

# "Depressions, Crises, and Economic Policy: The 1930s and Today"

Government Policies that Impede Competition

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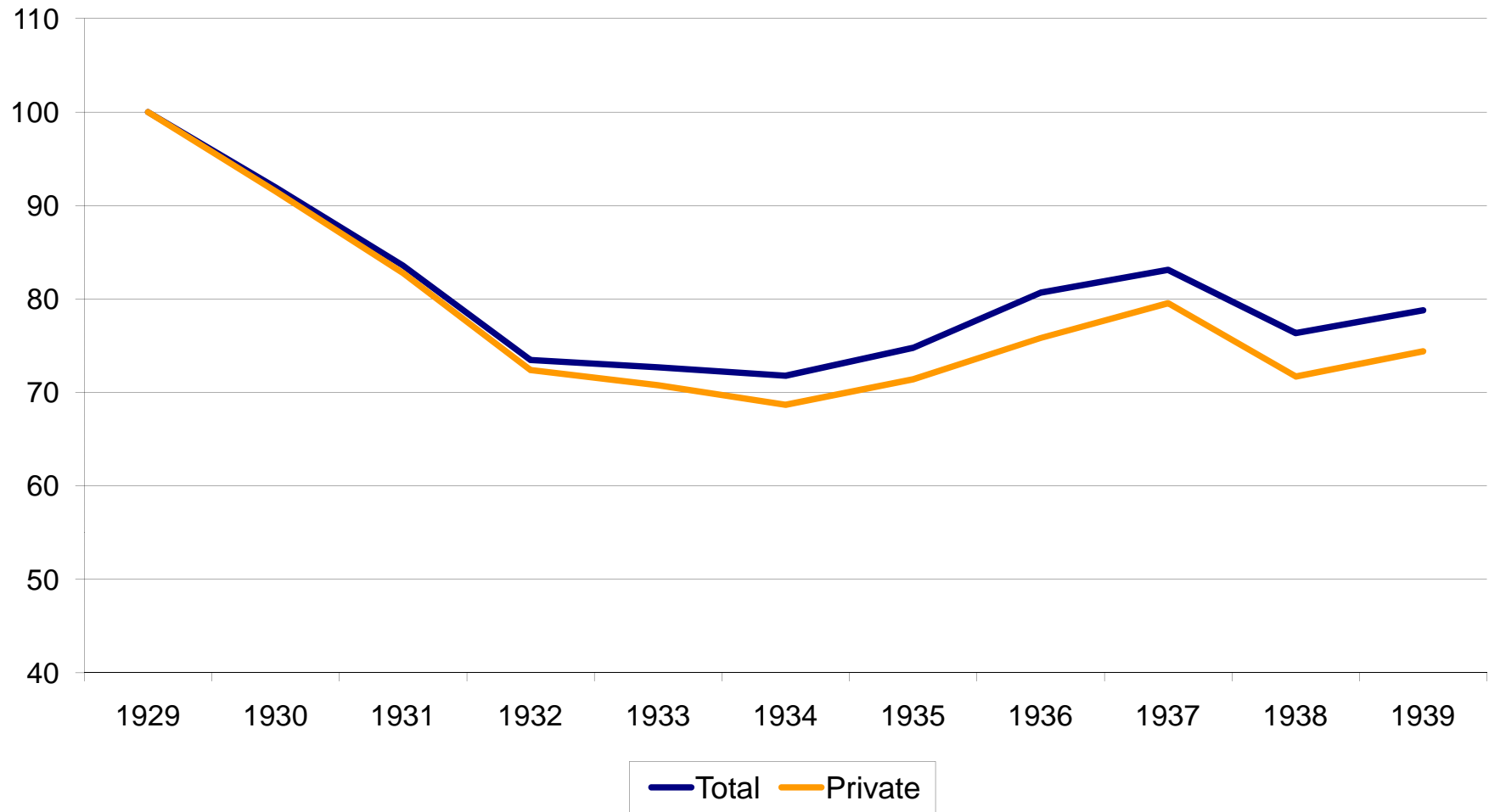
# Depressions and Crises

- Remain a significant challenge for economic theory
- Particularly in economies that function well – US & other OECD countries.
  - Why does a good economy go so bad, and for so long?
  - What causes them, and what prevents rapid recovery?
- Today, discuss US Great Depression and 2007-09 recession

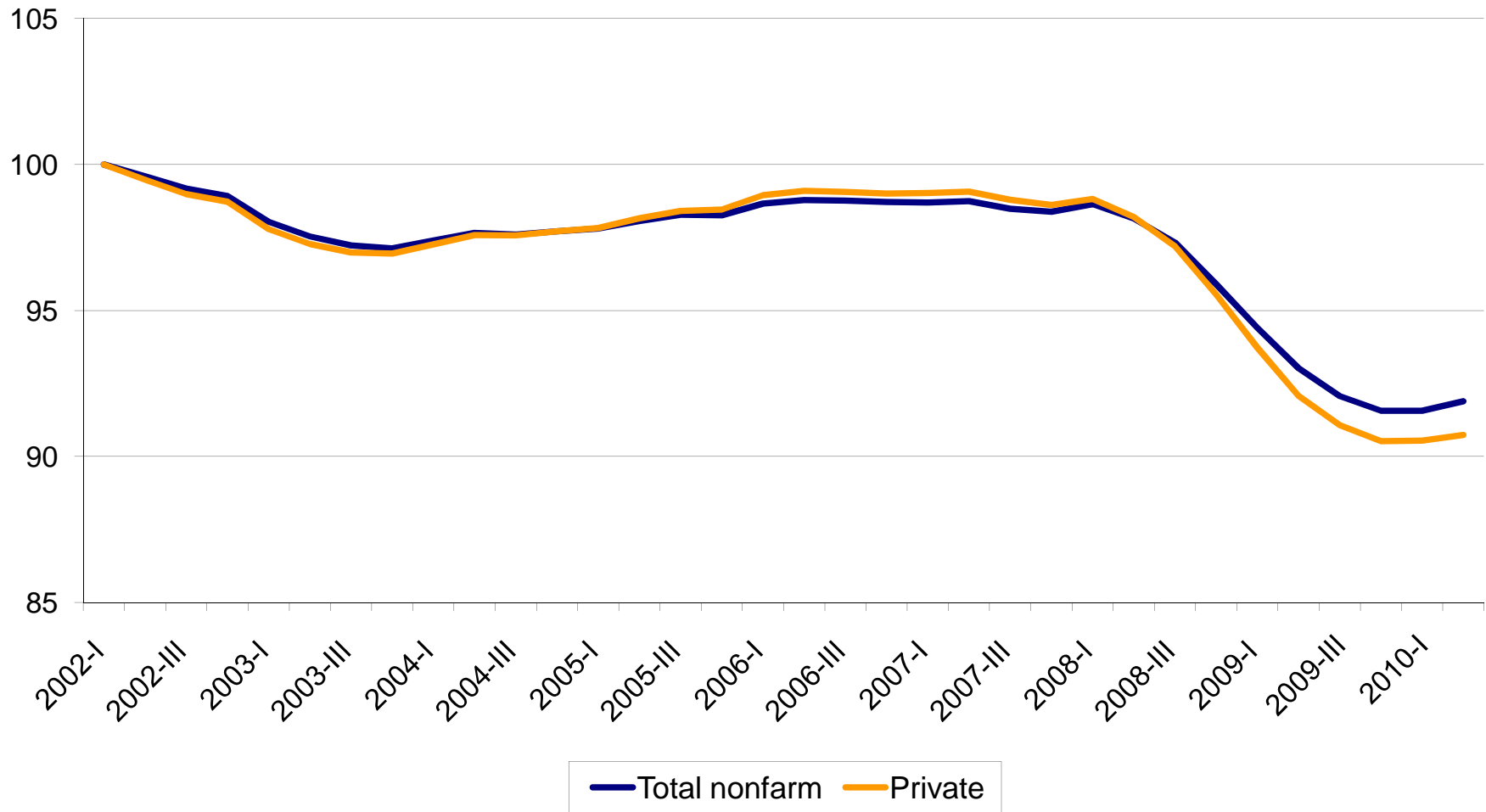
# 1930s and Today - Labor Market Distortions

- Key to understanding both episodes is labor market distortions
- Important for employment declines and recovery failure in both episodes
- Both episodes similar with  $MRS \ll MPL$

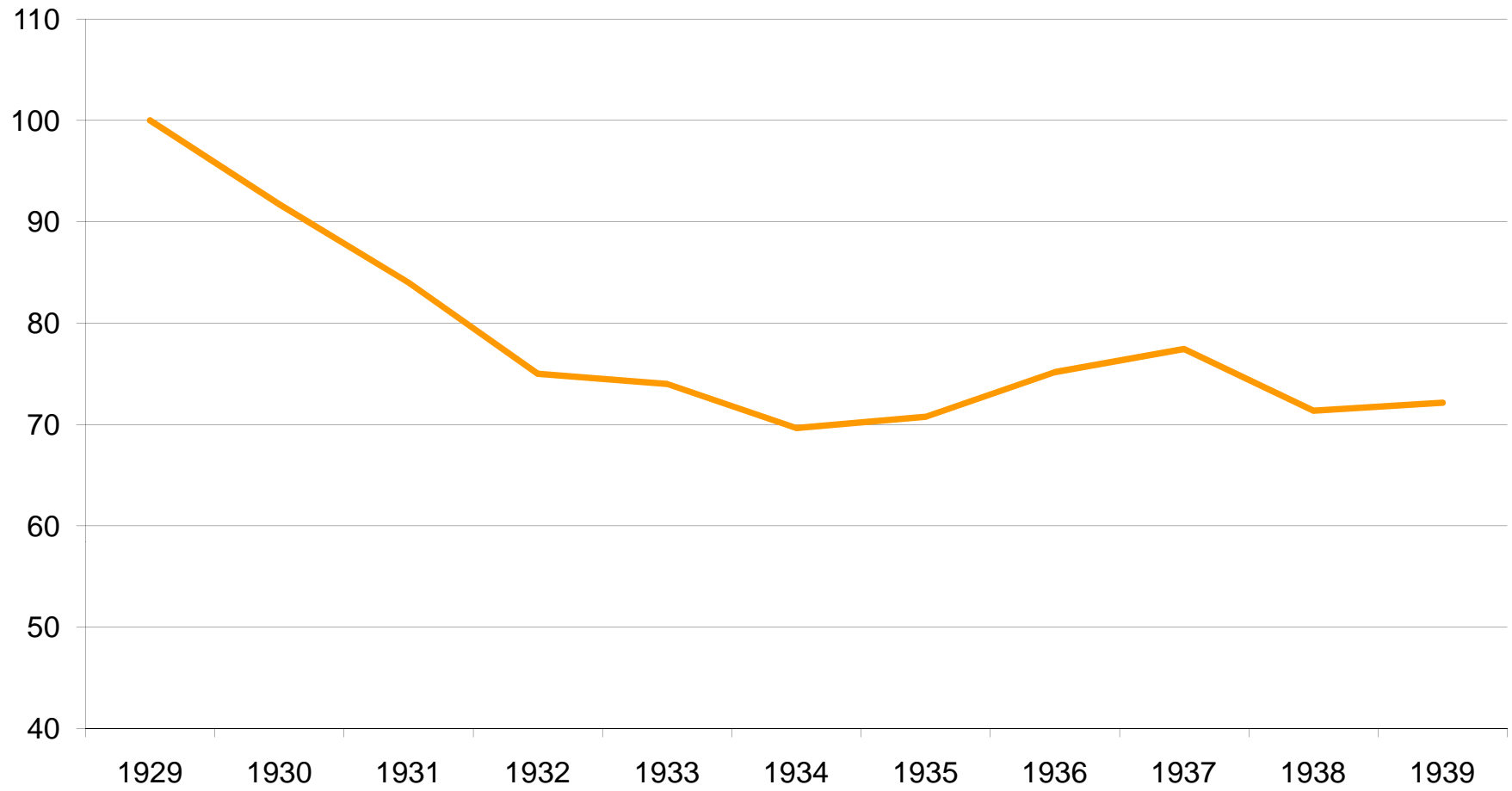
## Hours Worked Per Capita 1929-39 (1929 = 100)



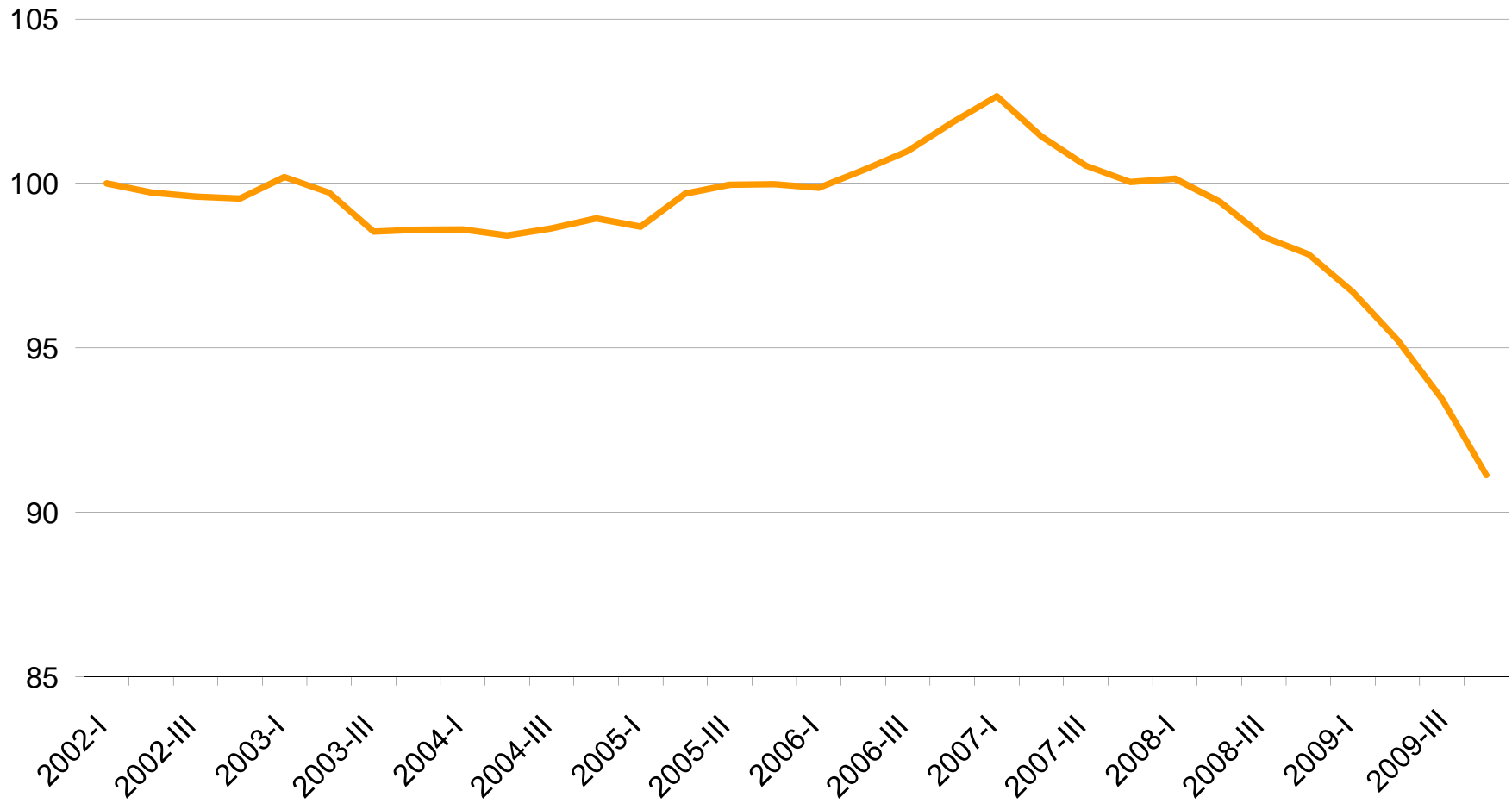
## Employment Per Capita 2002Q1 - 2010Q2 (2002Q1 = 100)



### Labor Wedge 1929-39 (1929 = 100)



### Labor Wedge 2002Q1 - 2009Q4 (2002Q1 = 100)



# Labor Market Distortions and Economic Policy

- Evidence policies that restricted competition key for 1930s
- Created labor market failure by setting wages above market clearing
- MRS gap puzzling today, though policy may also be important

- "What - or Who - Started the Great Depression?", *JET*, 2009
- "New Deal Policies and the Persistence of the Great Depression", with Hal Cole, *JPE*, 2004
- "The 2007-2009 Recession from a Neoclassical Perspective", *Journal of Economic Perspectives*, forthcoming

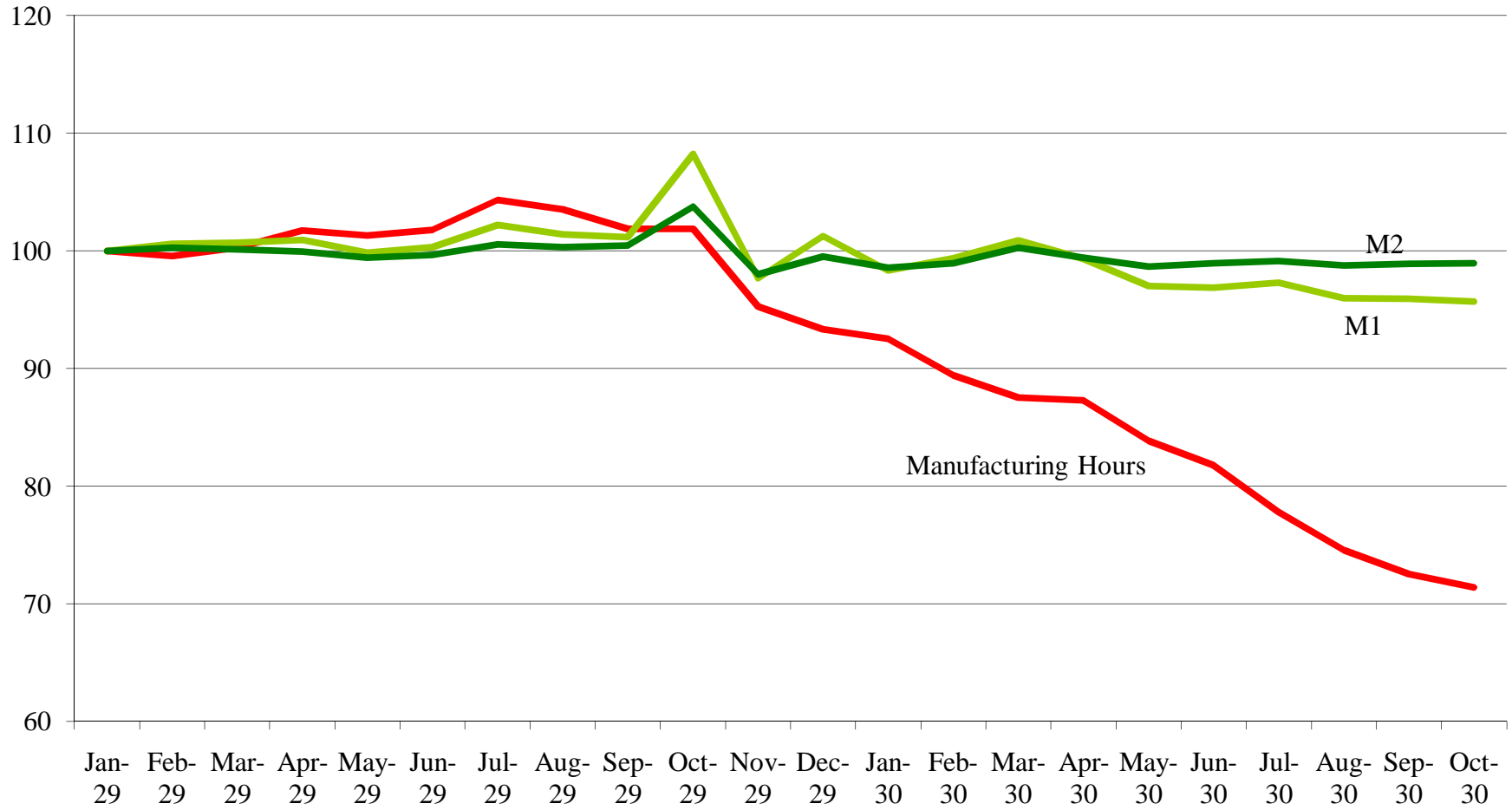
# 1930s: Hoover and FDR Market Interventions

- Both advanced policies that restricted competition and raised wages and relative prices
- Present evidence these policies reduced employment and distorted the MRS-W condition

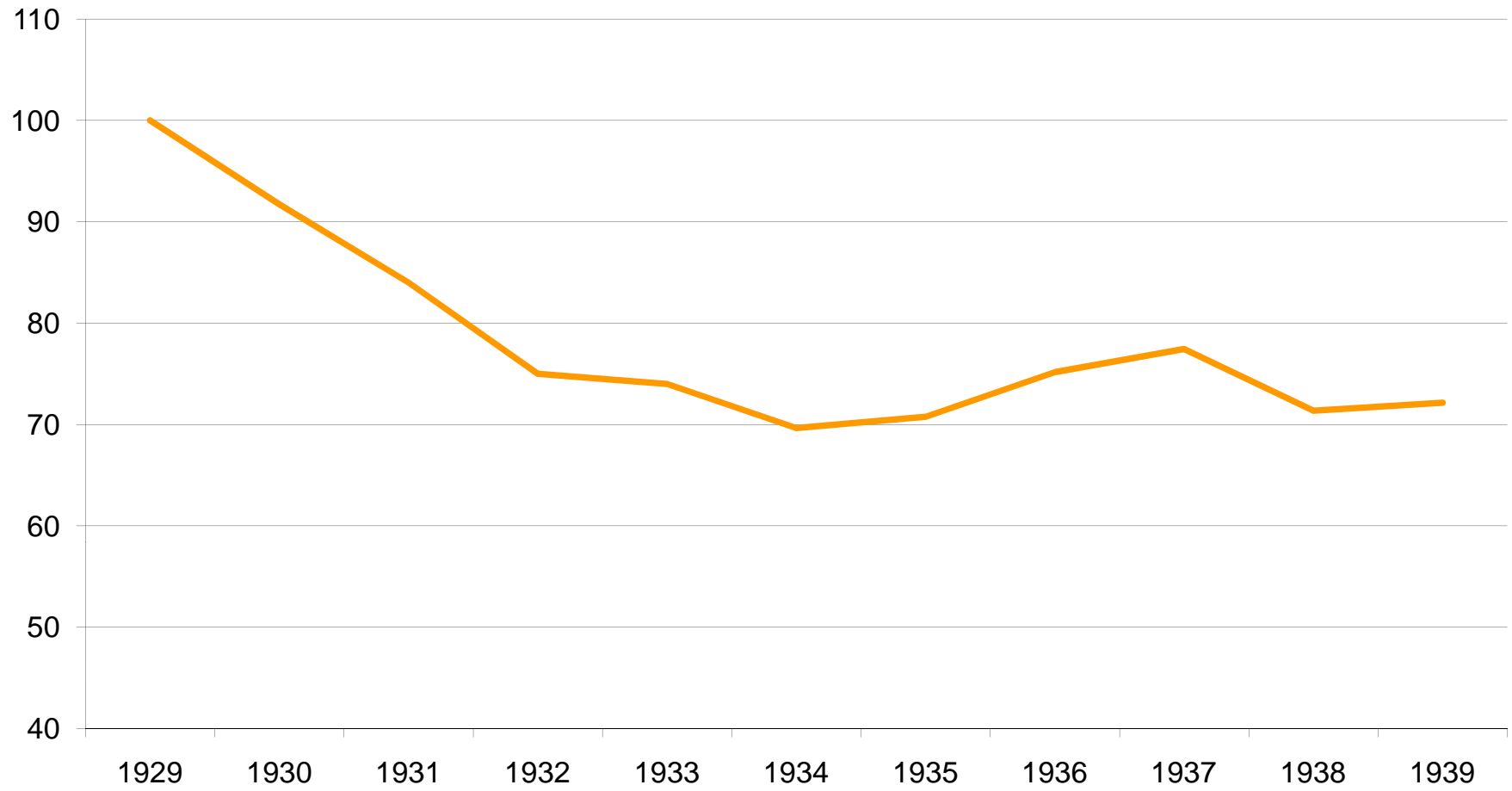
# Surprising Facts About the Depression

- Textbook views about Depression
  - Started as "garden variety recession"
  - Monetary and banking declines made it severe
  - Significant recovery after 1933
- Depression immediately severe, before monetary contraction and banking panics
- Industry Depressed but not agriculture
- Agricultural hours worked and output change little

Figure 1 - Manufacturing Hours and the Money Supply  
Index (Jan 1929=100)



### Labor Wedge 1929-39 (1929 = 100)



# Labor Market Distortions Begin in Late 1929

- Micro evidence - Curtis Simon, JEH, 2001
- Situation wanted advertisements provide data on *supply price* of labor
- Before depression, supply price of labor and wage very similar
- During depression, supply price *falls 30% lower than wage*
- Wage too high, labor market not clearing,  $MRS \ll W$

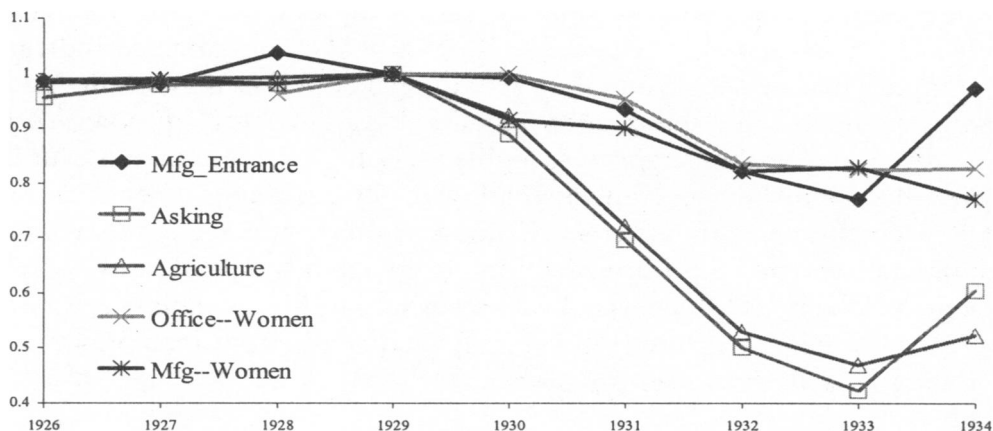


FIGURE 6  
NORMALIZED AGRICULTURAL WAGES PAID AND COMPARISONS, 1926–1934  
(1929 = 1.0)

Source: See note 30.

### *Wages Paid in Agriculture*

Some readers may find it difficult to credit the notion that the supply price of labor could have fallen so steeply between 1929 and 1933. The case would be strengthened if evidence could be found of a decline of this magnitude from another sector of the economy. The data from agriculture provide just such evidence. Aggregate data on wages and employment obscure important differences between the farm and nonfarm economy. Wages paid in agriculture—a sector that rivaled manufacturing in size—were remarkably flexible, and employment remarkably stable. Figure 6 graphs annual average wages paid in agriculture along with clerical wages asked.<sup>30</sup> Also shown for comparison are clerical wages paid and entrance wages paid in manufacturing. Again, all series have been normalized to equal unity in 1929. Between 1929 and 1933, wages paid in manufacturing declined by only 17.2 percent. By contrast, wages paid in agriculture fell by 53 percent between 1929 and 1933, which was remarkably close to the 58 percent decline in clerical wages asked. Over the same period, private nonfarm employment fell by 27.3 percent, and manufacturing employment fell by about 31 percent, but the quantity of labor employed in agriculture fell by only about two-tenths of one percent from 12,763 to 12,739 thousand.<sup>31</sup>

<sup>30</sup> These data were constructed by Lee Alston and T. J. Hatton, who compared wages in manufacturing and agriculture for a period that included during the Depression, and whose careful analysis included adjustments for the value of perquisites (as distinguished from board—many unboarded workers also received in-kind compensation).

<sup>31</sup> U.S. Bureau of the Census, *Historical Statistics*, p. 468. Total farm employment includes farm proprietors, hired labor, and “unpaid” family workers. Family workers rose from 9,360 to 9,874 thousand, about 5.5 percent. This rise was more than offset by a decrease in hired workers from 3,403

# What is Source of Labor Market Failure?

- Economic policies that fostered cartels and wage fixing
- Why policies chosen? Belief policies would raise employment - also redistribute
- Hoover on cartels:

"In 1927 as Commerce Secretary, I wrote the foreword to a bulletin on "Trade Association Activities" I said: 'the national interest requires a certain degree of cooperation between individuals in order that we may reduce and eliminate industrial waste....the great area of economic wrong that springs up under the pressures of destructive competition...through failure of our different industries to synchronize.. we enlisted the different trade associations in creation of codes of fair business practice that eliminate abuses."

# FDR Believed Competition Was The Problem

- FDR on competition:

"A mere builder of more plants, a creator of more railroads an organizer of more corporations, is as likely to be a danger as a help"

- Many of FDRs advisors were wartime economic planners
- Gov planning, not markets, used to allocate many resources during WWI
- Planners interpreted higher output as result of planning and wage administration
- Believed reducing competition and increase wages - as in WWI - would foster recovery

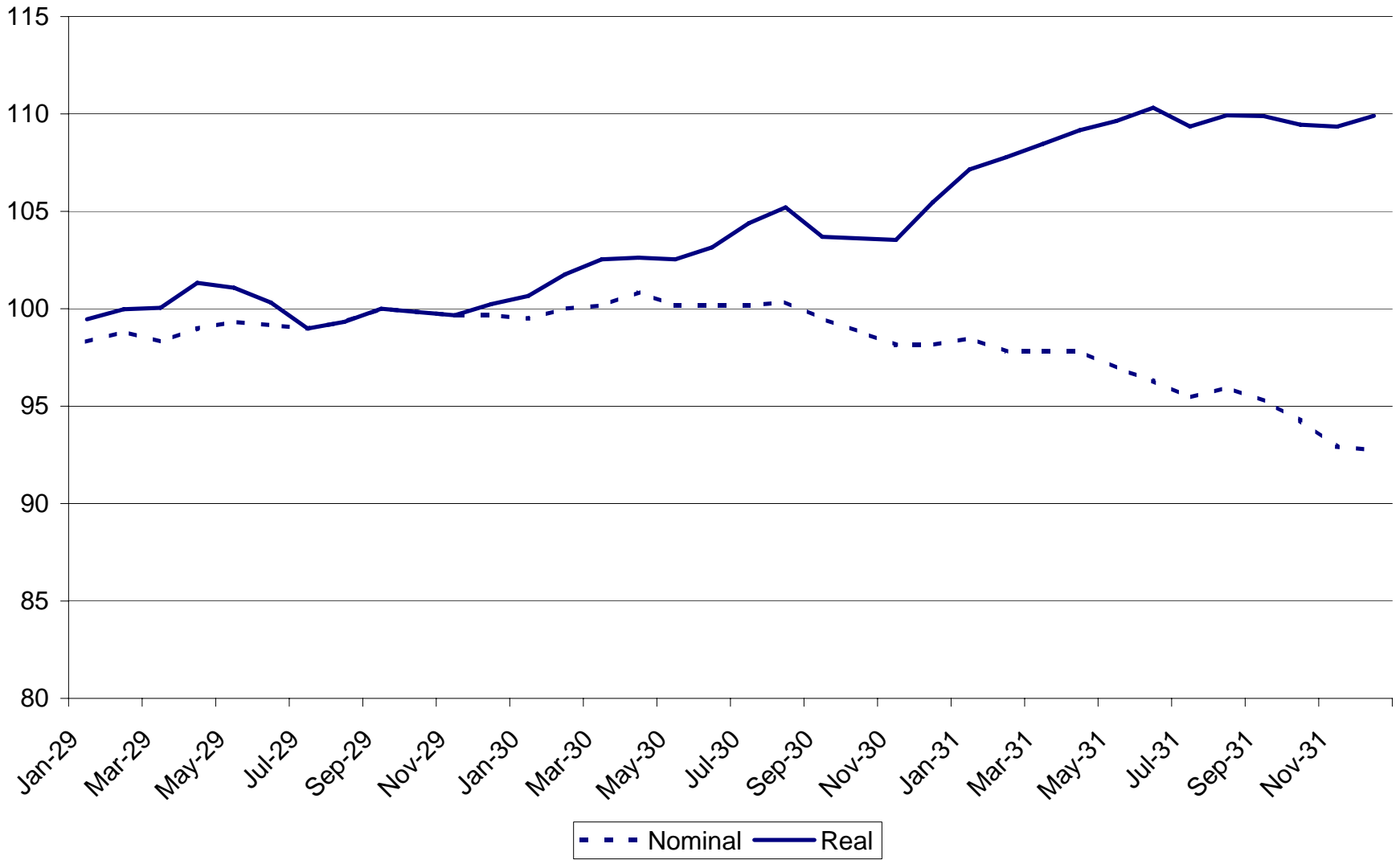
# Hoover's Wage Fixing Program

- After stock market crash, Hoover meets with Industry and advises:
  - "Dont cut wages, this will help me keep the peace with labor"
  - "wages have not kept pace with profits, this recession will not be born by workers"
  - "Share work as much as you can"
- Firms unanimously agree (GM, Ford, Dupont, US Steel...)

# Hoover's Wage Fixing Program

- Meets with organized labor, and asks them not to strike
- Both sides keep pledge
- As prices fall, real wage rises, and employment falls
- Industry asked if Hoover would support wage cuts
- Hoover declines "If wages are cut, there will be hell to pay with unions"
- Industry keeps wage pledge until late 1931

**Figure 3 - Manufacturing Wages**  
(Sept 1929 = 100)



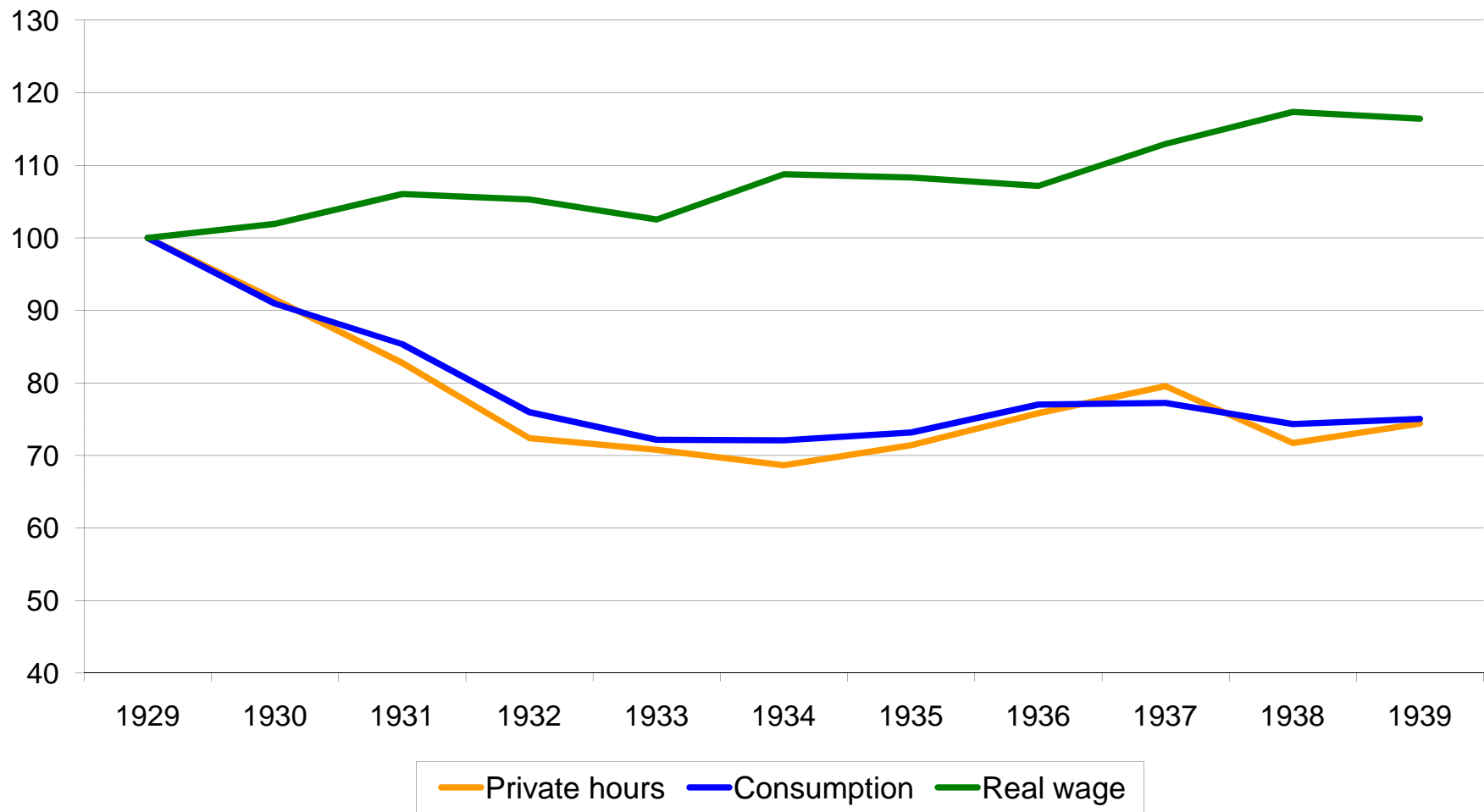
# FDR' Extends Cartels & Wage Fixing

- National Industrial Recovery Act (1933)
- Covered over 500 narrowly defined industries
- Explicit collusion (no antitrust prosecution)
- "Fair competition" codes were operating rules for industry
  - minimum prices
  - production and investment quotas - classic cartel
- Code approved by government only if:
  - immediately increase wages
  - industry agreed to collective bargaining
- NIRA ends in 1935, but policy continues with no anti-trust and Wagner Act

# Result of Policies - High Wages

- wages rise following policies
- mfg relative price and real wages rise 15 - 20% by 1938

**Per Capita Hours and Consumption, and Real Wage 1929-39**  
(1929 = 100)



# Analyzing Impact of Collusion/Wage Fixing Policies

- Economic model - 2 sectors - industry (subject to policy), agriculture (not subject to policy)
- Rep household has standard preferences over consumption and leisure
- Workers & firms bargain - bargaining power determined by probability gov shuts down cartel if industry cheats
- Policies account for about 2/3 of changes in output during 1930s
- Labor market failure reflects wage-fixing & cartelization that prevents wage from falling and clearing market

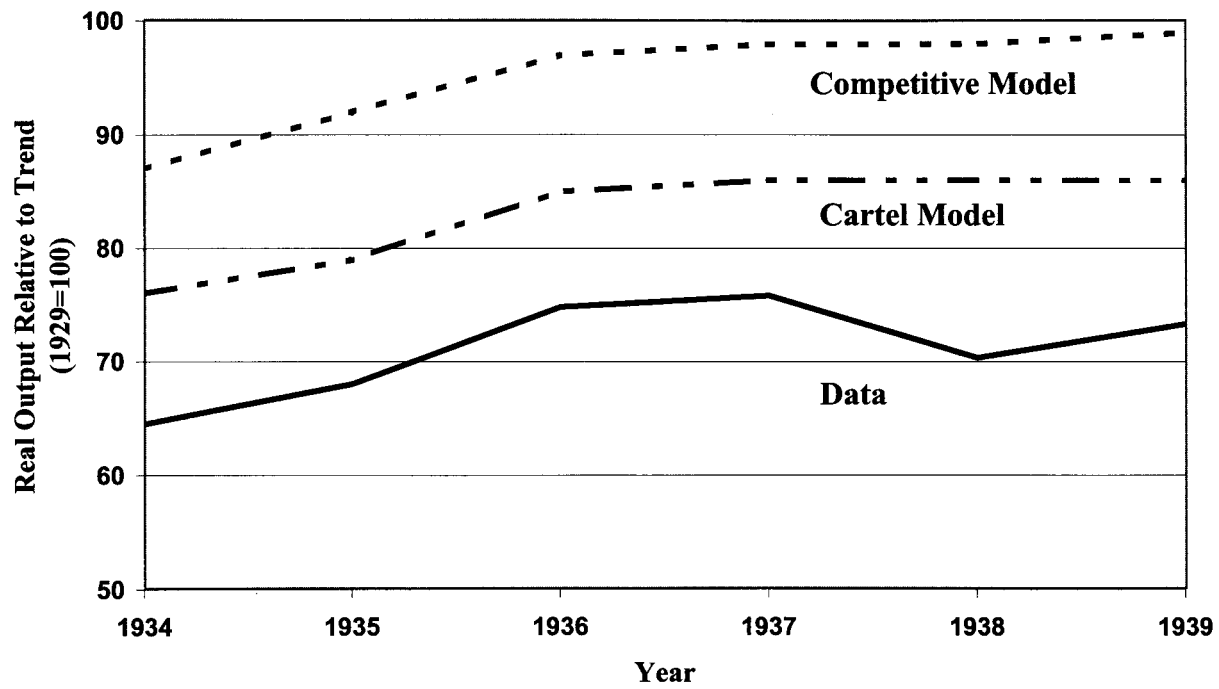


FIG. 2.—Output in the data and in the models

- Like 1930s, big labor decline and big gap between MRS and MPL
- MRS gap very different compared to other postwar fluctuations
- What accounts for  $MRS < W$  gap?
- Perhaps policies?
  - Market price of unemployed has fallen + unemployment benefits

TABLE 1: PERCENT CHANGES IN PER CAPITA VARIABLES  
FOR EACH NBER PEAK-TO-TROUGH EPISODE

**Panel A: US, Postwar Recessions vs. 2007-2009 Recession**

	Output	Consumption	Investment	Employment	Hours
Average postwar recessions	-4.4	-2.1	-17.8	-3.8	-3.2
2007-09 recession (2007:4 to 2009:3)	-7.2	-5.4	-33.5	-6.7	-8.7

**Panel B: 2007-2009 Recession, US vs. Other High Income Countries**

	Output	Consumption	Investment	Employment	Hours
US	-7.2	-5.4	-33.5	-6.7	-8.7
Canada	-8.6	-4.6	-14.1	-3.3	
France	-6.6	-3.4	-12.6	-1.1	
Germany	-7.2	-2.9	-10.2	0.1	
Italy	-9.8	-6.6	-19.6	-3.0	
Japan	-8.9	-3.6	-19.0	-1.6	
United Kingdom	-9.8	-7.7	-22.9	-2.9	
Average other high income countries	-8.5	-4.8	-16.4	-2.0	

Figure 2:  
LABOR DEVIATIONS, U.S. AND OTHER HIGH INCOME COUNTRIES  
(2007-IV = 100)

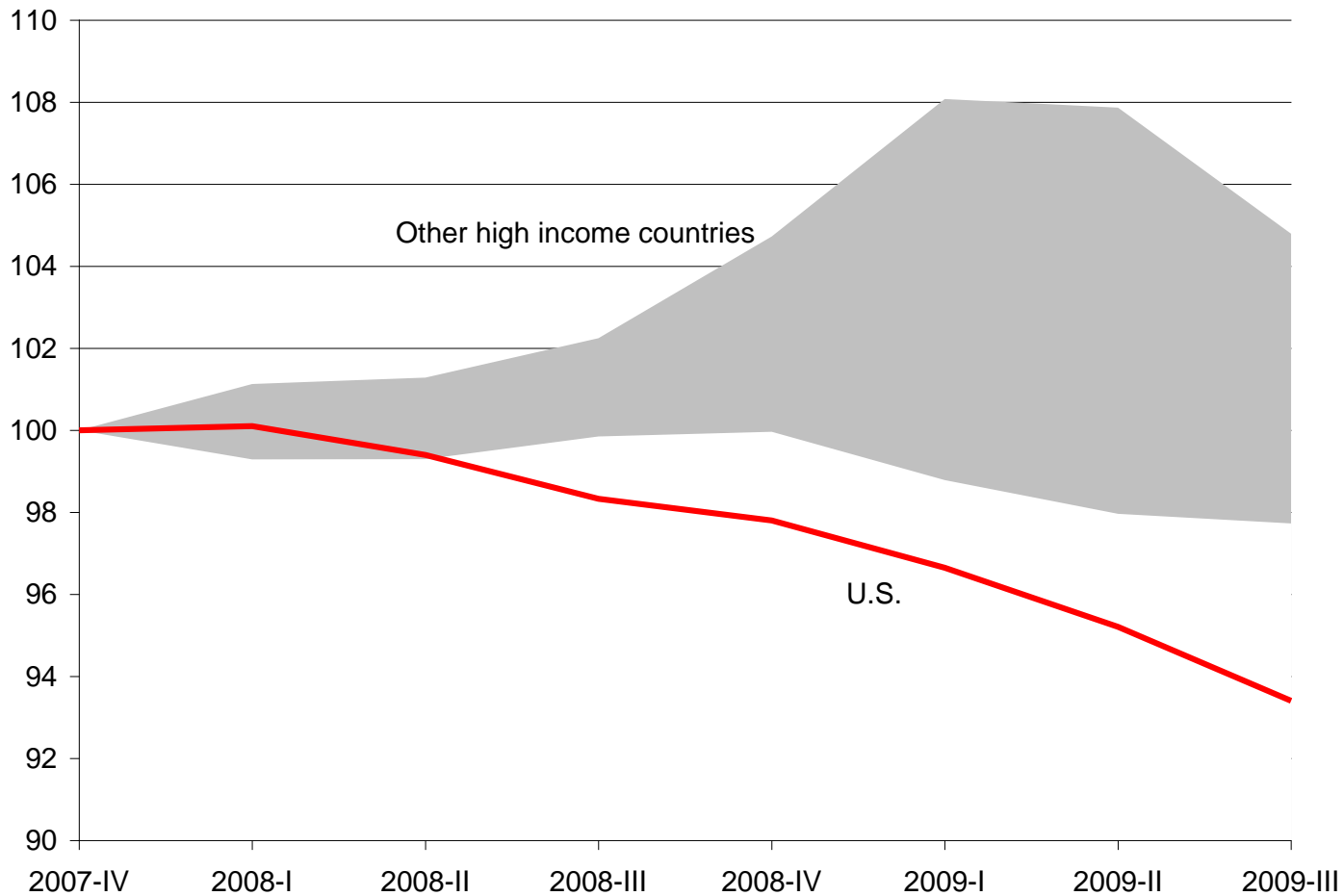
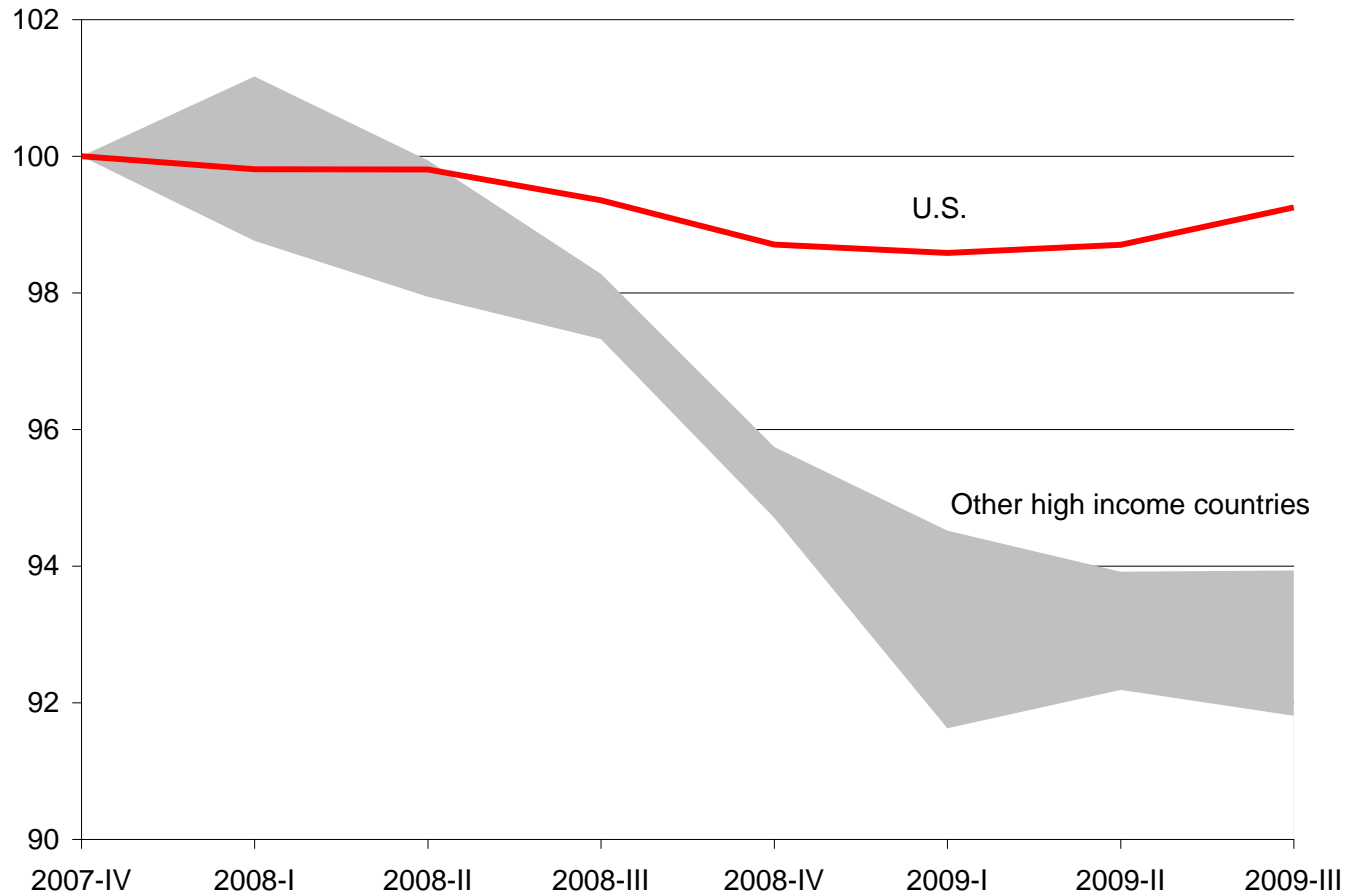


Figure 3:  
PRODUCTIVITY DEVIATIONS, U.S. AND OTHER HIGH INCOME COUNTRIES  
(2007-IV = 100)



Source: Author's calculation – see text.

Notes: Other high income countries include Canada, France, Germany, Italy, Japan, and U.K. The labor deviation is the percent difference between the marginal rate of substitution between consumption and leisure and the marginal product of labor when actual data are plugged into that equation. The productivity deviation is the Solow residual.

# Crises and Depressions

- Crises involve large labor market distortions
- Great Depression distortion related to economic policy
- Depression severe before monetary contraction & banking panics
- Remained depressed long after money supply grew & banking system stabilized
- Depression would have been less severe in absence of Hoover and FDR policies
- Future work: understanding labor distortions in other crises, including US 2007-09