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[Advisories](#)
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[News releases](#)
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[Faculty experts](#)

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[Animal research](#)
[Admissions](#)

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[Daily Bruin](#)
[Campus calendar](#)
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FDR's policies prolonged Depression by 7 years, UCLA economists calculate

By Meg Sullivan | 8/10/2004 12:23:12 PM

Two UCLA economists say they have figured out why the Great Depression dragged on for almost 15 years, and they blame a suspect previously thought to be beyond reproach: President Franklin D. Roosevelt.

After scrutinizing Roosevelt's record for four years, Harold L. Cole and Lee E. Ohanian conclude in a new study that New Deal policies signed into law 71 years ago thwarted economic recovery for seven long years.

"Why the Great Depression lasted so long has always been a great mystery, and because we never really knew the reason, we have always worried whether we would have another 10- to 15-year economic slump," said Ohanian, vice chair of UCLA's Department of Economics. "We found that a relapse isn't likely unless lawmakers gum up a recovery with ill-conceived stimulus policies."

In an article in the August issue of the Journal of Political Economy, Ohanian and Cole blame specific anti-competition and pro-labor measures that Roosevelt promoted and signed into law June 16, 1933.

"President Roosevelt believed that excessive competition was responsible for the Depression by reducing prices and wages, and by extension reducing employment and demand for goods and services," said Cole, also a UCLA professor of economics. "So he came up with a recovery package that would be unimaginable today, allowing businesses in every industry to collude without the threat of antitrust prosecution and workers to demand salaries about 25 percent above where they ought to have been, given market forces. The economy was poised for a beautiful recovery, but that recovery was stalled by these misguided policies."

Using data collected in 1929 by the Conference Board and the Bureau of Labor Statistics, Cole and Ohanian were able to establish average wages and prices across a range of industries just prior to the Depression. By adjusting for annual increases in productivity, they were able to use the 1929 benchmark to figure out what prices and wages would have been during every year of the Depression had Roosevelt's policies not gone into effect. They then compared those figures with actual prices and wages as reflected in the Conference Board data.

In the three years following the implementation of Roosevelt's policies, wages in 11 key industries averaged 25 percent higher than they otherwise would have done, the economists calculate. But unemployment was also 25 percent higher than it should have been, given gains in productivity.

Meanwhile, prices across 19 industries averaged 23 percent above where they should have been, given the state of the economy. With goods and services that much harder for consumers to afford, demand stalled and the gross national product floundered at 27 percent below where it otherwise might have been.

"High wages and high prices in an economic slump run contrary to everything we know about market forces in economic downturns," Ohanian said. "As we've seen in the past several years, salaries and prices fall when unemployment is high. By artificially inflating both, the New Deal policies short-circuited the market's self-correcting forces."

The policies were contained in the National Industrial Recovery Act (NIRA), which exempted industries from antitrust prosecution if they agreed to enter into collective bargaining agreements that significantly raised wages. Because protection from antitrust prosecution all but ensured higher prices for goods and services, a wide range of industries took the bait, Cole and Ohanian found. By 1934 more than 500 industries, which accounted for nearly 80 percent of private, non-agricultural employment, had entered into the collective bargaining agreements called for under NIRA.

Cole and Ohanian calculate that NIRA and its aftermath account for 60 percent of the weak recovery. Without the policies, they contend that the Depression would have ended in 1936 instead of the year when they believe the slump actually ended: 1943.

Roosevelt's role in lifting the nation out of the Great Depression has been so revered that Time magazine readers cited it in 1999 when naming him the 20th century's second-most influential figure.

"This is exciting and valuable research," said Robert E. Lucas Jr., the 1995 Nobel Laureate in economics, and the John Dewey Distinguished Service Professor of Economics at the University of Chicago. "The prevention and cure of depressions is a central mission of macroeconomics, and if we can't understand what happened in the 1930s, how can we be sure it won't happen again?"

NIRA's role in prolonging the Depression has not been more closely scrutinized because the Supreme Court declared the act unconstitutional within two years of its passage.

"Historians have assumed that the policies didn't have an impact because they were too short-lived, but the proof is in the pudding," Ohanian said. "We show that they really did artificially inflate wages and prices."

Even after being deemed unconstitutional, Roosevelt's anti-competition policies persisted — albeit under a different guise, the scholars found. Ohanian and Cole painstakingly documented the extent to which the Roosevelt administration looked the other way as industries once protected by NIRA continued to engage in price-fixing practices for four more years.

The number of antitrust cases brought by the Department of Justice fell from an average of 12.5 cases per year during the 1920s to an average of 6.5 cases per year from 1935 to 1938, the scholars found. Collusion had become so widespread that one Department of Interior official complained of receiving identical bids from a protected industry (steel) on 257 different occasions between mid-1935 and mid-1936. The bids were not only identical but also 50 percent higher than foreign steel prices. Without competition, wholesale prices remained inflated, averaging 14 percent higher than they would have been without the troublesome practices, the UCLA economists calculate.

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Meg Sullivan,
310-825-1046
msullivan@support.ucla.edu

NIRA's labor provisions, meanwhile, were strengthened in the National Relations Act, signed into law in 1935. As union membership doubled, so did labor's bargaining power, rising from 14 million strike days in 1936 to about 28 million in 1937. By 1939 wages in protected industries remained 24 percent to 33 percent above where they should have been, based on 1929 figures, Cole and Ohanian calculate. Unemployment persisted. By 1939 the U.S. unemployment rate was 17.2 percent, down somewhat from its 1933 peak of 24.9 percent but still remarkably high. By comparison, in May 2003, the unemployment rate of 6.1 percent was the highest in nine years.

Recovery came only after the Department of Justice dramatically stepped enforcement of antitrust cases nearly four-fold and organized labor suffered a string of setbacks, the economists found.

"The fact that the Depression dragged on for years convinced generations of economists and policy-makers that capitalism could not be trusted to recover from depressions and that significant government intervention was required to achieve good outcomes," Cole said. "Ironically, our work shows that the recovery would have been very rapid had the government not intervened."

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