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Five Myths About the Great Depression

Herbert Hoover was no proponent of laissez-faire.

By ANDREW B. WILSON

The current financial crisis has revived powerful misconceptions about the Great Depression. Those who misinterpret the past are all too likely to repeat the exact same mistakes that made the Great Depression so deep and devastating.

Here are five interrelated and durable myths about the 1929-39 Depression:

- *Herbert Hoover, elected president in 1928, was a doctrinaire, laissez-faire, look-the-other way Republican who clung to the idea that markets were basically self-correcting*. The truth is more illuminating. Far from a free-market idealist, Hoover was an ardent believer in government intervention to support incomes and employment. This is critical to understanding the origins of the Great Depression. Franklin Roosevelt didn't reverse course upon moving into the White House in 1933; he went further down the path that Hoover had blazed over the previous four years. That was the path to disaster.

Hoover, a one-time business whiz and a would-be all-purpose social problem-solver in the Lee Iacocca mold, was a bowling ball looking for pins to scatter. He was a government activist fixated on the idea of running the country as an energetic CEO might run a giant corporation. It was Hoover, not Roosevelt, who initiated the practice of piling up big deficits to support huge public-works projects. After declining or holding steady through most of the 1920s, federal spending soared between 1929 and 1932 -- increasing by more than 50%, the biggest increase in federal spending ever recorded during peacetime.

Public projects undertaken by Hoover included the San Francisco Bay Bridge, the Los Angeles Aqueduct, and Hoover Dam. The Republican president won plaudits from the American Federation of Labor for his industrial policy, which included jawboning business leaders to refrain from cutting wages as the economy fell. Referring to counteracting the business cycle and propping up wages, Hoover said: "No president before has ever believed that there was a government responsibility in such cases . . . we had to pioneer a new field." Though he did not coin the phrase, Hoover championed many of the basic ideas -- such as central planning and control of the economy -- that came to be known as the New Deal.

- *The stock market crash in October 1929 precipitated the Great Depression.* What the crash mainly precipitated was a raft of wrongheaded policies that did major damage to the economy -- beginning with the disastrous retreat into protectionism marked by the passage of the Smoot-Hawley tariff, which passed the House in May 1929 and the Senate in March 1930, and was signed into law by Hoover in June 1930. As prices fell, Smoot-Hawley doubled the effective tariff duties on a wide range of manufactures and agricultural products. It triggered the beggar-thy-neighbor policies of countervailing tariffs that caused the international economy to collapse. Some have argued that the increasing likelihood that the Smoot-Hawley tariff would pass was a major contributing factor to the stock-market collapse in the fall of 1929.

- *Where the market had failed, the government stepped in to protect ordinary people*. Hoover's disastrous agricultural policies involved the know-it-all Hoover acting as his own agriculture secretary and in fact writing the original Agricultural Marketing Act that evolved into Smoot-Hawley. While exports accounted for 7% of U.S. GDP in 1929, trade accounted for about one-third of U.S. farm income. The loss of export markets caused by Smoot-Hawley devastated the agricultural sector. Following in Hoover's footsteps, FDR concentrated on trying to raise farm income by such tactics as setting quotas on production and paying farmers to remove acreage from production -- even though this meant higher prices for hard-pressed consumers and had the effect of both lowering productivity and driving farmers off their land.

- *Greed caused the stock market to overshoot and then crash.* The real culprit here -- as in the housing bubble in our own time -- is the one identified by the economic historian Charles Kindleberger in the classic book "Manias, Panics, and Crashes": a speculative fever induced by excessively easy credit and broken by the inevitable return to more realistic valuations.

In the late 1920s, cheap and easy money fueled a tremendous increase in margin trading and a proliferation of "investment trusts" that offered little in the way of dividends or demonstrable earnings per share, but still promised phenomenal capital gains. "Speculation," as Kindleberger neatly defined it, "involves buying for resale rather than use in the case of commodities, and for resale rather than income in the case of financial assets."

The last thing Hoover wanted to do upon coming to office was to rein in the stock market boom by allowing interest rates to rise to a more normal level. The key to prosperity, in his view, lay not in sound money and rising productivity, but in letting the good times roll -- through government action aimed at maintaining high wages and high stock market valuations.

- *Enlightened government pulled the nation out of the worst downturn in its history and came to the rescue of capitalism through rigorous regulation and government oversight*. To the contrary, the Hoover and Roosevelt administrations -- in disregarding market signals at every turn -- were jointly responsible for turning a panic into the worst depression of modern times. As late as 1938, after almost a decade of governmental "pump priming," almost one out of five workers remained unemployed. What the government gave with one hand, through increased spending, it took away with the other, through increased taxation. But that was not an even trade-off. As the root cause of a great deal of mismanagement and inefficiency, government was responsible for a lost decade of economic growth.

Hoover was destined to fill the role of the left's designated scapegoat. Despite that, the one place where he and FDR truly "triumphed" was in enlisting the support of leading writers and intellectuals for government planning and intervention. This had a lasting effect on the way that generations of people think about the Great Depression. The antienterprise spirit among thought leaders of this time (and later) extended to top business publications. "Do you still believe in Lazy-Fairies?" Business Week asked derisively in 1931. "To plan or not to plan is no longer the question. The real question is who is to do it?"

In his economic policies and his incessant governmental activism, Hoover differed far more sharply with his Republican predecessor than he did with his Democratic successor. Calvin Coolidge, president from 1923 to 1929, made no secret of his disdain for Hoover, who served as his secretary of commerce and won praise from such highly regarded liberals as John Maynard Keynes and Jean Monnet. "That man has offered me unsolicited advice for six years, all of it bad," Coolidge said. He mockingly referred to Hoover as "Wonder Boy."

With the vitality of U.S. and world economies at stake, it is essential that the decisions of the coming months are shaped by the right lessons -- not the myths -- of the Great Depression.

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