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## **The Fallacies of Another New Deal, Part 2**

**by William L. Anderson**

In the latter part of 1920, the economy fell into a deep recession, which lasted well into 1921. As Murray Rothbard points out, it was the last downturn in which the government did not play much of a role. Newly elected President Warren G. Harding openly said that government should not be involved. Rothbard notes that at a 1921 conference on unemployment (called together by Herbert Hoover, the Secretary of Commerce) Harding emphatically made his views known:

President Harding's address to the conference was filled with great good sense and was almost the swan song of the Old Order's way of dealing with depressions.

Harding declared that liquidation was inevitable and attacked governmental planning and any suggestion of Treasury relief. He said, "The excess stimulation from that source is to be reckoned a cause of trouble rather than a source of cure."

When Hoover became president in 1929, he would not make Harding's "mistake." Indeed, in less than a year, he had signed the disastrous Smoot-Hawley Tariff, and had called together a conference of business and labor leaders and urged them to keep prices and wages from falling.

If there is one common error made by people of all groups, lay and professional, it is this: the belief that economic downturns are *caused* by falling prices. Indeed, Martin Feldstein of Harvard University, and President Ronald Reagan's chief economic advisor, wrote in 2008 in the *Wall Street Journal* that falling housing prices were *impeding* economic recovery.

Because people believe that falling prices *cause* economic downturns, the solution seems simple enough: force up prices across the board. That is what both Hoover and later Franklin Roosevelt tried to do, and the results were disastrous.

Prices fall as a result of changes in economic activity; they are the *effect* of certain changes, not their cause. For example, in recent months, housing prices have fallen because the go-go lending system that poured money into that market has come apart as a result of its own excesses.

To put it another way, the *economic fundamentals* of the housing market have changed, and an injection of new money into it will not change the fact that for the time being, it is a moribund market.

### **Forcing up prices**

Unfortunately, neither Hoover nor Roosevelt saw things that way, and both men were determined to force up prices by any means possible. For example, in November 1929, Hoover called a meeting of business and labor leaders to respond to the stock-market crash of a month before. Rothbard writes,

The most important White House conference was held on November 21. All the great industrial leaders of the country were there, including such men as Henry Ford, Julius Rosenwald, Walter Teagle of Standard Oil, Matthew Sloan, Owen D. Young, Edward Grace, Alfred P. Sloan, Jr., Pierre DuPont, and William Butterworth. The businessmen asked Hoover to stimulate the cooperation of government and industry. Hoover pointed out to them that unemployment had already reached two to three million, that a long depression might ensue, and that wages must be kept up! Hoover “explained that immediate ‘liquidation’ of labor had been the industrial policy of previous depressions; that his every instinct was opposed to both the term and the policy, for labor was not a commodity: it represented human homes.... Moreover, from an economic viewpoint such action would deepen the depression by suddenly reducing purchasing power.”

To force up prices, not only did Hoover urge that business keep prices and wages from falling, but he also signed the disastrous Smoot-Hawley Tariff the next year, which drastically increased tariff rates on large numbers of goods. Not only did the tariff invite retaliation from abroad, but it had the opposite effect on agriculture prices that Hoover supposedly had intended.

With export markets eliminated, farm prices fell, and with them came down the rural and small-town banks that did not have the capital to survive the inability of farmers to repay crop loans. Furthermore, contrary to what one might read from other economic historians, the Federal Reserve System aggressively pursued open-market operations in an attempt to expand credit. However, with the previous lines of production having been tapped out in the bust, this action only blocked the necessary liquidation of the malinvestments, thus blocking the recovery.

Famed investor Jim Rogers, on a recent television appearance, said that in a crash the companies with bad fundamentals, including those with a lot of unpayable debt or asset sheets that are low on cash reserves, are the ones that go down. However, not all firms and individuals have been played for suckers during the unsustainable boom, and they tend to have much more

solid fundamentals. It is precisely *those* firms and individuals, says Rogers, that lead the way out of the crash and bring about the economic recovery.

However, by insisting that the unhealthy firms be propped up, Hoover delayed the inevitable liquidations *and in the process kept the firms with healthy balance sheets from taking the necessary leadership positions*. From attempts to stop short-selling in financial markets to pushing a huge tax increase through Congress, he confounded good economics fundamentals with bad policies that made the trough deeper than it would have been had true laissez-faire policies been followed, and then blocked whatever recovery might have happened.

By the time Franklin Roosevelt took office in March 1933, the nation's overall rate of unemployment was an astounding 28 percent. Thousands of banks had failed and the entire U.S. banking system seemed to hang in the balance. Writes Lawrence Reed,

How bad was the Great Depression? Over the four years from 1929 to 1933, production at the nation's factories, mines, and utilities fell by more than half. People's real disposable incomes dropped 28 percent. Stock prices collapsed to one-tenth of their pre-crash height. The number of unemployed Americans rose from 1.6 million in 1929 to 12.8 million in 1933. One of every four workers was out of a job at the Depression's nadir, and ugly rumors of revolt simmered for the first time since the Civil War.

The Roosevelt administration promised it would end the Depression and bring the economy back to its feet. Instead, Roosevelt continued and expanded Hoover's programs, and the high rates of unemployment would continue for almost nine years. At the end of that period, in Roosevelt's unprecedented third term in office, America faced the most cataclysmic war in its existence.

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