again become mainstream economic policy.

This has led to much reverent discourse regarding the results of FDR's policies and the New Deal. In the midst of this more than slightly rose-coloured recollection of history, a refresher course on some of the programs of the New Deal and their actual effects is in order.

It is important to note that it is generally accepted by many prominent economists such as Irving Fisher and the Federal Reserve Chairman, Ben Bernanke, that the original cause of the Great Depression was a debt default-deflation spiral that led to a drastic contraction in the money supply.

This was preceded by a period of massive uncontrolled growth in the money supply that gave rise to a number of structural weaknesses in the U.S. economy. This situation was significantly exacerbated by the implementation of the Smoot-Hawley Tariff Act of 1930, which raised tariffs on a wide range of U.S. agricultural and industrial goods. Smoot-Hawley created an international trade war that greatly diminished imports and exports for the United States as well as for many other nations and pushed many countries into depression.[10] This all occurred prior to Franklin D. Roosevelt assuming the presidency.

To set the stage, it is worthwhile to review the unemployment[11] situation FDR presided over when he took power as well as the situation afterwards.

- The unemployment rate when Roosevelt was elected in 1932 was 23.6 per cent.
- The unemployment rate was 24.9 per cent for the whole of 1933, the year in which FDR's policies were implemented.
- The rate fell gradually from 1934 through 1937, reaching its trough of 14.3 per cent.
- However, in 1938, the rate rose significantly to 19 per cent, as the United States experienced the second of what was a double-dip depression (or even a triple-dip recession according to some), as FDR's temporarily stimulating economic policies could no longer be sustained or financed.
- Beginning in 1939, the rate fell through the entire World War II period, as the United States began to produce munitions and other goods for the allied war effort abroad (although it did not formally join militarily until December 1941) at the cost of massive budget deficits that took decades and government fiscal austerity to erase.

National Recovery Administration **NRA**

AAA Agricultural Adjustment Administration

The overall impact of the New Deal programs on the health of the economy during the Depression may be a debatable one, but it will not be debated here.

What will be examined here, however, is the erroneous reasoning behind and the negative impact of certain central New Deal programs.

Take as the first example the National Recovery Administration (NRA) programs. The NRA created cartels in 500 industries to limit competition, and it compelled businesses to reduce production and to increase prices and wages during a severe economic downturn when people could not afford to buy the most basic of necessities. Bizarrely, people who lowered prices were arrested and middlemen were deemed criminals. The objectives and methods bore all the hallmarks of a centrally planned industrial economy.

According to Donald Richberg, head of the NRA in 1934:

> A nationally planned economy is the only salvation of our present situation and the only hope for the future … There is no choice presented to American business between intelligently planned … industrial operations and a return to the gold-plated anarchy that masqueraded as 'rugged individualism' ... Unless industry is sufficiently socialized by its private owners and managers so that great essential industries are operated under public obligation appropriate to the public interest in them, the advance of political control over private industry is inevitable.[12]

The effects of the National Recovery Administration were devastating. According to some economists, the NRA increased the cost of doing business by 40 per cent. The economic impact of the NRA was immediate, powerful — and negative. In the five months leading up to the act's passage, signs of recovery were evident: factory employment and payrolls had increased by 23 and 35 per cent respectively. Then came the NRA, which shortened hours of work, arbitrarily raised wages and imposed other new costs on businesses. In the six months after the law took effect, industrial production dropped 25 per cent.[13]

The Agricultural Adjustment Administration (AAA) also implemented a collection of harmful programs. The AAA, in the name of raising prices to battle what Roosevelt perceived to be the country's biggest economic ill — deflation — forced farmers to cut production by essentially destroying excess crops (mostly cotton) and livestock. It is estimated that in 1933, 6-million piglets and 220,000 pregnant cows were slaughtered, and many cotton farmers plowed under one-quarter of their acreage.[14]

The mandated destruction of food and the increasing of its prices at a time when many Americans were already hungry due to shortages and lack of affordability was curious economic policy, to say the least. The AAA, under the direction of Henry Wallace, the Secretary of Agriculture, created a system that gave an advantage to landowners with large farms.

The AAA's policies effectively paid the landowners for not farming certain lands. The lands they chose not to farm were those of the tenant farmers whom they evicted, as the government payments to not farm were in excess of what they received in rent from the tenant farmers.[15]

Other examples of New Deal policies that were unhelpful to an economic recovery include the following:

- Raising the top personal income tax rate to 79 per cent, which effectively killed any incentive to take risks, create jobs, start new businesses or increase one's income, while it encouraged those who were wealthy to expend resources to shelter and hide their incomes.
- Imposing new taxes on a company's undistributed profits. This discouraged any incentive for a business to save money for the future or to reinvest unpaid profits (i.e., retained earnings) into the business for capital, modernization, funding future growth, etc., all of which would have led to future job growth.
- The passing of the Gold Confiscation of 1933 (Executive Order 6102), whereby citizens were required to give their gold to the government for a fixed rate or face 10 years in prison, needlessly made criminals of ordinary citizens and wasted the resources of the state.
- Subsidizing activities such as the arts and music through the Works Progress Administration added little to economic activity.

FDR's concept of full employment was difficult to understand when so-called full employment was to be achieved by massive government hiring and by paying for such employment by taxing individuals and businesses – in effect robbing Peter to pay Paul (and losing a few cents along the way due to the inherent inefficiency of recycling money through government).

FDR's reforms were far-reaching. They affected every facet of the economy and every group in America. In fact, many were over-reaching and were declared unconstitutional by the U.S. Supreme Court. A string of legislative and regulatory defeats at the hands of the Court led to FDR's attempts in 1937 to increase the size of the Supreme Court to stack it with more New Deal friendly justices, which was commonly known as the Court-packing Plan.[16] Ultimately, the Judicial Reorganization Bill of 1937, as it was formally known, never needed to be passed, as one justice changed sides and became more New Deal-legislation friendly in his rulings, giving the New Deal a slim 5-4 majority. However, it was far from certain FDR had the votes in Congress to pass the bill should it have come to that, and the entire episode diminished both FDR's and the New Deal's credibility with Congress.[17]

Toward the end of the 1930s, FDR was losing public support, as his policies were no longer seen to be improving the economy and in fact may have made things worse.[18]

Even his own Treasury Secretary, Henry Morgenthau Jr., who served from 1934 to 1945 and who had been by Roosevelt's side from nearly the beginning and had ensured adequate funding for FDR's programs, began to have his doubts. He wrote in his diary:

> We have tried spending money. We are spending more than we have ever spent before and it does not work. And I have

just one interest, and now if I am wrong somebody else can have my job. I want to see this country prosper. I want to see people get a job. I want to see people get enough to eat. 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 enormous debt to boot.[19]

As a final note on the New Deal, it is feasible that the aforementioned programs (as well as others) may have deepened the Depression.

A 2004 study conducted by two economists at the University of California, Los Angeles, Harold Cole and Lee Ohanian, concluded that FDR's New Deal policies actually prolonged the Depression by seven years and caused it to end (officially) in 1943 rather than in 1936.[20] Cole and Ohanian blame specific anti-competition and pro-labour measures Roosevelt promoted and signed into law on June 16, 1933.

President Roosevelt believed that excessive competition was responsible for the Depression by reducing prices and wages, and by extension reducing employment and demand for goods and services. So he came up with a recovery package that would be unimaginable today, allowing businesses in every industry to collude without the threat of antitrust prosecution and workers to demand salaries about 25 percent above where they ought to have been, given market forces. The economy was poised for a beautiful recovery, but that recovery was stalled by these misguided policies.[21]

Franklin Roosevelt may have been a heroic wartime president, standing shoulder to shoulder with British Prime Minister Winston Churchill resolutely against Nazism, fascism and communist totalitarianism. However, on the domestic economic front, he was far from a hero. Most critical for today's policy makers and the public — the fact is the New Deal did not rescue the United States from the Great Depression.

Given the current economic situation, where does this leave policy makers? Governments around the world have made the decision to significantly increase government spending (virtually all deficit financed) in the hopes of stimulating demand. That does not mean, however, that the specific policies and programs of the New Deal should also be emulated.

The economic situation today is significantly different from that of the 1930s.

The United States (and most developed economies) have in place the few useful programs and policies that arose out of the Great Depression such as unemployment benefits, public pensions and some form of government-assisted health care (in the United States for example, Medicare and Medicaid).

The specifics of how the stimulus funding is to be implemented and executed within each of the identified programs are largely yet to be determined. They must not be used to implement the types of questionable New Deal planned-economy equivalents in today's world (in particular with respect to the financial sector). Massive government spending and attempts at demand-side management are where the similarities between current economic policy and the New Deal must stop.

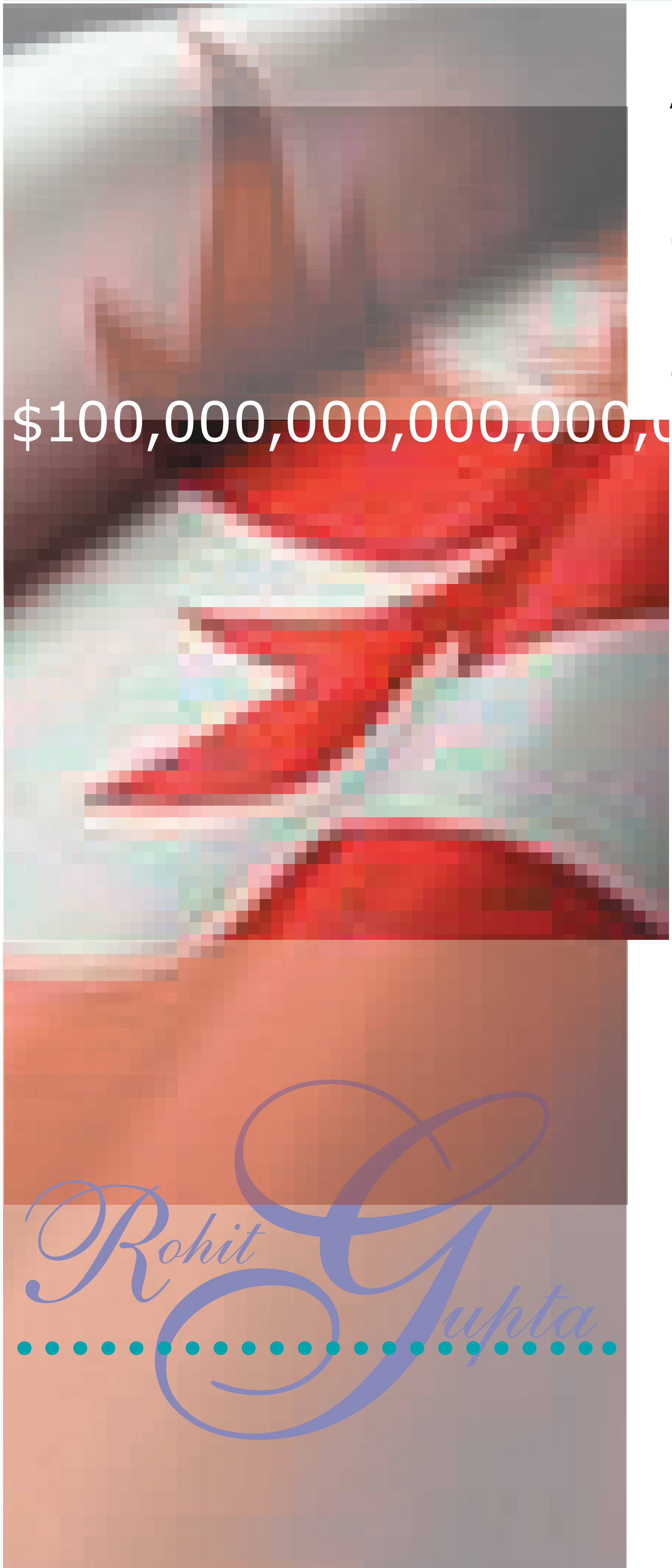
SIMPLY THE FACTS

Is the United States undergoing an unprecedented economic crisis?

Let us look at the numbers:

	The Great Depression	Today
Peak Unemployment Rate [22]	24.9% (1933)	7.6% (Jan. 2009)
% Decline in Real GDP (first year of contraction)[23]	-9.8% (1929-30)	-3.8% (2008)*
Peak No. of Unemployed Persons[25]	10.4 million (1938)	11.6 million (Jan. 2009)
U.S. Population[26]	129.8 million (1938)	304.1 million (July 2008 est.)
Number of Employed (civilian)[27]	43.1 million (1938)	142.1 million (Jan. 2009)
Inflation Rate – CPI (annual percentage change)[28]	-5.1% (1929-1933)	1.8%[29] (Dec. 2008)
% Decline in Dow Jones Industrial Average from Peak to Trough[30]	-86.5% (Aug. 1929 – Feb. 1933)	-45.8% (Oct. 2008 – Feb. 2009)

(*2008 Q3 – Q4 est.@ annual rates[24])



A final thought regarding the situation in Canada and the recent budget:

It is important to note that irrespective of how much the Canadian government spends or what programs it implements, the state of our economy will be determined largely by the health of the U.S. economy.

The effects of U.S. actions will swamp any taken by the government in Canada.

Thus, Canadians should hope President Obama is able to restore America's confidence and faith in its economy to get the United States out of its morass before it bankrupts itself.

The best thing Canada can do while it waits is keep its fiscal house in the best shape possible, including minimal deficits, and

simply hang on for the unfortunate but inevitable rough ride.

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