
The Defining Moment Hypothesis: The Editors' Introduction

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There is a widely held belief that the Great Depression was the “defining moment” in the development of the American economy. According to this view, the severity and length of the depression altered the basic rules, institutions, and attitudes governing the economy.

Bolstering this perception is well-known evidence that the growth of government as a share of GNP accelerated in the 1930s, although some of the increase was due to the collapse of GNP (fig. 1). Still, government as a share of GNP remained high even as the economy began to recover. Not only did the relative size of government expand, but the relationship between the federal government and state and local governments was also irrevocably altered in the mid-1930s. A striking change occurred around 1935 when the federal government, as a fraction of all government expenditures, grew largely at the expense of the localities. This change was independent of the growth of defense, international relations, and debt servicing and is apparent if intergovernmental grants are attributed to either the granting or receiving government (fig. 2).

Added to these time-series facts about the growth of government is that the most important social programs today originated in the 1930s. Social security, old-age assistance, welfare, and unemployment insurance were all part of the same bill passed in 1935. Regulation of agriculture, banking, and finance was vastly expanded, and organized labor was finally awarded its “bill of rights,” all as part of the New Deal. The notion that the government was responsible for the health of the American economy was codified, at the end of World War

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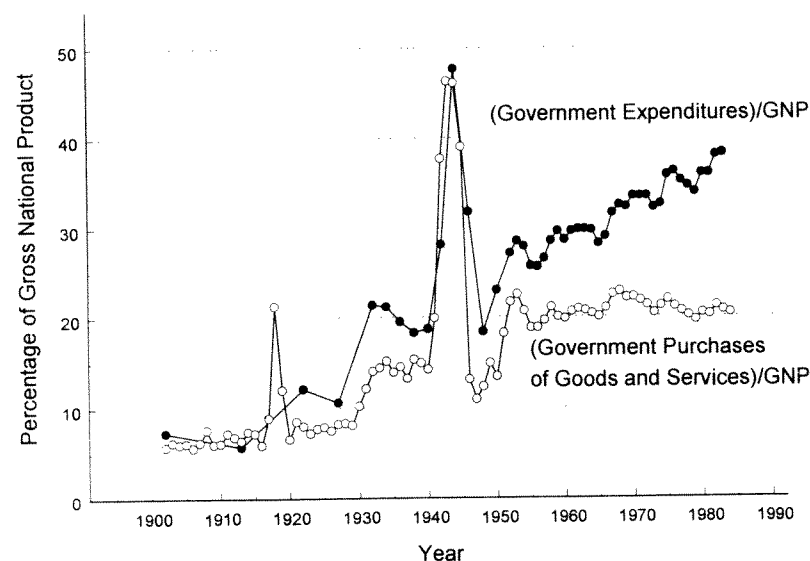


Fig. 1 Government (national, state, and local) as a share of GNP, 1902–84

Source: Higgs (1987, table 2.1).

Notes: Government expenditures include all spending by the three levels of government, whereas government purchases of goods and services exclude transfer payments. In all cases, intergovernmental grants are excluded to avoid double-counting. Thus, the growth in government, as a share of GNP, since the late 1950s has almost all come from an increase in transfer payments such as social security. The National Income and Product Account revisions, which extend back to the late 1950s, make government expenditure data for the most recent period noncomparable with historical data and lower the share of GNP that is government by reducing expenditures by state and local governments.

II, in the Employment Act of 1946. There is a very good case to be made, or so it would appear, for the idea that the 1930s was *the* “defining moment” in twentieth-century U.S. economic history.

The “Defining Moment” Hypothesis

The argument that the Great Depression was a watershed considers the protracted economic crisis as inducing fundamental change in the relationship between government and the private sector. But many of the innovations embraced in the 1930s—most of which were part of the Roosevelt administration’s New Deal—had been under consideration for some time, at both the state and national levels. Some important reforms had been passed decades earlier in other industrialized countries. It could thus be argued that change, already proceeding, was simply accelerated by the economic collapse.¹ In

1. Hughes (1977, 146), e.g., views the 1930s as a continuation of previous trends regarding government and the economy, possibly with some acceleration, but not a break.

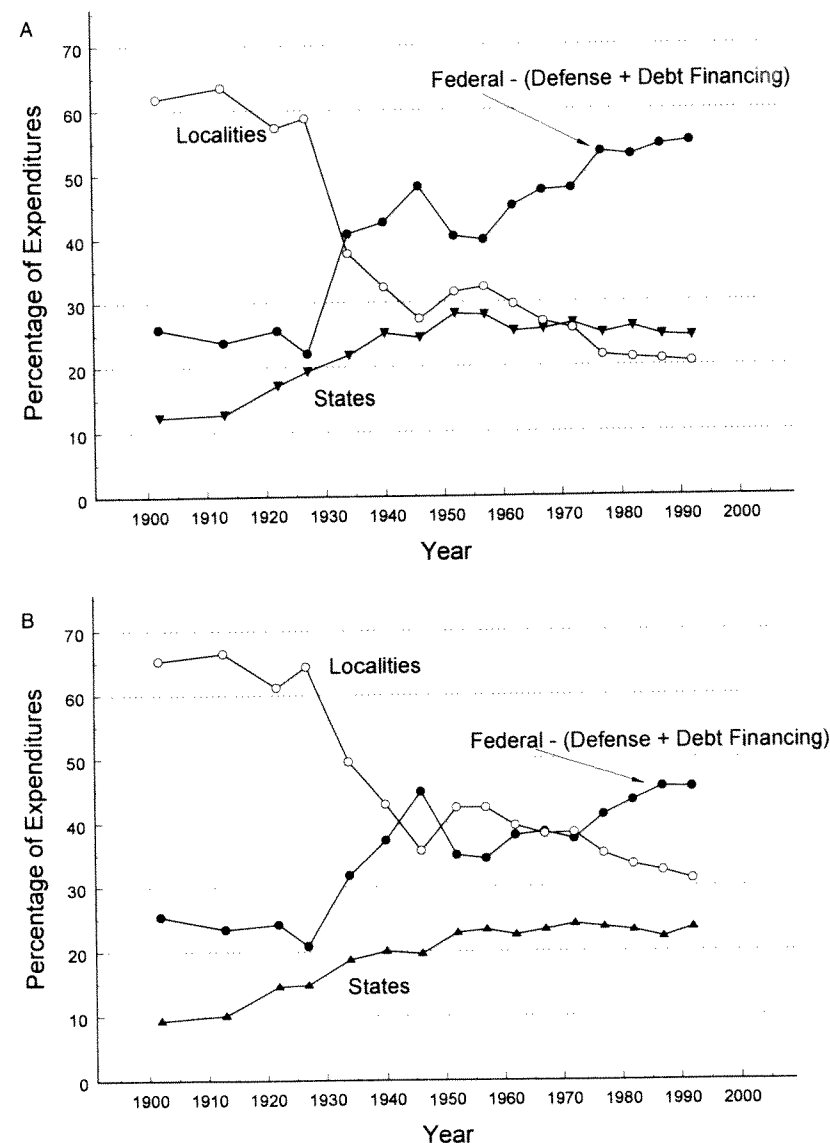


Fig. 2 Share of government expenditures by (A) granting and (B) receiving government, 1902–92

Source: Wallis and Oates (chap. 5 in this volume, figs. 5.1 and 5.2).

Notes: Shares for all three levels of government sum (vertically) to 100 percent for each year. Expenditures on national defense, international relations, and interest on the government debt have been excluded from federal expenditures. In panel A, all intergovernmental grants have been attributed to the granting (i.e., revenue-raising) government. In panel B, all intergovernmental grants have been attributed to the receiving (i.e., spending) government. Thus, the “granting” graph makes the federal government appear relatively larger than does the “receiving” graph.

some cases, the acceleration may have had real effects in altering the institutional details of legislation, features that remained in place for decades to come. But many aspects of the New Deal have not endured, and one question is why some became permanent fixtures whereas others did not.

Some scholars point to World War I as paving the way for many of the economic changes of the 1930s. For example, certain New Deal regulatory policies may have been accepted with greater alacrity because the government takeover of the railroads in World War I fostered the belief that government could succeed when private enterprise did not. The income tax, inaugurated in 1913, was so greatly increased in 1917, as was the taxation of the very rich, that the new system has been termed "the most significant domestic initiative to emerge from the war" (Brownlee 1996, 48). Agricultural price supports originated in World War I, although their function was to be altered by the New Deal. The War Finance Corporation was the model for the Reconstruction Finance Corporation, set up by President Hoover in 1932 and then used extensively by President Roosevelt in support of the New Deal. And wage and price controls during World War I, it has been claimed, set the stage for the New Deal's ill-fated National Industrial Recovery Act.

But if World War I provided the opening wedge for many New Deal programs, World War II may have cemented them in place, solidifying the notion that big government was crucial to the health of the economy and democracy. Figure 1 even appears to suggest that the cold war may have been the real factor that advanced government purchases as a fraction of GNP. The contributors to this volume are aware that the defining moment hypothesis is a complicated one. The answer may involve understanding what the New Deal would have been in the absence of World War I, as well as what the New Deal's legacy would have been without World War II and the cold war.²

The New Deal was not one but at least two programs. The "second" New Deal gained from the lessons of the "first." Had the Great Depression ended, say, before 1935, the legacy of the New Deal would have been far different. Parts of the National Industrial Recovery Act, struck down by the Supreme Court in 1935, lived a second life in subsequent legislation. Sections were resurrected by the National Labor Relations (Wagner) Act in 1935, the Robinson-Patman Act of 1936 (which made price discrimination illegal), the Miller-Tydings Act of 1937 (which exempted resale price maintenance contracts from antitrust laws), and the Fair Labor Standards Act in 1938 (which set hours and wage standards). The legislation of the post-1934 New Deal was often drafted to pass the test of a Supreme Court that had already nullified many of Roosevelt's key programs. This special crafting altered the form of many institutional details.

Most difficult of all the aspects of the defining moment hypothesis is how the Great Depression affected the perceptions of the American people about the role of government. We often read that American faith in institutions is

2. On the notion that almost all crises increase the size of government, see Higgs (1987).

today at a historic low point. Yet, government expenditures as a fraction of GNP have never been greater (fig. 1).³ Although there is marked distrust, there is also, today, a general acceptance of some governmental role in public goods provision, social insurance, regulation, the completion of various markets, the internalization of externalities, and even outright redistribution. Did the Great Depression alter the public's view concerning the functions of government, particularly those at the national level? It would certainly appear that it did.

Even though New Deal programs were politicized, the 1930s may have been a turning point in the extrication of government from control by the political parties. Prior to the 1930s the effect that government had on the public was often felt through the impact political parties had on people's lives. In the nation's cities, for example, government was identified with political machines and operated through the favors of city bosses. Patronage appointments at the state level and, before the federal civil service, at the national level were other routes through which the public received government largesse. The Union Army pension, the largest single social program prior to the New Deal, was clearly identified with the Republican Party. With the New Deal, however, social programs began to exist independently of political involvement and party affiliation.

Whatever the resolution of these difficult issues, one thing does seem clear. The increase in the size and scope of business and the greater proportion of Americans living in cities and working as wage earners gave rise to the notion that government could function better if it, too, were larger in size and more centralized in scope. Workers, no longer largely self-employed, were less personally responsible for the hardships that befell them, such as unemployment. More complex technology at home and in the workplace gave government an expanded regulatory role, and the greater density of population heightened the need for government to contain various "spillovers." But because local and state governments could not effectively regulate or tax mobile capital (and labor), the national government was destined to grow. States and localities required a coordinating mechanism, a role that could best be served by the national government.

The "call" for increased government and for greater scope of government built up gradually throughout the nineteenth century.⁴ Important debates continue to rage concerning whether the call for increased government came from

3. Although the last date in fig. 1 is 1984 (see note to fig. 1 concerning the reasons why), recent data (not consistent with pre-1960 data) do not show a decline from the early 1980s.

4. See, e.g., Hofstadter (1955) on the populist and progressive roots of the New Deal. Whereas the New Deal was a reaction to economic collapse, populism and progressivism were reforms directed at the bigness of enterprise and the corruption of state and local governments. Populism and progressivism were liberal in the sense that they were concerned with the protection of individual rights, but Hofstadter reminds his readers that reform was often reactionary and ambiguous. Populism, in particular, embraced many conservative elements such as nativism. Patterson (1969), however, argues that progressivism was essentially moribund on the eve of the Great Depression. Whatever the states did accomplish by 1933 in reaction to the economic crisis, and it was precious little, served as a reminder of how much had changed since the Progressive Era and how important the national government had become.

the right or the left, from business or labor, from big business or small business.⁵ For us, the key issue is whether, in the midst of this long-run process of economic change, the depression altered the form and function of government and, if so, through what route.

To examine the legacy of the Great Depression at the end of the twentieth century, a conference was organized and held in October 1996. Each of the 12 conference papers posed the question whether the depression decade of the 1930s was a defining moment for various aspects of economic policy and for particular sectors of the economy. Although the manner in which the topics were selected could have influenced the conclusions, we do not believe that to be the case. We began by identifying the four major sections of the volume: macroeconomic policy, government, social insurance and labor, and the world economy. Under each heading we chose topics considered to be among the most significant and for which we could identify a scholar to produce the chapter. As a group, we were never tied to a specific view on the subject (as our rather diverse contributions will attest).

The majority of the papers found support for the idea of a sharp break with the past, although some major changes represented accelerations of earlier developments. Several common themes emerge from the papers that explain how the depression influenced the U.S. economy's subsequent development. First, skepticism about the efficacy of government intervention withered as the public adopted the attitude that the government could "get the job done" if the free market did not. Business, however, was not always as enthusiastic. Although there is evidence that parts of the intellectual community were already disposed toward a bigger role for government, the depression convinced many doubters. Second, many innovations introduced by the New Deal were forms of social insurance. These new programs survived and often grew far beyond the intentions of their progenitors because they created groups of readily identifiable and organized beneficiaries while costs were diffused among the general public. Third, the character of federalism moved from "coordinate" to "co-operative" with extensive intergovernmental grants, giving greater influence to centralized government. Last, the conduct of economic policy—both domestic and international—changed to give more weight to employment targets and less to a stable price level and exchange rate. These developments became key features of the economy, shaping the course of its growth over the remainder of the century.

Origins and Persistence of the Depression

The papers in this volume are all concerned with the legacy of the Great Depression, not its immediate impact or its causes. But the changes it induced

5. For two novel interpretations, see Kolko (1967) on the conservative origins of government regulation and Libecap (1992) on the role of rent-seeking small business in the passage of the Meat Inspection Act and the Sherman Antitrust Act.

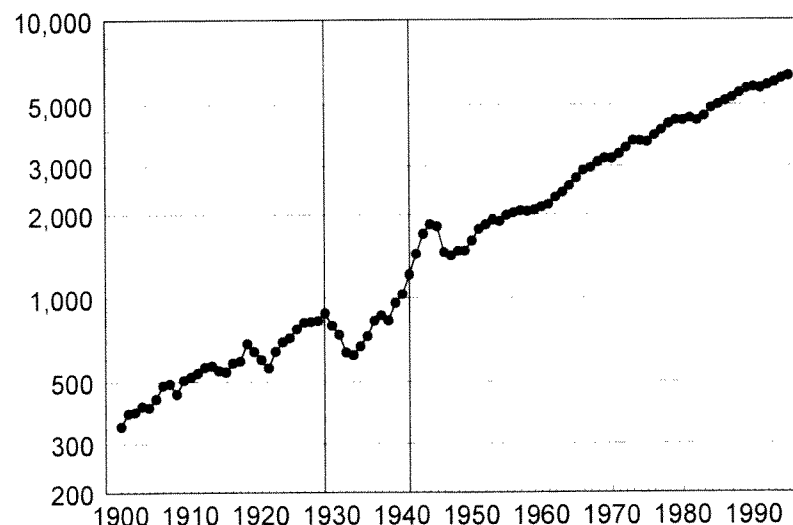


Fig. 3 Real GNP (billion 1990 dollars), 1900–1995

Sources: Nominal GNP and GNP deflator: 1900–1938, Balke and Gordon (1986, 781–83); 1939–58, U.S. Council of Economic Advisors (1991, tables B-1 and B-4); 1959–95, U.S. Council of Economic Advisors (1997, tables B-4 and B-24).

Notes: Real GNP is graphed in (natural) log form. The GNP deflator is spliced so that 1990 = 100. Vertical lines delineate the period of the Great Depression.

were consequences, in no small part, of its magnitude and perceived origins. It is, therefore, important to recall the dimensions of the depression that earned the appellation "great" as well as the literature on its origins.

In terms of its impact on economic performance, the depression was a disaster without equal in the twentieth century. The contraction phase of the depression, extending from August 1929 to March 1933, saw the most severe decline in key economic aggregates in the annals of U.S. business cycle history. Real GNP fell by more than one-third (fig. 3), as did the price level (fig. 4). Industrial production declined by more than 50 percent. Unemployment rose to 25 percent by 1933 (fig. 5). Not only was the descent precipitous, but the recovery from the business cycle trough was slow. The economy did not regain its 1929 GNP level until 1939.

Interpretations of the causes of the Great Depression have shifted radically over time. Businessmen, and especially bankers and financiers, were initially blamed for the collapse. Congressional hearings on the stock market crash of 1929 and the banking crises sought to identify specific practices and accountable individuals. The Securities Act of 1933, the Securities Exchange Act of 1934, and the Banking Acts of 1933, 1934, and 1935 endeavored to forbid reckless financial activities and to constrain institutions and markets to be more prudent. For some New Dealers, the operation of individual markets failed. Government intervention was needed to assist agriculture through the Agricul-

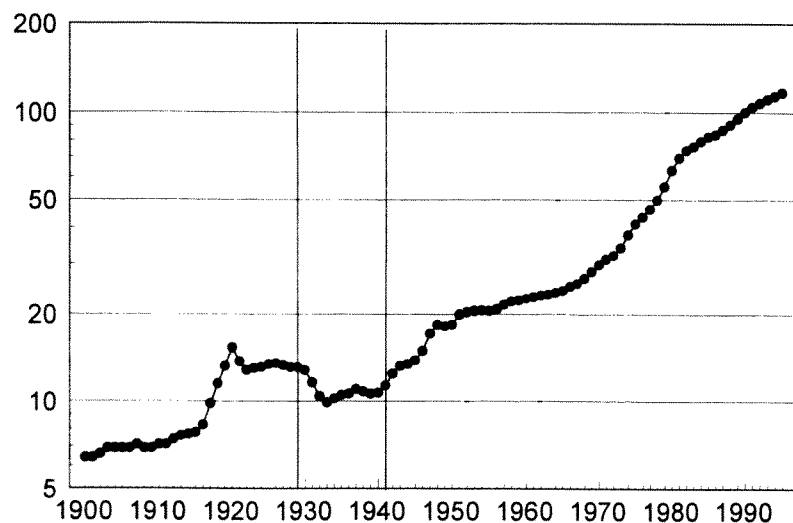


Fig. 4 Consumer price index, 1900–1995 (log scale; 1990 = 100)

Sources: 1990–1970, U.S. Bureau of the Census (1975, series E-135); 1971–95, U.S. Council of Economic Advisers (1996, table B-56).

Notes: The series have been transformed so that 1990 = 100. The consumer price index is graphed in (natural) log form. Vertical lines delineate the period of the Great Depression.

tural Adjustment Act and industry through the National Industrial Recovery Act. Centralized planning and direction seemed necessary to guide the functioning of markets, stabilize prices, and increase employment.

Confronted by the failure of the economy to recover, economists of the 1930s sought explanations for the causes of the Great Depression in John Maynard Keynes's *The General Theory of Employment, Interest and Money* (1936). These economists emphasized the collapse of investment produced by the end of the frontier, lower population growth from immigration restriction, the drop in residential construction, reduced wealth from the stock market crash, and the collapse of foreign trade following the Smoot-Hawley Tariff Act of 1930.⁶

Most economists today agree that the depression was primarily a consequence of both domestic and international monetary forces, although some emphasize the real forces of demography, structural change in the economy, and technology shocks.⁷ The monetary explanation for the Great Depression in the United States focuses on the money supply (M2), which declined by more than 33 percent between August 1929 and March 1933. The key source of the decline was a series of banking panics that led to the closing of more

6. On the Keynesian approach, see Temin (1976).

7. The literature on the causes of the Great Depression is vast. On the subject of domestic and international monetary forces, see, e.g., Bordo (1986, 1989), Eichengreen (1992), Romer (1993), and Temin (1993). On real-side factors, see, e.g., Temin (1989).

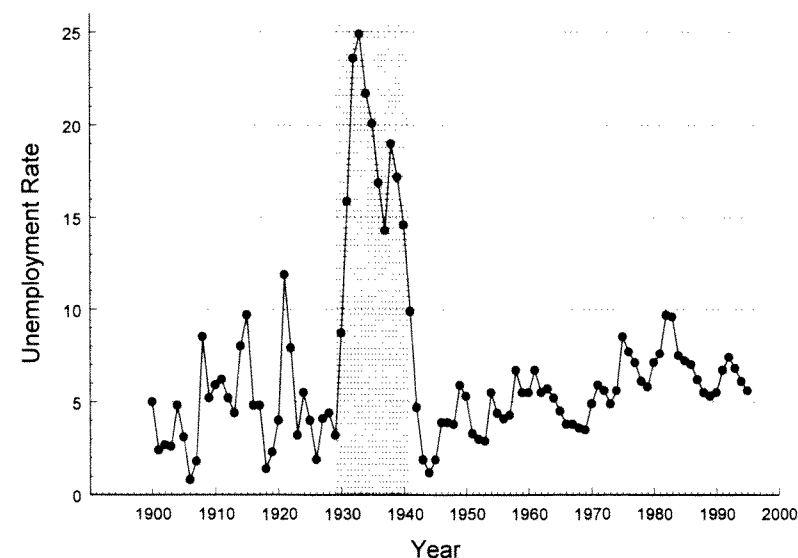


Fig. 5 Unemployment rate, 1900–1995

Sources: 1900–1970, U.S. Bureau of the Census (1975, series D-86); 1971–95, U.S. Council of Economic Advisers (1996, table B-39).

Notes: Hatched area delineates the period of the Great Depression. Unemployment refers to people 14 years old or older prior to 1947 and 16 years old or older afterward.

than one-third of the nation's banks in less than four years. The monetary collapse produced deflation and falling real output in the face of nominal rigidities.⁸ Friedman and Schwartz (1963) attribute monetary collapse and the banking panics to ineptitude by Federal Reserve officials who, according to their view, were unwilling and seemingly unable to use well-known tools of monetary policy to prevent the banking panics and to reverse the decline in money supply.⁹

In addition to domestic monetary forces, a recent revisionist view sees the gold standard as the cause of the Great Depression and its international propagator (see, e.g., Bernanke 1995; Eichengreen 1992; Temin 1989). According to this explanation, adherence to gold standard orthodoxy encouraged the monetary authorities of major countries, including the United States, to follow deflationary policies in the face of external shocks. Fixed exchange rates trans-

8. Alternative mechanisms by which monetary collapse may have led to depression include debt deflation (Fisher 1933) and credit disintermediation (Bernanke 1993).

9. Friedman and Schwartz (1963) explain the policy failure by institutional paralysis arising from a division between the Federal Reserve Board and the Reserve Banks, as well as the death of Benjamin Strong, the influential president of the Federal Reserve Bank of New York. For an alternative view—that the Federal Reserve followed a flawed policy strategy based on the real bills doctrine—see Meltzer (1995), Wheelock (1991), and Wicker (1965).

mitted the shock internationally, while maintenance of convertibility prevented the use of reflationary monetary policy domestically. Countries could extricate themselves from the depression only by cutting the link with gold (as Britain did in 1931 and the United States in 1933), devaluing their currencies, and following expansionary monetary and fiscal policies.¹⁰ The recovery that began in spring 1933, it is generally believed, reflected a series of Treasury-sponsored reflationary policies including the devaluation of the dollar in 1934 and expansionary fiscal policy and gold purchases (Friedman and Schwartz 1963; Romer 1992; De Long, chap. 2 in this volume).

Much concerning the origins, propagation, and persistence of the Great Depression is still debated. One feature, and possible consequence, of the slow and painful recovery that no one appears to contest was the growth of government.

Were the 1930s a Defining Moment for the U.S. Economy?

The Role of Government

The growth of large-scale government with a predilection for intervention is usually traced to the New Deal. Rockoff's chapter examines how the Great Depression produced a truly "great" expansion in the economic role of the federal government and created a propensity for further growth in subsequent decades. The transformation was a product of the depth and persistence of the unparalleled economic collapse. The federal government's share of civilian employment and its spending as a fraction of GNP both appear to have been permanently doubled by the depression, with the depression also initiating a steady growth in government's share of GNP.¹¹ The change was not merely one of size but also one of scope, with the government participating in many new areas. New Deal agencies continued to grow after World War II, and new agencies were formed to regulate more sectors of the economy.

One critical ingredient of this revolution was the decisive shift in public opinion about the appropriate role of government. The apparent failure of capitalism conditioned the public to accept proposed government intervention in markets. Farmers who lost their property, depositors turned away from their banks, the elderly with no pensions, and workers without jobs made the new government programs seem sensible. The question was no longer whether the government should intervene but why it should not.

10. There is debate on these points as well. Although the gold standard was the likely transmitter around the world of the deflationary shock from the United States, some argue that the Federal Reserve had sufficient gold reserves to follow expansionary policies without being hampered by "golden fetters" (Meltzer 1995).

11. There is an obvious difficulty in making such statements because GNP was enormously depressed in the 1930s. In addition, the federal government grew at the expense of other levels of government. On both these issues, see Rockoff (chap. 4 in this volume) and Wallis and Oates (chap. 5 in this volume).

And the question changed quickly. Given the limited role of government before 1929, the ability of the federal government to rapidly develop and deploy a wide variety of economic programs in response to the depression is striking. Rockoff shows that this rapid response was made possible by an ideological shift among economists from *laissez-faire* to interventionism that preceded the Great Depression by at least a decade. Only when its attention was focused by the calamity was the public ready to listen. "The New Deal," writes Rockoff, "was just what the doctors (of economics) ordered and . . . they believed their advice was soundly based on clinical evidence" (Rockoff, chap. 4 in this volume). The overwhelming majority of articles analyzing New Deal-type programs in major economic journals between World War I and 1929 were favorable. While the economic collapse galvanized even University of Chicago economists behind public works programs, most economists, especially microeconomists, had long studied and found merit in government intervention to correct what they judged to be market failures and deficiencies. Proposals for a minimum wage, social security, unemployment compensation, public ownership, public works, securities regulation, and deposit insurance were already on the table. Having studied reforms instituted in Europe, Canada, Australia, and at the state level in the United States, economists generally found favorable, supporting empirical evidence.

The experts were convinced of the need for more government intervention, but it took the depression to damage the public's strong ideological bias against it. Once established, the public's predisposition toward intervention endured for several decades. Beginning with the stagflation of the 1970s, skepticism about government intervention began to reappear. A shift in public opinion, like that in the 1930s, was preceded by a shift in opinion among economists. The 1930s was a defining moment in the conception of government's role. Even though public and professional opinion has continued to evolve, the depression created an environment of opinion that allowed the establishment of many lasting institutions.

A New Federalism

Although the size and scope of government intervention grew throughout the industrialized world in response to the depression, the American experience was strongly conditioned by its federal political structure. Wallis and Oates show that the depression and New Deal accelerated the move from "coordinate" or "dual" federalism to "cooperative" federalism. Prior to the economic collapse, states and localities had operated with relative independence from the national government. The depression made the national government dominant. It grew mainly at the expense of local, not state, governments (see fig. 2). The national government's influence was made even greater during the New Deal because much of its spending took the form of intergovernmental grants to states and localities. Today, federal grants no longer have economic expansion as their objective. Rather they provide fiscal support for specific projects

or for income maintenance. These grants, by the estimates of various economists, have a highly stimulative—what is known as a “flypaper”—effect on recipient governments, thus serving to increase the overall size of government.

Whereas some New Deal programs were uniform nationally, many had a truly federal character, allowing states authority in decision making when they accepted matching grants from Washington. This characteristic, which had few historical precedents, made the programs more palatable politically and helped ensure that they would become permanent fixtures by creating support not only among the programs’ ultimate beneficiaries but also among the administering state and local governments. During the 1960s and 1970s there was an explosion of social welfare programs; some were expansions of those begun during the New Deal. Others (like the War on Poverty) extended government in new directions, but not ones that would have been foreign to many New Dealers’ agendas. Beginning in the 1970s, and especially in the 1980s, Congress and the Republican administration gutted the War on Poverty. Yet many New Deal and New Deal-inspired programs remain part of the national landscape. Thus, for fiscal federalism, the 1930s were clearly a defining moment.

Protection and Insurance for Industry, Agriculture, and Banking

The Great Depression and the New Deal had profound effects on particular sectors. New Deal legislation altered the balance of power between special interest groups, and it locked in change in certain sectors. Innovations occurred in agriculture and banking. In those sectors, the New Deal increased the level and altered the character of intervention by providing new safety nets for farmers and for bank depositors. But this intervention stands in contrast to the decisive movement, at the same time, away from protectionism in U.S. tariff policy. In all three cases, the 1930s were a defining moment, but for different reasons.

Federal agricultural policy during the New Deal, according to Libecap, shifted from the provision of public goods and transfers on a limited basis to programs designed to raise prices and support farm incomes by controlling supply and enhancing demand. Although some of these programs find precedent in World War I policies, the intent of government purchases then was to aid the war effort, not raise prices. But farmers could not help noticing the influence government had on agricultural prices during the Great War, and in the 1920s, they lobbied for relief. Yet little came of their efforts. The major legislative emphasis was through the McNary-Haugen bills of the 1920s, which offered modest support for agricultural prices. These bills, however, were seen as special interest legislation and were not enacted into law. The more extensive and far-reaching farm crisis of the 1930s, with its plummeting incomes and soaring foreclosures, altered the perception of protective farm programs. Agricultural legislation eventually covered virtually all domestically produced commodities. The broad safety net and array of services offered to farmers helped to create a powerful and politically active farm lobby.

In banking, the New Deal created a corset of regulations that reduced com-

petition and insured deposits, protecting both depositors and bankers. Much of the legislation—notably deposit insurance—had been proposed before the depression, but it took the banking collapse of 1930–33 to alter the perception that deposit insurance was simply special interest legislation. Federalism, coupled with nineteenth-century banking legislation, had long before created a system of distinctly separate financial intermediaries numbering in the thousands. These, in turn, spawned interest groups concerned with preserving the structure of this system. When the New Dealers considered remedies for the collapse of the banking system, they did not attempt to alter the basic structure of the banking and financial system. Instead, they introduced anticompetitive legislation, such as controlled entry, prices, and products, and they instituted deposit insurance, all to preserve the status quo ante. Other countries also enacted various types of anticompetitive legislation to assist their weakened financial systems during the depression, but deposit insurance was a uniquely American invention designed to protect the small banks that had proliferated because of our federal structure and a host of pre-1930s regulations. The U.S. public’s general approval of insurance and its apparent success here made the idea of deposit insurance an exportable policy remedy in the 1960s, despite its specifically U.S. origin.

White shows in his chapter that banks, beginning in the 1950s, pressed Congress to increase the level of deposit insurance. Other financial intermediaries, concerned about the competitive advantages bestowed by deposit insurance, followed their lead and convinced Congress to broaden the insurance of financial liabilities, far beyond the initial boundaries conceived by the New Dealers. The introduction of new legislation—more deposit insurance in 1950, 1966, 1969, 1974, and 1980 plus insurance of thrifts, pension funds, and brokerage accounts in the 1970s—rarely occasioned any outcry because the public was conditioned by experience to regard the insurance of deposits and other liabilities as an appropriate task for government.

The financial structure generated by the New Deal and subsequent, complementary regulation allowed the macroeconomic shocks of the 1970s and 1980s to wreak havoc on savings and loan associations and banks. In their aftermath, most anticompetitive regulation was swept away. What remain are the policies that provide protection to concentrated groups of beneficiaries—banks and other financial intermediaries—while spreading the cost to the wider public.

As Irwin shows, the depression was also a defining moment for American commercial policy. But, instead of expanding protectionism, a formal system for tariff reduction was inaugurated. Throughout the nineteenth century, the nation cycled through high- and low-tariff regimes, as elections alternated power between the high-tariff Republicans and the low-tariff Democrats. The overwhelming Democratic victory in 1932 would traditionally have led Congress to revise tariff schedules downward. But worldwide depression produced a rise in foreign trade barriers that made unilateral tariff reduction an unattractive political option. The consequence of worldwide economic and politi-

cal chaos was a startling innovation—the Reciprocal Trade Agreements Act (RTAA) passed in 1934—whereby Congress granted the president the authority to negotiate reciprocal trade agreements without seeking congressional approval. Although there were no real pre-1930s antecedents, the way for reciprocal trade agreements negotiated by the president was eased by the introduction of the income tax in 1913 and the adoption, in 1923, of an unconditional most-favored-nation trade policy.

The RTAA locked in a process that has served to lower trade barriers. Rent seeking may have shifted to other forms of trade barriers, such as quotas, but under the RTAA industries are far less able to secure higher protective tariffs than under the previous system. This New Deal change is in direct contrast to the protection garnered in the 1930s by agriculture and banking. The RTAA survived the return of a Republican president and Congress in the 1950s. It became a fixture, as business and labor groups supported freer trade, which appeared not to threaten the dominant position of the United States in the post-World War II economy when open markets were linked to national security in the cold war.

A New Deal for Labor

At first glance, the misery visited upon American workers during the depression years was at least partly compensated for by the New Deal's granting of various types of social insurance and a "bill of rights" to organized labor. The unemployed gained some protection; an old-age pension scheme was created; the elderly poor, the disabled, and others in need were to receive federally encouraged state aid; and legitimation in the eyes of the law was awarded to unions. But the chapters on these issues reveal that the Great Depression was a defining moment for only some aspects of these enduring programs and legislation.

Most of the social programs of the New Deal were not invented in the 1930s. Various states had debated unemployment insurance (UI) schemes, for example, long before the Great Depression. Massachusetts did in 1916, as did Wisconsin in 1921. But, although six state legislatures introduced bills prior to the depression, UI generated little interest at the national level. Similarly, various state-level old-age assistance programs were in force before the depression. But these noncontributory programs provided scant income to few individuals and had strict means tests.

According to Baicker, Goldin, and Katz, unemployment compensation was destined to be adopted even in the absence of the depression, although the actual form taken by UI was crucially shaped by the environment of the 1930s. Miron and Weil echo the notion of eventual passage with regard to old-age pensions but do not see the 1930s as having substantially shaped the structure of the social security program.

The design of UI reflected, in part, Roosevelt's long struggle with the Supreme Court, and in that sense the depression was a defining moment in this

case study. The American UI system is unique. It is operated separately by each of the states and is experience rated within each state, which means that employers are generally penalized for causing unemployment. Although the essential characteristics of the program have not changed since 1935, its coverage has expanded from just over one-half, at its inception, to virtually the entire workforce today. UI was given a federal-state, rather than a national, structure because even though the Roosevelt administration might have generated sufficient congressional support to pass a national UI system, it feared the Supreme Court would invalidate it. Thus, UI was designed as a federal-state system to be upheld by the Court, and this structure has become a permanent feature. The experience rating of the system is linked by Baicker et al. to the federal-state structure, although the depression need not have been a defining moment here. Similarly, other portions of the Social Security Act, such as old-age assistance, aid to disabled persons, and aid to dependent children were instituted at the state level with partial support by federal contributions. Court precedent regarding conditional grants assured that such programs would survive the scrutiny of even a staunchly conservative Supreme Court.

The old-age insurance part of social security, however, was forced to deviate from the structure of these other programs. It was created as a national system because there was no other way to achieve actuarial soundness. At the time of its passage in 1935, 20 countries had compulsory, contributory, non-means-tested old-age insurance programs. But old-age pensions would not have passed Congress in 1935 had it not been for Roosevelt's steadfast desire to be the president who gave the American people their old-age security. UI, not old-age pensions, had broad-based support with the public and Congress. Roosevelt creatively tied the two together.

His administration further ensured that social security would be locked in place forever by making it self-financing out of payroll taxes, thereby creating the perception that benefits were paid as a matter of employee right. Roosevelt stated his intentions best: "We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. . . . With those taxes in there, no damn politician can ever scrap my social security program" (Schlesinger 1958, 308–9). Furthermore, the program expanded modestly to cover spouses and widows, in the 1950s to cover all private employees and the self-employed, and finally in 1983 to cover all federal civilian employees—meeting the architects' goal of universal coverage. Although the founders of social security did not anticipate the better health, higher life expectation, and lower labor force participation rates of future generations of American workers, Miron and Weil show in their chapter that the program has grown according to plan, with little change in the projected replacement rates and benefits.

Whereas social security and unemployment compensation have become permanent features of the economic landscape, unionization, which boomed during the depression, has not. The singular rise and long duration of unemploy-

ment helped to drive the surge in union membership. Previous spurts of union growth were modest by comparison, but then the economic contractions were also relatively modest. Most labor historians have attributed the burst of unionization during the 1930s to the passage of the National Industrial Relations (Wagner) Act in 1935 coupled with the dynamic leadership of the Congress of Industrial Organizations unions. The depression was certainly the catalyst for union formation and the rise in union membership, but Freeman shows that economic conditions, not new legislation, drove much unionizing activity. Recognition strikes and the growth of existing unions were the key factors, not the use of the new National Labor Relations Board election rules.

The Wagner Act did not guarantee a unionized economy, but it did prevent a sharp decline in union membership after the depression. A return to stable economic growth, the changing nature of work, and greater international trade all led to a long, slow decline in private sector unionization. Except for the public sector, labor market changes have reduced unionization to its predepression level. The act's primary effect, according to Freeman, has not been as much to aid the union cause as to reinforce labor-management conflict. Unionization became a legalistic business fought in the courts and before the National Labor Relations Board, with no provision for unions of supervisors, professionals, and managers or intermediate organizations—staff associations, work councils, or company unions—to give a voice to workers.

Macroeconomic Policy

At the macroeconomic level, the Great Depression inaugurated a new period of instability and policy activism. The birth of fiscal and monetary policy activism greatly complicated the choices of policymakers. As Obstfeld and Taylor point out, the "trilemma" of twentieth-century policymakers has been the incompatibility of fixed exchange rates, capital mobility, and discretionary monetary and fiscal policy. Before World War I, fixed exchange rates and capital mobility provided a stable international regime for the major economic powers, conducive to a century of steady growth and prosperity. The regime precluded the systematic use of discretionary fiscal policy. World War I shut down the gold standard, halted capital mobility, and was witness to extraordinary macroeconomic measures. Afterward, an attempt was made to reestablish the gold standard. The restoration was short lived as the dislocations of the Great Depression and World War II washed away the ideological attachment to gold. Exchange rates were fixed under Bretton Woods, but free convertibility was postponed, capital controls continued, and realignments permitted. This seismic shift of opinion reflected the deep-seated belief that domestic concerns must, at times, take precedence over adherence to a fixed exchange rate. In the 1930s, the public in the United States and Western Europe learned to judge a government not solely by its promise to maintain a fixed parity and price stability but also by its ability to maintain full employment and growth. Discretion-

ary domestic policy became a form of macroeconomic insurance against a new economic disaster.

The implications of this important change were largely cloaked by the disintegration of capital markets, which began during World War I, underwent a brief hiatus in the 1920s, and was completed during World War II. Fixed exchange rates were set under the Bretton Woods agreement, but capital controls remained in place. Yet these controls—like domestic price controls—could not endure market pressures indefinitely. Domestic political coalitions for capital controls in the United States, and elsewhere, were too feeble to frustrate the public's interest in the pursuit of full-employment policies by the government. The gradual reintegration of capital markets, begun in the 1960s, brought the trilemma to the fore. And when governments could not abstain from discretionary macroeconomic policy, the system of fixed exchange rates collapsed in the 1970s.

The Great Depression's legacy of domestic policy activism ultimately led to an international policy regime of floating exchange rates and international capital mobility. Bordo and Eichengreen address the counterfactual question of whether a fixed-rate regime could have survived in the absence of the Great Depression. This regime would have avoided the Bretton Woods innovations and would have been a gold exchange standard of pegged rates and unlimited capital mobility. It would have been suspended during World War II then reinstated at the original parities after the war, following the post-World War I example. It is unlikely, however, that this resumption would have been achieved by a big deflation and recession, as had occurred in 1919–21, because of the memory of that negative experience. The liquidity generated during the war obviated the need to repeat the post-World War I experience of deflation. Rapid economic growth would then have produced a gold scarcity, leading to a pure dollar-gold exchange standard. The unwillingness of many countries to accept this evolution would have precipitated a move to floating exchange rates. Thus, the Great Depression was not a defining moment for the international monetary system because it did not alter the system's ultimate evolution.

Like other developed nations, the United States had traditionally adhered to an orthodox fiscal policy of balanced budgets in which macroeconomic management of the business cycle was nonexistent. Deficits happened only in times of war, and in the peace that followed, surpluses reduced the debt incurred during the war. Hence, in the 1920s, the U.S. government debt was halved. The depression created a large peacetime deficit, which seemed impossible to cure by tax increases or cuts in spending. As De Long's chapter shows, the government was forced, during the depression, to change its ideology and trumpet the fiscal advantages of unbalanced budgets.

The depression also made fiscal policy potentially effective by increasing the size of government to the point at which the new automatic stabilizers could contribute significantly. The failure of the economy to rapidly recover

convinced the public that cyclical deficits were an acceptable fact of fiscal life. New Deal relief programs, unemployment compensation (which began paying out in 1938), and other automatic stabilizers were regarded by the public as important guarantees or insurance. Congress attempted to codify this momentous shift in the nation's opinion with the Employment Act of 1946. Neither the economic crises nor the response of replacing fiscal conservatism with macroeconomic activism were unique to the United States. Rather, they were common to most industrialized nations. The Keynesian fiscal revolution, initiated by the Great Depression, pushed beyond these changes in its second generation to an acceptance of not just cyclical but also structural deficits in the 1980s. Recent demands for a balanced budget amendment suggest that peacetime budget deficits may not be permanent features of the macroeconomic landscape.

Whereas the precepts of fiscal policy had remained unchanged for a century before the depression, the establishment of the Federal Reserve System in 1913 was a recent institutional innovation. In the decade before the Great Depression, the Federal Reserve had pursued an active countercyclical monetary policy. Calomiris and Wheelock argue that the depression did not change the Federal Reserve's goals and tactics as much as it altered its tools and external environment.

The Fed's pre-1929 procyclically biased operating procedure continued, first during the depression and then during World War II. The gravity of the depression and the obtuseness of Federal Reserve officials, however, weakened the public's long-standing unwillingness to accept political pressure on monetary policy. By increasing the power of the presidentially appointed Federal Reserve Board over the Federal Reserve Banks, New Deal banking legislation reduced the Fed's independence vis-à-vis the Treasury. The Fed was also granted authority to use government securities to back note issues, removing a key limit on the monetization of debt. Most important, abandonment of the gold standard in 1933 helped permanently eliminate a crucial restraint on policy. The continuance of the Fed's pre-1930s operating methods, pressures to monetize government debt, and the lifting of the nominal gold anchor allowed the Fed to acquiesce to low-level inflation in the 1960s. Once the last vestiges of the gold standard were erased, when Nixon closed the gold window in 1971, inflation spiraled upward.

Conclusion

The chapters in this volume offer testimony to the legacy of the Great Depression. Without the depression, there would not have been a flood of New Deal-style legislation. Some innovations would have occurred following the dictates of economic growth, the two world wars, and the nation's political economy. But, lacking the catalyst that jarred public attitudes and demanded action, the new economic institutions would have been more modest and dif-

ferent in character. The large role of today's government and its methods of intervention—from the pursuit of more activist monetary policy to the maintenance and extension of a wide range of insurance for labor and business—derive from the crisis years of the 1930s. Not all programs inaugurated by the New Deal have survived. But 60 years later, the basic imprint of the defining moment is still visible.

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