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# Hoover's pro-labor stance helped cause Great Depression, economist says

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(PhysOrg.com) -- Pro-labor policies pushed by President Herbert Hoover after the stock market crash of 1929 accounted for close to two-thirds of the drop in the nation's gross domestic product over the two years that followed, causing what might otherwise have been a bad recession to slip into the Great Depression, a UCLA economist concludes in a new study.

"These findings suggest that the recession was three times worse — at a minimum — than it would otherwise have been, because of Hoover," said Lee E. Ohanian, a UCLA professor of economics.

The policies, which included both propping up wages and encouraging job-sharing, also accounted for more than two-thirds of the precipitous decline in hours worked in the manufacturing sector, which was much harder hit initially than the agricultural sector, according to Ohanian.

"By keeping industrial wages too high, Hoover sharply depressed employment beyond where it otherwise would have been, and that act drove down the overall gross national product," Ohanian said. "His policy was the single most important event in precipitating the Great Depression."

The findings are slated to appear in the December issue of the peer-reviewed *Journal of Economic Theory* and were posted today on the website of the National Bureau of Economic Reasearch (www.nber.org) as a working paper.

Hoover's approach is unlikely to be considered today as a means of responding to economic crisis, but it does illustrate the perils of ill-conceived government policies in times of economic upheaval and confusion, says Ohanian, a macroeconomist who specializes in economic crises.

"Hoover's response illustrates the danger of knee-jerk policy reactions in a time of crisis," he said. "Almost always when bad policies are adopted, it's during a period of crisis. The real risk is picking a cure that turns out to be worse than the disease."

While economists have long debated the factors that led to the Great Depression, Ohanian's findings are novel because they don't simply pinpoint — they also quantify — the considerable impact of such labor-market distortions. The findings also challenge Hoover's pro-market reputation. "This was a president who had served as secretary of commerce under his predecessor, yet many of the mistakes he made were remarkably similar to those later made by Franklin D. Roosevelt, whose reputation is much less market-based and more pro-labor," Ohanian said.

To isolate the culprit of the Depression, Ohanian spent four years sifting through historic wage data from the Conference Board, information from Hoover's own memoirs and press accounts of the Hoover administration. Ohanian also conducted sophisticated economic modeling that allowed him to see how the economy would have progressed had Hoover's policies not been enacted.

At the time, Hoover was concerned about two potential crises, Ohanian found. He was afraid the stock market collapse of October 1929 would result in a recession with deflation, leading to dramatic wage cuts, as a period of deflation had done just a decade earlier. And because of a series of recent legislative and court decisions that had expanded the power of organized labor, he also worried about the possibility of crippling strikes if such wage cuts were to come to pass.

"Hoover had the idea that if wages were kept high for workers and they shared jobs instead of being laid off, they would be able to buy more goods and services, which would help the economy improve," Ohanian said.

After the crash, Hoover met with major leaders of industry and cut a deal with them to either maintain or raise wages and institute job-sharing to keep workers employed, at least to some degree, Ohanian found. In response, General Motors, Ford, U.S. Steel, Dupont, International Harvester and many other large firms fell in line, even publicly underscoring their compliance with Hoover's program.

Designed to placate labor and safeguard workers' buying power, the step had an unintended effect: As deflation eventually did set in, the inflation-adjusted value of these wages rose over time, effectively giving workers a raise precisely at the time when companies were least in a position to afford such increases and precisely when productivity was beginning to fall.

"The wage freeze effectively raised the cost of labor and, by extension, production," Ohanian said. "If you artificially raise the price of production, your costs go way up and you pass them on to the customers, and they buy that much less."

Reluctant to lower wages due to Hoover's entreaties, employers in the manufacturing sector responded by reducing the work week and laying off workers. By September 1931, the manufacturing sector was already hurting: Hours clocked by workers had fallen by 20 percent and employment by 35 percent.

Overall, the economy suffered, with the GDP falling by 27 percent. In a situation in which wages would have been expected to fall, they remained at about 92 percent of what they had been two years earlier. When adjusted for deflation, they had actually climbed by 10 percent, Ohanian found. Interestingly, during the dreaded period of deflation a decade earlier, some manufacturing wages fell 30 percent. GDP, meanwhile, only dropped by 4 percent.

"The Depression was the first time in the history of the U.S. that wages did not fall during a period of significant deflation," Ohanian said.

The paper, "What — or Who — Started the Great Depression" is not Ohanian's first research on the underlying causes of this dark period in American history. Along with former UCLA economics professor Harold L. Cole (now a professor of economics at the University of Pennsylvania), Ohanian published research in 2004 indicating that Roosevelt's response also had an unintentionally deleterious effect. By their calculations, fallout from Roosevelt's National Industrial Recovery Act (NIRA) dragged out the Depression for seven years longer than a more market-based response would have.

While several other economists have also implicated Roosevelt in the Great Depression's extensive duration, the UCLA research is unique because it is based on mathematical models that pinpointed the exact extent to which Roosevelt's policies prolonged the Depression, according to the UCLA economists. They calculated that the policies accounted for 60 percent of the Depression's duration.

Similarly, Hoover's employment policies have been cited as a precipitating factor in Depression. But the latest UCLA study uses modern economic tools to quantify the impact of the president's wage freeze and job-sharing policies and also provides a theory for why the major industrial businesses followed Hoover's request. By Ohanian's calculation, Hoover's policies accounted for 18 percent of the 27 percent decline in the nation's GDP by the fourth quarter of 1931.

Often-cited causes of the Depression include banking failures and large contractions of the money supply. The problem is, Ohanian says, neither of these events occurred significantly until mid-1931 — nearly two years after Hoover's fateful wage policies.

Moreover, unemployment did not plague the part of the labor force that was exempt from Hoover's 1929 wage policy. While farm employment would be reduced by Dust Bowl climatic conditions in 1935, at the outset of the Depression it remained surprisingly strong, Ohanian found. In fact, hours clocked in the agricultural sector, which comprised about 30 percent of the workforce at the time, were roughly unchanged through 1931. And unlike in the manufacturing sector, agricultural wages fell dramatically, by 30 percent.

"Wages fell substantially, but farm employment rates held steady until the Dust Bowl," Ohanian said.

Despite continued calls from industry for wage cuts in 1930 and 1931, Hoover held industry to their original promise, Ohanian found. By late 1931, manufacturers requested that Hoover provide relief in the form of increasing their ability to collude for price-setting purposes. Hoover denied this request. In response, industry signaled they would no longer support the wage freeze.

"In late 1931, industry finally did cut wages, but it was too late," Ohanian said. "By this point, the economy was in an unprecedented, full-blown depression."

Source: University of California - Los Angeles