Slouching Towards Utopia?:
An Economic History of the Long Twentieth Century

XIII. Climbing Out of the Great Depression

J. Bradford DeLong
U.C. Berkeley Economics and Blum Center, NBER, WCEG

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13.1: The Course of Recovery

The rule to memorize about recovery from the Great Depression: the sooner countries went off the gold standard, the better; and the less that gold standard habits of orthodoxy fettered countries thereafter, the better.

The Scandinavian countries bailed first, and did best. Japan and Britain abandoned the gold standard in 1931, but Japan embraced expansionary policies more thoroughly. The U.S. and Germany abandoned the gold standard in 1933, but Hitler had a clearer view that Nazi persistence and success required putting people to work than FDR did with the try-everything-expediency of his New Deal. France stuck it out on the gold standard until 1937, and did worst of all.

The Great Depression was not only deep but long. The first reason was workers' unwillingness to risks, but rather to settle for what manner of living they could find that was most secure. The experience of long and high unemployment costs a large and deep shadow on the labor market: a phenomenon that Blanchard and Summers named *hysteresis*, in rather poor analogy with electromagnetism. Thus risky but profitable enterprises had a difficult time attracting the workers they needed, and so investment remained depressed.

The second reason it was long was the memory of and the belief that economies needed to get back to the gold standard. Those kept governments in the 1930s from taking many of the steps to boost production and employment they might have: the gold standard was dead by 1931, but its ghost continued to haunt the world economy. Thus few reflationary measures were undertaken. The one that was was currency depreciation: stimulating net exports by switching demand to and away from foreign-made goods. Commentators disparaged currency depreciation as "beggar-thy-neighbor". It was. But it was the only thing generally undertaken that was effective.

The third was the lack of a *hegemon* to guide coordinated action in international monetary affairs. The major monetary powers of the world passed up their chances to do anything constructive together. Recovery, where it came, was national only, not global.

The persistence of the Great Depression shook the internal politics of almost every country in the world. In Scandinavia that social democratic parties had more-or-less successfully managed to navigate through the Great Depression put them into power for the succeeding half-century. In much of continental Europe Depression reinforced reaction: one of the gifts that the Great Depression gave the world was Spain's long-lived fascist dictator, Generalissimo Francisco Franco; a second such gift was Adolf Hitler. In America, by contrast, the Great Depression did not empower reaction but rather liberal and social democratic experimentation the growth of the social insurance state by providing the setting for Franklin Roosevelt's New Deal.

This is somewhat of a surprise: why did the Great Depression push the U.S. not right but left? My guess is: sheer luck—Herbert Hoover and the Republicans were the right and were in power when the Great Depression started, they were thrown out of office in 1932, and the American political order was not then good soil for growth of a further-right movement.

13.1.1: The First New Deal

13.1.1.1: FDR at The Chicago Convention

Before the 1930s, U.S. presidential candidates and simply not appeared at the national political conventions. Candidates were supposed to remain at their homes, tending to their private affairs, until informed (a week or so after the convention) by party officials that they had been chosen. They were supposed to emulate the Roman politician Cincinnatus, who mythically remained on his small farm ploughing his crops until told that he had been elected commander-in-chief of the Roman army and dictator of Rome. The conventional pretense was that the man did not seek the office: the office sought the man.

Then-Governor of New York Roosevelt broke tradition and flew to Chicago—in part, historian Frank Leuchtenburg says, to disprove whispers that a polio victim with paralyzed legs was too frail to undertake a full-scale American presidential campaign—and spoke: "breaking the absurd tradition that the candidate should remain in professed ignorance of what has happened.... You have nominated me... I know it... I am here to thank you for the honor.... [I]n so doing I broke traditions. Let it be from now on the task of our Party to break foolish traditions.... I pledge you, I pledge myself to a new deal for the American people."

13.1.1.1: What Was the New Deal?

What was Roosevelt's "New Deal"?

First, it was a unique moment in American political history. Usually American politics is the politics of near-gridlock. The elections of the 1930s would be different. Roosevelt won 59 percent of the vote in 1932—an eighteen percentage-point margin over Herbert Hoover. Congress swung heavily Democratic in both houses. To an extent never before seen since the Civil War, the president and his party had unshakable working majorities in both houses of the legislature—if Roosevelt could persuade a fractious coalition, including many southern legislators who were Democrats only because the white south remembered that it was Republican Abraham Lincoln who had freed the slaves, to come with him.

The new majority was looking for direction. Roosevelt had little idea what he was to do, either. But he did have a conviction that he could do something important. And he was certain that Herbert Hoover had gotten. What Hoover had been doing was raising tariffs, maintaining the gold standard, acting aggressively to balance the budget, and block attempts to start employment-promoting public works. Roosevelt was going to do the opposite.

Otherwise? Roosevelt was going to do things, and if you had a half-plausible thing, you had a chance of persuading Roosevelt to try to do it. So was born the strategy of the New Deal: stop doing everything Hoover was doing, try everything you can think of; drop and abandon things that do not seem to be working; push the things that seem to be working.

Procedural and perhaps constitutional niceties should not, could not be respected in the crisis. Roosevelt announced that he would have limited patience with those who tried to block him. With respect to congress, for example, if congress failed to enact his not-yet-constructed program: “I shall not evade the clear course of duty that will then confront me. I shall ask the Congress for the one remaining instrument to meet the crisis—broad Executive power to wage a war against the emergency, as great as the power that would be given to me if we were in fact invaded by a foreign foe.”

The day after his inauguration President Roosevelt exceeded what a reasonable observer would have seen as his statutory powers by forbidding the export of gold and declared a bank holiday—a nationwide banking shutdown to freeze the then-ongoing banking crisis. The justification? The World War I-era “trading with the enemy” act. But there was no enemy. Within four days the House and Senate had convened and—the House unanimously—passed Roosevelt’s banking reform bill, arranging for the reopening of solvent banks, the reorganization of other banks, and giving Roosevelt complete control over gold movements.

The second bill Roosevelt submitted to congress—also passed immediately—was an “economy” bill, cutting federal spending and bringing the budget closer to balance. The third submission was a request for an end to Prohibition—for the repeal of the constitutional amendment banning alcohol. On March 29 Roosevelt called on congress to regulate financial markets. On March 30 congress established Roosevelt’s Civilian Conservation Corps. On April 19 Roosevelt took the United States off of the gold standard. On May 12 congress passed Roosevelt’s Agricultural Adjustment Act. On May 18 Roosevelt signed the Tennessee Valley Authority bill creating, the first large government-owned utility corporation in the United States.

Also on May 18, President Roosevelt submitted to congress the center-piece of his first hundred days: the National Industrial Recovery Act, or NIRA. All factions within the newly-constituted administration won something in the legislation:

- Businesses won the ability to collude—to draft “codes of conduct” that would make it easy to maintain relatively high prices, and to “plan” to match captacity to demand.
- Socialist-leaning planners won the requirement that the government—the National Recovery Administration, or NRA—approve the industry-drafted plans.
- Labor won the right to collective bargaining, and the right to have minimum wages and maximum hours incorporated into the industry-level plans.

- Spenders won some $3.3 billion in public works.

The first new deal was: a strong "corporatist" program of joint government-industry planning, collusive regulation, and cooperation; the entire farm sector on the federal dole indefinitely with strong regulation of commodity prices; building and operating utilities; undertaking huge amounts of public works spending; establishing meaningful federal regulation of financial markets; insurance for small depositors' bank deposits; mortgage relief; unemployment relief; plus promises to lower tariffs, lower working ours, and raise wages.

13.1.1.2: How Did the First New Deal Work?

What did it all add up to?

The NIRA did break the back of expectations of future deflation. The creation of deposit insurance and the reform of the banking system made savers willing to trust their money to the banks again. It began the reexpansion of the money supply. Corporatism and farm subsidies did spread the pain of the Great Depression to some extent. Taking budget balance off the agenda helped. Promising unemployment and mortgage relief helped. Promising public-works spending helped. All these policy moves kept things from getting worse. They certainly made things somewhat better. And things became substantially better immediately.

Herbert Hoover and ilk ranted that Roosevelt's policies were Bolshevist. Hoover and his ilk ranted that Roosevelt's refusal to commit in November 1929 to continue Hoover's policies had killed the economy over the winter, and had created a false baseline relative to which Roosevelt was falsely claiming victory. Hoover and his ilk ranted that recovery would have come of itself, and faster than under the New Deal, if only Hoover had won a second term and had a supportive congress.

But the rest of Roosevelt's "hundred days"? It is not clear whether the balance sheet of the rest of the hundred days is positive or negative. The "economy" bill that cut spending and relief did harm. Much of financial market regulation (save deposit insurance) was simply irrelevant to the Great Depression. Farm subsidies set the American government on a path that would prove expensive and counterproductive for the next sixty years.

The full-fledged policy of monetary inflation and mammoth fiscal deficits that might have pulled the country out of the Great Depression quickly—that did pull Germany under Hitler out of the Great Depression quickly—was not tried. 1934 was a better economic year than 1933, 1935 was better than 1934, and 1936 was better than 1935, but not by much.

Consumers complained that the NRA raised prices. Workers complained that it gave them insufficient voice. Businessmen complained that the government was telling them what to do. Progressives complained that the NRA created monopoly. Spenders worried that collusion among businesses raised prices, reduced production, and increased unemployment. Roosevelt's experiment with "corporatism"—which crusty Democrats like Senator Carter Glass denounced as "the utterly dangerous effort of the federal government at Washington to transplant Hitlerism to every corner of this nation" was over.

The slide in which each year was worse than the one before had been ended by the Depression. Some ground had been regained. But happy days were not here again.

13.1.2: The Second First New Deal

Therefore Roosevelt kept trying different things.

If business-labor-government "corporatism" did not work—and was blocked by the Republican Supreme Court—perhaps a safety net would. The most enduring and powerful accomplishment of the New Deal was to be the Social Security Act, which provided federal cash assistance for widows, orphans, children without fathers in the home, and the disabled; and which also set up a near-universal system of federally-funded old-age pensions.

If pushing up the dollar price of gold did not work well enough, perhaps strengthening the union movement would: another enduring accomplishment of the New Deal was the Wagner Act, that set down a new set of rules for labor-management conflict, strengthened the union movement, and meant that the wave of unionization in the United States in the 1930s survived for half a century (rather than being rolled back within half a generation, as had happened to previous expansions of the union movement in the United States. Massive public works an dpublic employment programs restored some self-esteem and transferred some money to households without private-sector jobs—but at the probable price of some delay in recovery, as firms and workers saw higher taxes.

Antitrust policy? The breaking-up of utility monopolies? A more progressive income tax? Finally, a hesitant embrace of deficit spending not just as an unavoidable temporary evil but as a positive good? All were tried. In the end they probably did little to cure the Great Depression in the United States. But they did turn the U.S. into a modest European-style social democracy.

And as the decade came to an end Roosevelt's concerns shifted to the forthcoming war in Europe and to the Japanese invasion of China. Dr. New Deal was replaced by Dr. Win the War.

13.1.3: Patterns of National Recovery Outside the United States

13.1.3.1: Hitlerian Germany

Germany recovered from the Great Depression relatively rapidly once Hitler had taken power and broken adherence to monetary and fiscal orthodoxy. With the Gestapo in the background to suppress agitation for higher wages, better working conditions, or the right to strike, and with strong demand from the government for public works and military programs, unemployment fell rapidly in Germany in the 1930s. The Great Depression in Germany had been the deepest in the world save for the United States. Recovery was fastest save for Japan, and Scandinavia.

Hitler appears to have been focused on employment and weapons, not adding to industrial capacity and increasing national wealth. Build national highways, yes—but build them not by building individual city-to-city or resources-to0-industry links, but by building as much as possible first where it would be seen as many as possible. Political effectiveness and military capacity were the priorities. Political effectiveness we understand. But weapons? Armies? Hadn't World War I taught the Germans, and even the Nazis, and even Hitler, not to do *that* again?

No, it had not. Despite being wounded twice by shell and gas, and struck temporarily blind and dumb, despite Germany's defeat, Hitler seems to have thought that wars were good and easy to win. He took his Malthusianism dead seriously: "Germany has an annual increase in population of nearly nine hundred thousand souls. The difficulty of feeding this army of new citizens must grow greater from year to year and ultimately end in catastrophe." Thus Germany must "march along the road of the Teutonic knights of old, to obtain by the German sword sod for the German plow and daily bread for the nation." And Fate was on Germany's side: "By handing Russia to Bolshevism…. [The] Germanic nucleus of its upper leading strata... has been replaced by the Jew.... The giant empire in the east is ripe for collapse." To be ready to take advantage of that forthcoming collapse of Judeo-Bolshevist Russia, the first priority was to get Germany a strong military.

13.1.3.2: Ramsey MacDonald's and Stanley Baldwin's Britain

The Labour Party had won 47 percent of the seats in the general election of 1929, thinking somehow that its task was, in Robert Skidelsky's words, i"govern without conviction a system it did not believe in but saw no real prospect of changing". Prime Minister Ramsey MacDonald. Chancellor of the Exchequer Philip Snowden, and the bulk of the cabinet believed that the gold standard needed to be maintained—and that the budget needed to be balanced. Labour members of Parliament and its grass-roots activists were violently opposed to *any* reductions in unemployment benefits or in public-sector pay scales. The Liberals essential to the coalition violently opposed all tax increases, especially tariffs. In August 1931 Ramsey MacDonald solved this dilemma by breaking his party. Together with three other Labour Party ministers, he joined with two Liberal cabinet members and four Conservative Party ministers to form a "National" government.

The following month—September of 1931—large-scale capital flight from Britain began: foreign-exchange speculators believed that the gold standard in Britain was likely to fall, and they wanted to get their money out while they could. Governor of the Bank of England Montagu Norman… had a nervous breakdown, and his subordinates were not willing to act boldly, especially not since a Labour government they did not understand was in power. On September 19 Great Britain abandoned the gold standard.

But Britain's abandonment of the gold standard was not followed by large-scale reflation. The Bank of England did its part, cutting back on its short-term discount rate. The National-Conservative government did not do its. In October the Conservative Party swept the general election, winning 78 percent of seats in the House of Commons. The government that followed was Conservative. Conservative Stanley Baldwin ran things, with ex-Labourite Ramsey MacDonald as an initial figurehead Prime Minister. Britain's recovery from the Great Depression was slow and painful.

13.1.3.3: France Clings to the Gold Standard

France's undervalued exchange rate parity meant that, when the Great Depression began, it had little *initial* effect on France. For the first two years of the Great Depression, France was barely affected. But as exports dropped, country after country devalued to try to regain some foreign demand. Increasingly, countries that had not devalued found their industries uncompetitive, their payments in deficit, and their maintenance of convertibility a source of domestic unemployment because they had to maintain higher interest rates and apply further deflation to keep foreign exchange speculators' greed in balance with their fear. Belgium next door abandoned gold convertibility in 1935. In France it became clearer and clearer that the gold standard was not working. But French politics did not allow for a decisive change of course. A fragmented electorate produced unstable coalition governments. From the crash of 1929 to 1936, the French Prime Ministers were, in succession: Briand, Tardieu, Chautemps, Tardieu again, Steeg, Laval (remember him?), Tardieu yet again, Herriot, Boncour, Daladier, Sarraut, Chautemps again, Daladier again, Doumergue, Flancin, Bouisson, Lavel (again), Sarraut (again), and finally Leon Blum, Popular Front Prime Minister who grasped the nettle, and France and the rest—the Netherlands, Switzerland—abandoned their gold parity in 1936.

Blum promised to restore pensions and public-sector wages to the levels they had held before the budget cuts of the preceding two years. Blum promised to greatly increase unemployment benefits. Blum had promised to defend the franc—no devaluation. Blum promised to balance the budget. Blum promised to cut back on military spending. Blum promised to share the work and the wealth by cutting back on working hours and supporting strikes. It did not add up. Blum abandoned the gold standard. But that did not mean substantial expansion of aggregate demand: the government's belief that the government *should* be trying to balance the budget led to the scaling-back of its non-military spending programs. The investing public's—correct—belief that socialism meant inflation meant that internal price rises quickly more than offset the positive, stimulative effects of a devaluation on the money supply and on exports (particularly since the devaluations were done only under pressure of necessity).

France entered 1938, the last year before the beginning of World War II in Europe, with its level of industrial production still less than the level attained in 1929.

13.1.3.4: Japan

In Japan fiscal orthodoxy and budget balance were abandoned in 1931. The Great Depression was not deep, and was over by 1932.

Takahashi Korekiyo was not one of the "Meiji Six", but he was in the next rank of Japanese modernizers. The then-72-year-old Takahashi Korekiyo became Minister of Finance for the third time in 1931, and he had little tolerance for European models of “sound finance”. He drove policies: Japan abandoned the gold standard, devalued its currency in order to boost demand by making its export industries hyper-competitive and generating an export boom, and embarked on a massive program of armaments. Industrial production in Japan in 1936 was half again as much as it had been in 1928. Good short-run economic policy. As private businesses and households were unwilling to spend as they sought to deleverage, foreign purchasers of Japanese exports and the Japanese government did take up the slack.

Bad long-run strategy: The armaments boom and the loss of civilian control over the military led to getting involved in a land war in Asia and then launching pin-prick attacks on the world's two superpowers, Britain and the United States. That was not likely to end well. It did not. But Takahashi Korekiyo did not live to see World War II. He was one of three senior politicians successfully assassinated on February 26, 1936, when the Imperial Way faction of the army attempted to seize power and kill their political opponents not just in the government and parliament but in the Control Faction of the army as well. He had not allowed the military budget to be pushed high enough to please the coup plotters.

13.1.3.5: Scandinavia

In one region of western Europe alone was the Great Depression shallow, short, and followed by a decade of strong economic growth: Scandinavia. Scandinavia’s politics during the 1930s prefigures the successful pattern of social democracy that was to come to dominate politics and economic management in the industrial core after World War II.

Consider Sweden, the heart of the Scandinavian model. Swedish socialism had been relatively strong even at the beginning of the twentieth century. And in the interwar period the Swedish socialists won enough votes to exercise power. In sharp contrast to their counterparts in Britain and France—who had no idea of what a left-wing exercise of political power would be (in large part because they bought their own propaganda that the cruelties of interwar capitalism were an inevitable part of the functioning of a market economy).

Housing subsidies, paid holiday and maternity benefits mandates, expanded public-sector employment, government loans to the newly-married—all made possibly by a monetary policy that early cut loose from the gold standard, and pursued the goal of domestic balance through easy money and stimulated exports through the consequent low value of the real exchange rate. The countercyclical policies of the Wicksell and Wigforss-led Stockholm School were successful in rapidly eliminating the Great Depression without setting off fears of imminent hyperinflation.

The Swedish socialists' success aided their transformation into social democrats: they lost their commitment to the apocalyptic doctrines of socialism: lost their belief that all private property was inherently evil, lost their belief that only a great and sudden revolutionary transformation could bring about a better society. The welfare state became the new goal. Democracy became a goal rather than a tactic. All of the industrial core was to—successfully—follow the Swedish model or some variant thereof for the generation after World War II.

13.1.4: Global Patterns

The major monetary powers of the world regularly passed up their chances to do something constructive to help the world monetary system as late as 1933, when the London Economic Conference collapsed in disagreement. The French believed that they should try to maintain the gold standard. The British, who had long since abandoned the gold standard, were unwilling to, in Eichengreen's words, "…tie their policies to those of a foreign partner [the United States] of whose intentions they were unsure." Thus:

> …those [relatively few] reflationary measures that were undertaken in the 1930s were initiated unilaterally… [and] involved currency depreciation… switching demand toward [home-produced goods] and stimulating net exports. The improvement in the initiating country's competitiveness was, of course, a deterioration in the competitiveness of its trading partners. This led commentators to disparage currency depreciation for its beggar-thy-neighbor effects. But the fact that these depreciations were beggar-thy-neighbor should not be allowed to obscure their effectiveness…

The earlier (and the further) countries depreciated their currencies in the Great Depression, the faster (and the sooner) was their recovery. Depreciation removed the necessity of cutting government spending and raising taxes to ensure international confidence in a country's commitment to the gold standard. Depreciation allowed countries to expand their money supplies. Depreciation allowed countries to rescue their banking systems without worrying about the consequences of bank rescue for international investor confidence.

But depreciation and reflation were not very effective as measures for curing the Great Depression because they were not fully tried. Depreciation was near-universal. Reflation was not. Hence the recovery of world aggregate demand from its depressed levels of the early 1930s was very slow until the very end of the decade, when the threat of war made governments realize that spending public money building weapons was more important than trying yet again to balance the budget.

13.2: The Depression as Defining Moment

13.2.1: The Coming of Social Democracy to America

In the long run Franklin D. Roosevelt's policies mattered not because they cured the Great Depression, but because they left behind a different—a much more social democratic—America. In sector after sector, the Great Depression encouraged and allowed to do things that brought the U.S. government much closer to the social democracies of Europe.

The most important social programs of twentieth century America all started in the 1930s. The Social Security system, federal provision of a right to old-age assistance even outside the contributory Social Security system, the framework within which labor unions operate and bargain with their employers, aid to families with dependent children—although that "right" is gone: in today's America poor children receive government support only to the extent that their parents' behavior is pleasing to the state—unemployment insurance, the peculiar American farm subsidy system, and our system of financial regulation are all parts of the policy reaction to the Great Depression. Perhaps most important, the Great Depression produced and solidified the idea that the *government* was responsible for the health of the economy.

Without the Great Depression, and the New Deal policy reaction to it, the government's role in the United States today would be very, very different. Some historians interested in continuity trace the roots of New Deal programs back to World War I or to the progressive era: proposals for changing financial market regulations to require disclosure, the income tax, wartime agricultural price supports, support for labor in northeastern and midwestern states, and others. But progressive-era policies and proposals had by and large failed of enactment, and the progressive era had come to a close. Social experiments involving steps toward social democracy in Minnesota or Wisconsin or Massachusetts had not attracted large-scale support elsewhere. And wartime government control over the economy had been followed by postwar decontrol, and a return to "normalcy."

It may well be that the key is that the Great Depression changed Americans' hearts and minds about the role and place of government. The Great Depression underlined how private might fail, and how public might succeed in ameliorating if not resolving problems. Michael Bordo, Claudia Goldin, and Eugene White ask: "Did the Great Depression alter the public's view concerning the functions of government, particularly those at the national level?" And they answer: "It would certainly appear that it did." Capitalism had failed—at least partially failed—and it was hard to argue to workers without jobs (or who remembered that they or their parents had been without jobs), to farmers who had lost their farms (or to those who remembered that they or their parents had lost their farms) that government intervention would inevitably destroy a near-utopian near-*laissez faire* economy.

Thus the Great Depression called forth a substantial increase in the government share of the economy, both in the scale of programs started during the New Deal and in people's willingness to consider other possible roles for the government.

13.2.2: Could "It" Have Happened Here?

In June 1932 the "Bonus Expeditionary Force" converged on Washington. 20,000 massed war veterans who traveled to and demonstrated in Washington to try to convince congress to pay them at once bonuses for World War I that congress had voted to pay in 1945. The B.E.F. marchers camped in "Hoovervilles" and shantytowns and in unused government buildings. and Herbert Hoover panicked.

Hoover ordered the chief of the District of Columbia police to clear the veterans out of the buildings along Pennsylvania Avenue. First the police and then the army—commanded by Douglas MacArthur, armed with tanks, cavalry sabers, tear gas, and bayonets—cleared Pennsylvania Avenue, crossed the Anacostia River, and burned the shantytowns. Hoover's claimed the marchers "included a large number of hoodlums and ex-convicts determined to raise a public disturbance" and were "organized and promoted by the Communists". Moreover "they were frequently addressed by Democratic Congressmen". Horrors! Most had returned home peacefully, but, according to Hoover, there were: "5,000 mixed hoodlums, ex-convicts, Communists, and a minority of veterans in Washington... fewer than a third of them had ever served in the armies, and... [45 percent] were ex-convicts and Communists."

Herbert Hoover, writing his memoirs in his retirement, was a bitter man. But if he were to be trusted, he had seen the unemployed veterans camped in Washington as the vanguard of a Communist Revolution. Even so, he made it very clear that anything that had gone wrong that day was not his fault, but that of Treasury Secretary Ogden Mills, Army Chief-of-Staff Douglas MacArthur, or future president and Republican moderate Dwight D. Eisenhower:

> Old buildings… occupied… stood in the way of construction work going on as an aid to employment in Washington…. The Treasury... requested these marchers to move to other quarters…. More than 1,000 of the disturbers marched from camps outside of the city armed with clubs and made an organized attack upon the police…. Police Commissioner Glassford failed to organize his men…fired to protect their lives… killed two marchers…Douglas MacArthur… General Eisenhower…without firing a shot or injuring a single person, they cleaned up the situation.

But:

> My directives to the Secretary of War, however, were not carried out.… I did not wish them driven from their camps…. Our military officers, however, having them on the move, pushed them outside the District of Columbia...

If Hoover is correct, then commander of the army Douglas MacArthur disobeyed orders given by his civilian superiors and used military force against American citizens exercising their constitutional right to petition for the redress of grievances. Hoover and Douglas MacArthur both agreed that the B.E.F. was “a mob... animated by the essence of revolution,” and MacArthur at least believed that if there had been any further delay in disbursing the marchers “the institutions of our government would have been very severely threatened.”

Hoover’s search for anti-American enemies conspiring against him was not limited to impoverished ex-veterans. It included the legislative barons of the Democratic Party (who); the legislative barons of the Republican Party (who); and the powers-that-be on Wall Street, who had, Hoover believed, turned into “bears” conducting “bear raids” on the market to push prices down, line their own pockets further, and deepen the Great Depression. Early in 1932 Hoover summoned Wall Street’s powers-that-be to account: either they were to stop their “bear raids” on the market and restore stock prices, or he would encourage the Senate to go on an investigative witch-hunt.

We were still—even with the burning of the B.E.F. shantytowns—light-years away from Hitler's suppression of the German Social Democratic Party, or Pinochet's soccer-stadium massacres of Chilean leftists and supposed leftists after his coup. But Hoover's reaction to the Bonus March is not so singular. There were additional signs of proto-fascism in the Depression-era U.S.: Huey Long, the anti-semitic radio priest Charles Coughlin, Gerald L.K. Smith. But we were still far from Mussolini's murders of socialist legislators like Mateotti, or from French Premier Daladier's resignation from the Prime Ministership out of fear of the French fascist mobs in the Paris streets outside.

Would the United States have stayed as far from a breakdown of democracy in the absence of Roosevelt's New Deal? What would four years of continued deep depression with no visible signs of recovery—if Hoover had been reelected, if America had stuck to the gold standard, and if as a result America's economic trajectory in the mid-1930s had mirrored that of France, but from a 1933 base of a much deeper depression—have brought?

13.3: Social Democracy and Societal Well-Being

13.3.1: Income Distribution and Societal Well-Being

The usefulness of market systems as social allocation and control mechanisms—as instruments to guide economic activity in ways that promote the general welfare—depends on the distribution of income. Markets carry out their implicitly assigned tasks with ruthless efficiency. The key to managing systems of markets is to determine what instructions the market is being implicitly given, and how to alter those instructions.

Systems of markets can indeed promote the general welfare under certain conditions. These required conditions are that property rights be well-defined, and that spillovers be small—thus market systems will be good at activities like allocating labor or finding and exploiting minerals (where property rights in land are set), and will be bad at activities like directing the proper amount of resources to research (for one firm can receive powerful benefits from another's research) and controlling pollution (for no one polluter benefits directly and immediately from his own pollution reduction).

There is another required condition: that the general welfare be defined in a way that weights the material well-being and utility of each individual in an appropriate manner that depends on his or her wealth. Suppose each doubling of material consumption adds an equal amount to individual utility—that the first dollar of income is more valuable than the second, the second more valuable than the third, and so on. Then theoretical economists' formulas and theorems take on a particularly simple form: the market maximizes the general welfare if and only if the general welfare weights each person's well-being by the market value of his or her wealth.

With unequal distribution a market economy will generate extraordinarily cruel outcomes. If my wealth consists entirely of my ability to work with my hands in someone else's field, and if the rains do not come so that my ability to work with my hands has no productive market value, then the market will starve me to death.

13.3.2: The Eclipse of Market Ideology

13.3.2.1: George Orwell's Take

The failure of "orthodox" economics to have anything constructive to say about the Great Depression paved the way for the emergence of social democracy. *Laissez-faire* had been supported by habits of mind. Social Darwinism, the benefits of free competition, and the rest seemed much less reasonable, and must less worthwhile during the Great Depression. As George Orwell put it: "the thing that horrified and amazed me was to find that many were *ashamed* of being unemployed. I was very ignorant, but not so ignorant as to imagine that when the loss of foreign markets pushes two million men out of work, those two million are any more to blame than the people who draw blanks in the Calcutta Sweep." And few had a reply in the depths of the Great Depression.

But once unemployment is no longer seen as the fault of the unemployed, any belief that the market order of income and work unpleasantness is the result of personal responsibility becomes vulnerable as well. Thus someone like Orwell could reframe coal miners not as unskilled workers with a union who were probably overpaid, but benefactors whom the rest of us had not properly acknowledged: "Practically everything we do, from eating an ice to crossing the Atlantic… from baking a loaf to writing a novel, involves… coal…. It is only because miners sweat their guts out that superior persons can remain superior. You and I and the editor of the *Times Lit. Supp*., and the Nancy Poets and the Archbishop of Canterbury and Comrade X, author of *Marxism for Infants*—all of us really owe the comparative decency of our lives to poor drudges underground, blackened to the eyes, with their throats full of coal dust, driving their shovels forward with arms and belly muscles of steel."

Orwell's touchstone for judging a social system was a combination of honesty, decency, prosperity, and liberty, but with the accent on decency. The social and economic system had a moral obligation to treat these men-its most productive resource-well. It was not decent that they should be without work. And since the system did not live up to the obligations it had undertaken, it did not deserve to survive.

13.3.2.2: Few Alternatives

One alternative was on the left: to believe that the Soviet Union existed and had promised a way out. A *positive* example of another, presumed to be better system. For example, Orwell's publisher Victor Gollancz, in the introduction Gollancz wrote to *The Road to Wigan Pier,* held that the Soviet Union had been a great boon because it had demonstrated that socialism was possible: "'I agree with you that Socialism would be wholly admirable if it would work-but it wouldn't'.... was more frequently heard in 1919 than in 1927, in 1927 than at the end of the first Five Year Plan, and at the end of the first Five Year Plan than to-day."

But how about claims that even though the Soviet Union existed, it was inefficient —hence would stay poor? Vladimir Lenin dismissed claims that competitive market equilibrium produced greater prosperity and superior resource management. Lenin was confident that this was nonsense. Not only did governments during wartime resort to command-and-control, but every large firm did so as well: "Large enterprise[d]… on the basis of exact computation of mass data, organizes according to plan the supply of primary raw materials… transported to the most suitable place of production… when a single center directs all the successive stages of work… we have socialization of production" It was obvious to him "that private economic relations and private property relations constitute a shell which is no longer suitable for its contents… [and] which will inevitably be removed" as long as the Soviet Union could survive. And in the 1930s it was not stupid to see the market economy as delivering little but inequality and unemployment.

A second alternative was on the right. It was silent on the issue of the causes of unemployment and poverty—save to blame enemies, foreign and domestic, who worked the system to the detriment of the people: probably rootless cosmopolites, financiers plus intellectuals who misled the people, often with names like Trotsky or Rothschild—Judeo-Bolsheviks or plutocrats, and these days we see those combined into both in the current Hungarian government's demonization of George Soros. It focused instead on a leader rallying the people to assign them direction to give their lives purpose and win them respect from others, and if there was social order and people and purpose and respect, economic inequalities would no longer gall.

13.3.2.3: Was There a Real Third Way?

Were those the only alternatives? With the coming of the Depression, it was not unreasonable to conclude that the old order was bankrupt. By 1939 representative democracy was to be found only in Great Britain and its Dominions, in the United States, in France, and in the arc of small northwestern European countries: Switzerland, Luxembourg, Belgium, the Netherlands, Denmark, Norway, Sweden, and Finland. Few would claim that market economies had delivered, or could reasonably promise that they would deliver Everywhere else the combination of democratic representative governments and market economies had been tried and been found wanting. It seemed quite likely that you had a Hobson's choice: You could abandon the market economy, and hope that an as-productive and more-equal socialism could deliver human freedom and something like political democracy (although the example of the internal politics of the Soviet Union gave no confidence). You could abandon political democracy, and so hope then, under the guidance of a wise leader to provide purpose, preserve the market economy and private property and the choice, autonomy, and inequality—for most a bug, for some a feature—that it brought (although the examples of Mussolini and Hitler gave little hope for avoiding regimentation and preserving freedom of thought and discussion).

If choices boiled down to Hitler or Stalin, how should people choose?

Many—including thinkers and politicians who would play major roles in the 1940's in setting the foundations of the post-World War II liberal democratic industrial capitalist order—chose Stalin for at least a little while, doubting the survival (or the value) of the old order, and hating Hitler more.

13.3.3: The Emergence of Social Democracy

13.3.3.1: The Voice in the Air: John Maynard Keynes

So how was it that a genuine, alternative third way entered the lists in the contest to replace the bankrupt old order—and won?

John Maynard Keynes stands as a symbol of the new ideology, the ideology of a middle road: Keynesianism and the "mixed economy." Keynesian emerged in the nick of time, had by the end of World War II become the dominant ideology in the world economy's North Atlantic industrial core. It provided North America and western Europe with a Keynesian escape hatch from what had been insoluble crises and contradictions in the years up to 1939: solid ground between *laissez faire* on the one hand and some form of Total State on the other. You could avoid the waves of mass unemployment and the extremes of relative wealth and poverty of the first without risking the dangers of the second.

One way to read Keynes's *General Theory of Employment, Interest, and Money* is as a confident prediction that all that was needed in order to remove the deficiency of *laissez faire* were relatively minor reforms, and that such relatively minor reforms could successfully stabilize the economy with nearly-perpetual full employment. An activist welfare-state government with a commitment to full employment had the tools to level the distribution of income, eliminate Great Depressions, and could put economies back onto the road to utopia.

If governments would only lower interest rates and spend money freely (without raising taxes) in times when total demand was low and raise interest rates and raise taxes (without spending) in times when total demand was high, Great Depressions could be avoided. Gross inequality was produced by mass unemployment and the fear of mass unemployment. Mass unemployment was produced by the extreme severity of the business cycle. And the extreme severity of the business cycle were "the fruits of risk, uncertainty, and ignorance". The cure was straightforward: "partly to be sought in the deliberate control of the currency and credit by a central institution, and partly in the collection and dissemination on a great scale of data relating to the business situation". Call it minimal central planning: "society in exercising directive intelligence… yet it would leave private initiative and enterprise unhindered".

Stabilize the macroeconomy, and al of a sudden political democracy, human liberty and freedom from regimentation, and the productivity and growth benefits of a (largely) market economy could be grasped. And humanity could then awaken from the nightmare of 1914-1945 to what had been reality before 1914, when humanity had been progressing fitfully—slouching—towards utopia.

Keynes recognized that his third-way economic cure would be and was being denounced. From the left, it would be denounced because it would leave the fundamental contradictions of capitalism unaddressed. In the generation after World War II the left believed that the Keynesians, the compromisers, the ideologues of the "mixed economy" were somehow unfairly stealing the future. Capitalism contained *fatal and irresolvable* contradictions that could not be forever avoided by Keynesian sleight-of-hand. Authors like Paul Sweezy would confidently predict socialism and government planning would deliver a more efficient allocation of productive forces and a faster rate of economic growth: we will outlive you, and so have to preside at your funeral, in the Russian proverb that Nikita S. Khrushchev used in the late 1950s.

From the right, it would be denounced because an economy could not forever by government financial legerdemain live beyond its means on its wits, as Churchill's Private Secretary P.J. Grigg put it. The most incisive if not the shrewdest critic of Keynes, the University of Chicago's Jacob Viner, said that Keynesianism worked only if "volume of employment, irrespective of quality, is considered important", and only as long as "the printing press could maintain a constant lead" in an inevitable race with "the business agents of the trade unions" could it avoid inflationary self-destruction. In the 1970s the right wing believed that day had come, and convinced the world to take the Neoliberal Turn. Others followed Schumpeter: the business cycle was an essential part of the process of economic growth, and attempts to artificially keep the unproductive at work would only store up more trouble for the future. The University of Chicago's John Cochrane was echoing Schumpeter when in November 2009 he welcomed recession because "people pounding nails in Nevada need to find something else to do", and recession unemployment would be a welcome spur.

So Keynes snarkily cast shade at his then-present and future intellectual opponents, highlighting that his escape hatch would seem to a"nineteenth-century publicist or to a contemporary American financier to be a terrific encroachment on individualism", but telling such to shape up and get with the program, for he had "the only practicable means of avoiding the destruction of existing economic forms in their entirety". Moreover, if they were smart they would understand that successful capitalism needed the support of an activist government ensuring full employment, for without it only the lucky innovators would survive, and only the mad would attempt to become innovators: "if effective demand is deficient… the individual enterpriser… is operating with the odds loaded against him…. Wealth has fallen short of… savings… [with] losses… [for] those whose courage and initiative have not been supplemented by exceptional skill or unusual good fortune."

13.3.3.2: "Orthodoxy" Did Not Work

Neoclassical economists have faith in market economies' abilities to eventually cure depressions, even in the presence of unsound economic policies. Depressions and high unemployment arise when markets malfunction, or fail to find the correct equilibrium. But excess supply of labor and excess supply of goods should eventually register.

How well did these "natural" full employment equilibrium-restoring forces work in the Great Depression?

The answer is: not at all well.

Even granted that policies to fight the Great Depression were not forthcoming, the persistence of the Depression still comes as a shock. In a normal pre-Great Depression business cycle, the economy the economy closes 97% of the gap back to usual employment in three years. But the Depression shows a different picture: the economy closed only half of the gap back to full employment in three years.

The standard orthodox answer was that it was, somehow, big government's fault that the Great Depression lasted so long: the market, after all, cannot fail but can only be failed.

13.3.3.3: Keynesianism Worked

Those countries that had attempted to exit through the Keynesian escape hatch (largely by fortunate accident) during the Depression did indeed do relatively well. The Great Depression was relatively mild in countries that had devalued their currencies early, printed money and inflated their price levels, ensured low interest rates, and had run large budget deficits.

World War II provided further proof: in the United States unemployment that had been called "structural" or "permanent" during the 1930s and had appeared immune to the self-adjusting forces of the market as well as to the entire armament of the New Deal vanished entirely in the 1940s under the pressure of vastly expanded government spending. The United States fought World War II *without* reducing the real value of civilian consumption: all U.S. war production came from new capacity, or from capacity that stood idle at the end of the 1930s.

So how did it happen that the first post-World War II generation of governments found their way to adopting the policies that led through the Keynesian escape hatch? And why was Keynes so right—why were his policy recommendations so apt for the post-World War II world?

A first, very important factor helping to make post-World War II economic reconstruction a success was *the shadow of the past.* Post-World War II reconstruction took place against the background catastrophe of World War II and of the preceding Great Depression.

In response to the high persistence of unemployment in the interwar years, economists abandoned the idea that business cycles were the economy's best feasible response to inevitable shocks to present circumstances and expectations about the future, and that the Great Depression had been generated by the largest such shock ever seen. Instead, they turned to alternative—Keynesian—approaches to explain the persistence of high unemployment.

Perhaps these alternative approaches were not so much theories of business cycles as policy recommendations accompanied by promises that supporting theories would be constructed later. Certainly the rearguard of "liquidationists" so argued. But for a while the idea that "even a panic is not altogether a bad thing" appeared dead, and staked.

The political and economic struggle between parties and classes in interwar Europe had ended in the mutual ruin of the contending parties. Right-wing factions had wanted low wages, no welfare state, stable prices (along with social order and nationalist self-assertion); left-wing factions had wanted high wages and an extensive welfare state. The far left had no tolerance for the near left. Mainline politicians in the interwar period, whether social democrats looking forward to the implementation of the socialist Gotha Program or Clause IV, or right-wing politicians interested in demolishing the embryonic welfare state and restoring traditional authorities, had looked forward to establishing their vision of the distribution of wealth and the role of the government by overrunning opposition—at the ballot box if possible, and through street violence and purges if necessary. The end of this political and economic struggle had been the rise of fascism and Nazism, which had benefitted no one.

The magnitude of Depression-era unemployment also shifted politicians', industrialists', and bankers' beliefs about the key goals of economic policy. Before the Depression a stable currency and exchange rate were key. But after the Depression even the bankers recognized that a high overall level of employment was more important than avoiding inflation: universal bankruptcy and mass unemployment were bad for workers, but they were worse for capitalists and bankers.

Thus entrepreneurs, the owners and managers of real capital—industry—and even the bankers found that they gained, not lost, from a commitment to maintain high employment first. High employment meant high capacity utilization. Rather than seeing tight labor markets erode profit margins by raising wages, owners of property saw high demand spread fixed costs out over more commodities and so increase profitability.

There is a sense in which Christian and social democracy, the twin political powers of the post-World War II world, evaded class-conflict based dilemmas of the interwar and pre-World War I politics *because* the shock of the Great Depression shifted politics from a concern over redistribution to a concern over production. All would lose heavily from another Great Depression. It seemed much more worthwhile to compromise, and to pursue policies that would enlarge the pie to be distributed rather than for either side—either the left or the right—to engage in substantial redistribution. For all parties the post-World War II mission became, in Charles Maier's words:

> one of expanding aggregate economic performance and eliminating poverty by enriching everyone, not one of redressing the balance among economic classes or political parties. The true dialectic was not one of class against class, but waste versus abundance.

It is very hard to argue that accepting the "mixed economy" was a mistake for anyone. Had either owners or workers tried to hold out for more—as they did in the interwar period—they might well have ended up with far less.

In later years once the workings of the Keynesian order became clear—in the second and third post-World War II generations—the tasks of macroeconomic management would prove harder, and the truth of the doctrines of Keynes's disciples would become less clear. But in the first post-World War II generation, the Keynesian escape hatch provided governments, polities, and economies with what seemed like a miraculous solution to all the interwar dilemmas.