Regime Uncertainty

Why the Great Depression Lasted So Long and Why Prosperity Resumed after the War

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"There have been endless analyses of individual economic policies; there has been little attention to changes in policy regimes."
—PETER TEMIN (1989, 134)

The Great Depression is one of the most studied topics in American economic history, and one about which scholars remain in serious disagreement. Perhaps the topic is too big, and its study would be more fruitful if it were broken down into subtopics. Thus, one might consider separately the causes of the Great Contraction, the unparalleled macroeconomic collapse between 1929 and 1933; the Great Duration, the twelve successive years during which the economy operated substantially below its capacity to produce; and the Great Escape, generally understood to have been brought about, directly or indirectly, by American participation in World

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War II. The Great Contraction has received the most attention, and its investigators show no signs of reaching a consensus. The Great Duration has received somewhat less study, though still a good deal, and the range of views among students of this aspect of the Great Depression is perhaps slightly narrower. Regarding the Great Escape, there seemed until recently to be hardly any disagreement.

In a paper published in 1992, however, I called into question the prevailing understanding of the Great Escape by challenging the reality of "wartime prosperity" during World War II. In the present paper I extend that argument, attempting to shed new light on the Great Duration and the Great Escape. For present purposes I make no attempt to explain the Great Contraction, merely recognizing that it occurred and that it had certain aspects, including most notably a collapse of private investment.

In the earlier paper I argued that a return to genuine prosperity—the true Great Escape—occurred only after World War II ended, not during the war as suggested by the idea of wartime prosperity. During the war years the economy operated essentially as a command system, and as a result the normal measures of macroeconomic performance (e.g., gross domestic product, the price level, and the rate of unemployment) were either conceptually or statistically incomparable with corresponding measures before and after the period subject to the wartime distortions.

In my understanding, one simply cannot speak with confidence about such matters as, for example, the rate of growth of real GDP or the rate of inflation from year to year during the period from 1941 to 1947. From 1941 through 1945, vast quantities of munitions were produced along with a restricted set of price-controlled civilian goods, some of which were physically rationed (Krug 1945; Harris 1945). Comprehensive price controls, gradually imposed in 1941 and 1942, were not abandoned for good until late in 1946 (U.S. Bureau of the Budget 1946, 235–73; Rockoff 1984, 85–176). Because the actual wartime prices could not even have approximated the prices of an economy in full competitive equilibrium, they cannot serve as appropriate weights for the construction of a meaningful national product aggregate. Unemployment virtually disappeared as conscription, directly and indirectly, pulled more than 12 million potential workers into the armed forces and millions of others into draft-exempt employments, but under the prevailing conditions the disappearance of unemployment can hardly be interpreted as a valid index of economic prosperity (Higgs 1992, 42–44).

Given the institutional discontinuity created by the wartime command economy, our understanding of the period from the late 1930s to the late 1940s, so far as it depends on the usual macroeconomic measures, must necessarily contain a huge gap. To insist on using the standard measures notwithstanding the complete evaporation of their institutional underpinnings would mislead us far more than frankly facing up to the fact that, for the war years, the usual measures have no real substance. One can compute them, of course, by making a great many assumptions and swallowing hard. But the wartime numbers that look so solid and comparable sitting there in the middle of a long time series are essentially arbitrary.

What we can say with confidence is that as of 1940, the economy had not yet recovered fully from the Great Depression; when the meaningfulness of the macroeconomic indexes began to fade in the second half of 1940, the Great Escape had not yet been completed. For the next five years the war-command system foreclosed conventional comparable measurements of the performance of the macroeconomy. Then, from mid-1945 until perhaps as late as the first quarter of 1947, the demobilization, reconversion, and decontrol of the economy continued to muddy the macroeconomic waters. Finally, certainly by 1948 and probably by 1947, economic conditions were sufficiently free of wartime distortions and their postwar carryovers that we can confidently make comparisons with, say, 1940 or earlier years. What we see then, of course, is that the postwar economy enjoyed a high degree of prosperity, whether judged by its low unemployment rate or by its high real GDP relative to the corresponding index for any prewar year.

We know, then, that sometime during the period of 1941 to 1947, the economy made its Great Escape. In my 1992 paper I argued that the war years themselves witnessed a deterioration of economic well-being in the sense of consumer satisfaction either present (via private consumption) or prospective (via accumulation of capital with the potential to enhance future civilian consumption) and that the Great Escape actually occurred during the demobilization period, especially during its first year, when most of the wartime controls were eliminated and most of the resources used for munitions production and military activities were returned to civilian production.

In light of the foregoing observations, we may justifiably adopt the following chronology: Great Depression, 1930 to 1940; transition to the war economy, 1940 to 1941; war-command economy, 1942 to 1945; demobilization, reconversion, and decontrol (the true Great Escape), 1945 to 1946; postwar prosperity, 1946 and beyond.

I shall argue here that the economy remained in the depression as late as 1940 because private investment had never recovered sufficiently after its collapse during the Great Contraction. During the war, private investment fell to much lower levels, and the federal government itself became the chief investor, directing investment into building up the nation's capacity to produce munitions. After the war ended, private investment, for the first time since the 1920s, rose to and remained at levels sufficient to create a prosperous and normally growing economy.

I shall argue further that the insufficiency of private investment from 1935 through 1940 reflected a pervasive uncertainty among investors about the security of their property rights in their capital and its prospective returns. This uncertainty arose, especially though not exclusively, from the character of federal government actions and the nature of the Roosevelt administration during the so-called Second New Deal from 1935 to 1940. Starting in 1940 the makeup of FDR's administration changed substantially as probusiness men began to replace dedicated New Dealers in many positions, including most of the offices of high authority in the war-command economy. Congressional changes in the elections from 1938 onward reinforced the movement away from the New Deal, strengthening the so-called Conservative Coalition. From 1941 through 1945, however, the less hostile character of the administration expressed itself in decisions about how to manage the war-command economy; therefore, with private investment replaced by direct government investment, the diminished fears of investors could not give rise to a revival of private investment spending. In 1945 the death of Roosevelt and the succession of Harry S Truman and his administration completed the shift from a political regime investors perceived as full of uncertainty to one in which they felt much more confident about the security of their private property rights. Sufficiently sanguine for the first time since 1929, and finally freed from government restraints on private investment for civilian purposes, investors set in motion the postwar investment boom that powered the economy's return to sustained prosperity notwithstanding the drastic reduction of federal government spending from its extraordinarily elevated wartime levels.

What Happened to Investment?

As economic historian Alexander Field (1992) has written, "no coherent account of the depth and duration of the Depression can ignore the causes of fluctuations in investment spending" (786). Figure 1 illustrates both real gross domestic product (GDP) and real gross private investment (GPI) from 1929 to 1950.[1] As the figure shows, both real GDP (bars, left-side scale) and 1. As indicated earlier, the data plotted for 1941–1946, especially those for 1942 to 1945, are unsuitable for analysis. I show them in this and the succeeding figure to reveal what would be at stake if one were to proceed in a conventional manner, treating these observations as real GPI (thin line, right-side scale) plunged from 1929 to a trough in either 1932 or 1933, the former by 29 percent, the latter by 84 percent. Both variables recovered rapidly after

1. As indicated earlier, the data plotted for 1941–1946, especially those for 1942 to 1945, are unsuitable for analysis. I show them in this and the succeeding figure to reveal what would be at stake if one were to proceed in a conventional manner, treating these observations as comparable with the preceding and succeeding ones. The data source is the U.S. Council of Economic Advisers (1995, 406).

1933: by 1937, real national product had regained 96 percent of its loss in the Great Contraction, and investment had recouped 64 percent of its loss. The "Roosevelt recession" of 1937 to 1938 cut short the recovery: real GDP fell by 4 percent in 1938, gross investment by 34 percent. Real national product recovered quickly after 1938, and in 1939 it finally exceeded its previous peak value of 1929. (Of course, this level of GDP was no longer a "full-employment" level; the rate of unemployment [Darby variant] was 11.3 percent.)[2] Investment recovered more slowly. Even in 1941, when stimulus from the defense mobilization had become substantial, real GPI had not quite regained its 1929 level. For what the data are worth, they show that private investment plunged to very low levels during the years the United States was a declared belligerent. After the war ended, however, real GPI exceeded its previous (1929) peak substantially; it stood 23 percent higher even during the recession year 1949. Both real GDP and real GPI data show that during the period of 1946 to 1950, the Great Escape had been made.

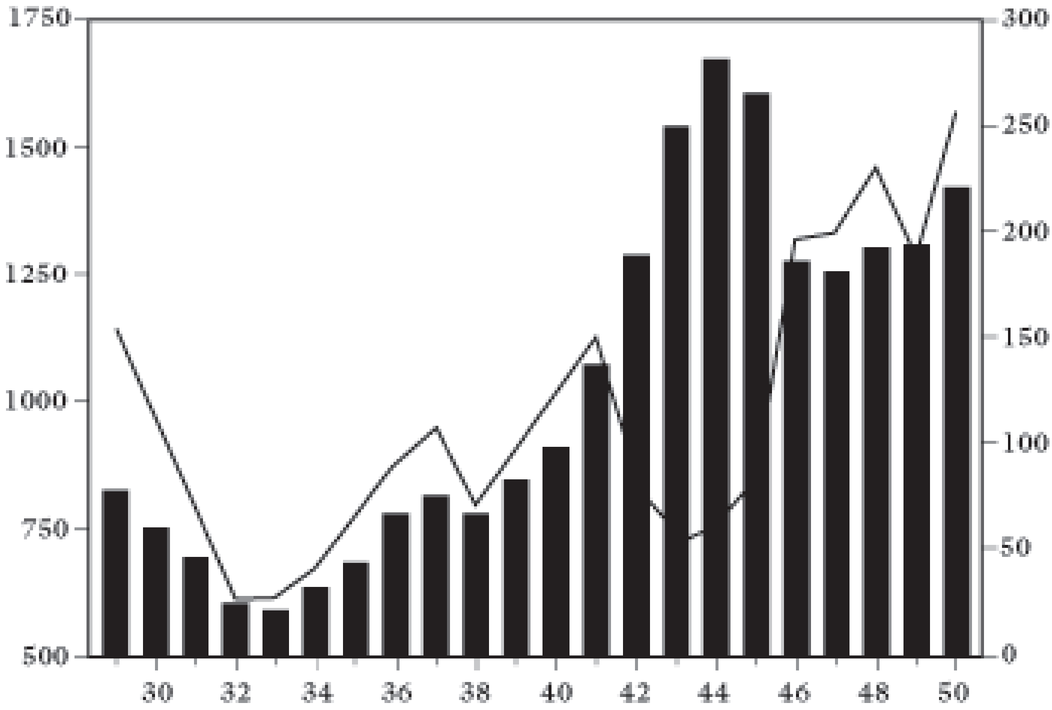

Figure 1. Gross Domestic Product (billions of 1987$) and Gross Private Investment (billions of 1987$), 1929–1950

2. Darby's measure of unemployment counts persons employed in government emergency work-relief programs as employed, whereas the official measure of unemployment counts these persons as unemployed. See Darby (1976)

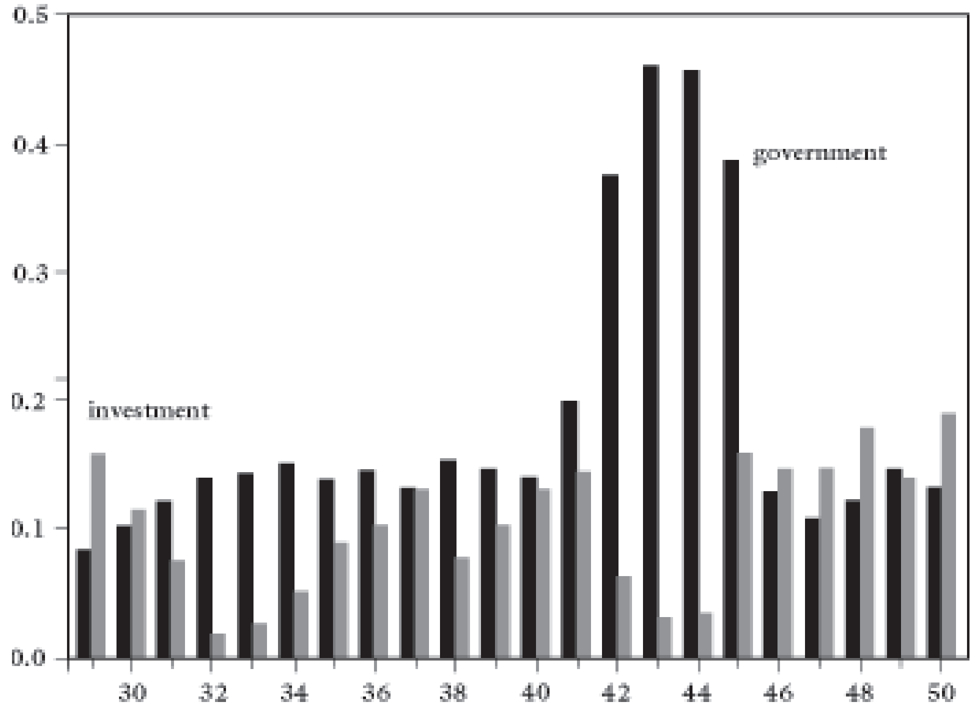

Figure 2. Government Purchases (Current$) and Gross Private Investment (Current$) Relative to Gross Domestic Product (Current$), 1929–1950

Figure 2 provides an alternative depiction of the course of private investment spending (along with government spending, for comparison).[3] Using current-dollar investment as a proportion of current-dollar GDP, this approach avoids the distortions potentially affecting data shown in figure 1 due to the index-number problem or measurement errors in the deflators. As the figure shows, gross private investment (gray bars) plunged from almost 16 percent of GDP in 1929 to less than 2 percent in 1932; recovered to 13 percent in 1937 before falling again in the recession of 1938; and as late as 1941 stood at only 14 percent. During the war years, private investment ratios ranged from 3 to 6 percent. From 1946 through 1950 they ranged from 14 to 19 percent and averaged 16 percent—the same as in 1929.

One appreciates even better the deficiency of investment in the 1930s by considering net, rather than gross, investment. From 1929 to 1941 the capital consumption allowance amounted to 8 to 10 percent of GNP (U.S. Bureau of the Census 1975, 234, Series F144–45). In 1929, when gross private investment was $16.2 billion, net investment was $8.3 billion. Net investment fell precipitously to $2.3 billion in 1930 and then became negative during each of

3. The data source is the U.S. Council of Economic Advisers (1970, 177).

the following five years. In the period of 1931 to 1935, net investment totaled *minus* $18.3 billion. After reviving to positive levels in 1936 and 1937, net investment again fell into the negative range in 1938 ($0.8 billion) before resuming its recovery. For the eleven-year period of 1930 to 1940, net private investment totaled *minus* $3.1 billion. Only in 1941 did net private investment ($9.7 billion) exceed the 1929 amount.[4]

The data leave little doubt. During the 1930s, private investment remained at depths never plumbed in any other decade for which data exist. Stimulus from the defense buildup increased it in 1940 and 1941; then wartime controls curtailed it from 1942 through 1945. Only in 1946 and the following years did private investment reach and remain at levels consistent with a prosperous and growing economy.

A Hypothesis about Why Investment Remained Depressed

Eleven years is an extraordinarily long time for investment to remain drastically subpar, so it is plausible that the long doldrums had some extraordinary cause—in any event, that is the idea explored here. Nothing in this investigation is meant to test, refute, or otherwise shed light directly on any of the many macroeconomic models that have been advanced over the years to explain business fluctuations in general or the Great Depression in particular. Rather, my inquiry may be viewed as complementary to any analysis that holds private investment's failure to revive fully to have been at least partially responsible for the Great Duration.

Many such explanations have been advanced. For example, economist Lester Chandler (1970) concluded in a widely cited book: "The failure of the New Deal to bring about an adequate revival of private investment is the key to its failure to achieve a complete and self–sustaining recovery of output and employment" (132). In very similar language, economic historian Peter Fearon (1987) observed: "Perhaps the New Deal's greatest failure lay in its inability to generate the revival in private investment that would have led to greater output and more jobs" (208). Obviously, regardless of what else might have been happening, no one could expect a resumption of prosperity when the economy—its labor force continuing to grow—went more than a decade without any increase of the capital stock.

My hypothesis supplements my previous argument that the Great Escape did not occur until after the end of the war. Indeed, the argument I shall make

4. The 1929 benchmark was quite representative of the latter 1920s: gross private investment averaged $15.7 billion per year from 1925 through 1929 (Swanson and Williamson 1972, 55).

ties together events during the latter half of the depression and events during the war years to arrive at an explanation for why investment finally recovered fully only after VJ-Day, creating sustained prosperity and normal economic growth thereafter.

The hypothesis is a variant of an old idea: the willingness of businesspeople to invest requires a sufficiently healthy state of "business confidence," and the Second New Deal ravaged the requisite confidence (Krooss 1970, 199–201; Collins 1981, 23–52; Fearon 1987, 209–11; Brinkley 1995, 31–34). Of course, one difficulty with the hypothesis is that business confidence is a vague notion and one for which no conventional empirical measure has been developed. I shall try to narrow the concept somewhat and to show that one can shed empirical light on it by using the findings of systematic opinion surveys and evidence on the behavior of investors in the financial markets.

To narrow the concept of business confidence, I adopt the interpretation that businesspeople may be more or less "uncertain about the regime," by which I mean, distressed that investors' private property rights in their capital and the income it yields will be attenuated further by government action. Such attenuations can arise from many sources, ranging from simple tax-rate increases to the imposition of new kinds of taxes to outright confiscation of private property. Many intermediate threats can arise from various sorts of regulation, for instance, of securities markets, labor markets, and product markets. In any event, the security of private property rights rests not so much on the letter of the law as on the character of the government that enforces, or threatens, presumptive rights. "What does provide some degree of protection," notes Andrzej Rapaczynski (1996),

> is the political system, together with the economic pressure groups that ensure that the state does not go "too far" in interfering with the owner's control over assets. This politically determined thin line may be understood as the real definition of property rights conferred by the state, as distinct from the somewhat fictitious legal notion of property rights. How broadly property rights are defined in this real sense and how effective states' (largely nonlegal) commitment is to their security is a more serious problem than the issue of legal protections against the more traditional form of takings. (93)

As Lee J. Alston, Thráinn Eggertsson, and Douglass C. North (1996) have recently observed, echoing venerable wisdom, "In an economy where entrepreneurship is decentralized, economic actors will hold back on long-term investments unless the state makes credible commitments to honor its contracts and respect individual ownership rights" (4).

It would be easy to dismiss an investigation of, first, increased regime uncertainty as a cause of the investment drought that contributed to the Great Duration and, second, reduced regime uncertainty as a cause of the investment surge that propelled the Great Escape. In retrospect it seems hyperbolic to put much weight on the fears of investors in the latter half of the 1930s that the regime might soon undergo changes that would seriously jeopardize their private property rights—after all, we know quite well that the U.S. economy did not fall into outright fascism, socialism, or some other variant of government takeover. Roosevelt, we now know, never became a dictator along the lines of his contemporaries Stalin, Mussolini, and Hitler; the New Dealers were no Brown Shirts. But what seems so obvious to us in retrospect had a quite different appearance to many contemporaries (Flynn 1944, 166–258; Roose 1954, 209–31, 250; Krooss 1970, 159–209; Garraty 1973). No one knew for sure what the future held. According to economic historian Herman Krooss (1970), "Business leaders sincerely believed that the government was in evil hands…and preparing the way for socialism, communism, or some other variety of anti-Americanism" (197). As I shall demonstrate shortly, the possibility that the United States might undergo an extreme regime shift seemed to many investors in the late 1930s and early 1940s not only possible but likely.

In recent years economists have developed a number of models incorporating uncertainty more explicitly into the analysis of investment. This new approach recognizes that much investment not only entails irreversibilities or sunk costs, but can be delayed. Given these attributes, economist Robert Pindyck (1991) reports, "investment spending on an aggregate level may be highly sensitive to risk in various forms…[including] uncertainty over future tax and regulatory policy." One implication is that "a major cost of political and economic instability may be its depressing effect on investment" (1141; see also 1110–12). As Pindyck notes, "[m]ost econometric models of aggregate economic activity ignore the role of risk, or deal with it only implicitly. A more explicit treatment of risk may help to better explain economic fluctuations, and especially investment spending" (1142). Although I make no attempt here to estimate an econometric model incorporating uncertainty, the approach of my analysis is, in its substance, compatible with the approach of the new investment models.

At the same time, it is also compatible with the views expressed by many economists of an earlier generation, including Joseph A. Schumpeter (1939), who observed "how unrealistic any theory of investment opportunity is which leaves the political factor out of account" (1043), and Kenneth D. Roose (1954), who argued that the relations of business and government during the latter half of the 1930s were "infected with such hatreds and distrusts" that "the risks and uncertainties of investment decision were seriously increased" (224). Roose concluded that "the uncertainties created by government policies as to the nature of the economic system which was evolving undoubtedly reduced the number of long-term investment commitments" (232). In their monumental monetary history, Milton Friedman and Anna Schwartz (1963) endorsed Roose's assessment (495–96).

The Sources of Regime Uncertainty

Despite the encroachments of taxation, regulation, and other government action at all levels that had been occurring for half a century or more (Hughes 1991, 92–135; Higgs 1987, 77–167; Keller 1990), as late as 1932 businesspeople in general and investors in particular remained—certainly in retrospect—relatively free of major threats to the prevailing regime of private property rights.

Then, during the next two presidential terms, the Roosevelt administration proposed and Congress enacted an unparalleled outpouring of laws that significantly attenuated private property rights (Leuchtenburg 1963; Badger 1989). State legislatures followed suit with their "little New Deals" (Leuchtenburg 1963, 198–88; Badger 1989, 283–84) and relentless tax increases (Brownlee 1996, 83, 85). Table 1 lists only some of the more important federal enactments diminishing or threatening private property rights. As financial economist Benjamin Anderson ([1949] 1979), an astute contemporary observer, remarked, "The impact of these multitudinous measures—industrial, agricultural, financial, monetary, and other—upon a bewildered industrial and financial community was extraordinarily heavy" (357).

Anderson was hardly the only contemporary economist convinced that the New Deal measures caused the Great Duration. Schumpeter, one of the world's leading authorities on business cycles, wrote in the first edition of his Capitalism, Socialism and Democracy, published in 1942,

> The subnormal recovery to 1935, the subnormal prosperity to 1937 and the slump after that are easily accounted for by the difficulties incident to the adaptation to a new fiscal policy, new labor legislation and a general change in the attitude of government to private enterprise all of which can…be distinguished from the working of the productive apparatus as such.… [S]o extensive and rapid a change of the social scene naturally affects productive performance for a time, and so much the most ardent New Dealer must *and also can* admit. I for one do not see how it would otherwise be possible to account for the fact that this country which had the best chance of recovering quickly was precisely the one to experience the most unsatisfactory recovery. ([1942] 1962, 64–65; emphasis in original)

Table 1. Selected Acts of Congress Substantially Attenuating or Threatening Private Property Rights, 1933–1940

1933	**1936**
Agricultural Adjustment Act	Soil Conservation & Domestic Allotment Act
National Industrial Recovery Act	Federal Anti-Price Discrimination Act
Emergency Banking Relief Act	Revenue Act of 1936
Banking Act of 1933	
Federal Securities Act	**1937**
Tennessee Valley Authority Act	Bituminous Coal Act
Gold Repeal Joint Resolution	Revenue Act of 1937
Farm Credit Act	National Housing Act
Emergency Railroad Transport Act	Enabling (Miller-Tydings) Act
Emergency Farm Mortgage Act	
Home Owners Loan Corporation Act	
1934	**1938**
Securities Exchange Act	Agricultural Adjustment Act
Gold Reserve Act	Fair Labor Standards Act
Communications Act	Civil Aeronautics Act
Railway Labor Act	Food, Drug & Cosmetic Act
1935	**1939**
Bituminous Coal Stabilization Act	Administrative Reorganization Act
Connally ("hot oil") Act	
Revenue Act of 1935	**1940**
National Labor Relations Act	Investment Company Act
Social Security Act	Revenue Act of 1940
Public Utilities Holding Company Act	Second Revenue Act of 1940
Banking Act of 1935	
Emergency Relief Appropriations Act	
Farm Mortgage Moratorium Act	

Schumpeter had elaborated on this interpretation three years earlier in his treatise, *Business Cycles* (1939, 1037–50), insisting that "the individual measures obviously tended to reinforce each other" (1045) in their discouraging effect on investors.

Taken together, the many menacing New Deal measures, especially those from 1935 onward, gave businesspeople and investors good reason to fear that the market economy might not survive in anything like its traditional form and that even more drastic developments, perhaps even some kind of collectivist dictatorship, could not be ruled out entirely (Roose 1954, 65–69). As Schumpeter (1939) remarked of businessmen in the late 1930s, "They *are* not only, but they *feel* threatened. They realize that they are on trial before judges who have the verdict in their pocket beforehand, that an increasing part of public opinion is impervious to their point of view, and that any particular indictment will, if successfully met, at once be replaced by another" (1046).

One of the chief ironies of the Roosevelt administration's policies is that "for the most part the New Deal relied on private investment to stimulate recovery yet its rhetoric precluded the private confidence to invest" (Badger 1989, 116). Early in his presidency, Roosevelt took seriously "the risk of worsening the economic depression by undermining business confidence and investment," but by 1935 he "had gained confidence in the prospects for economic recovery and was less worried about a business backlash" (Brownlee 1996, 71–72). Under political pressure from radical challengers such as Huey Long, Francis Townsend, Father Charles Coughlin, and others, FDR had begun to voice heightened hostility to investors as early as 1934 (Leuchtenburg 1963, 95–117). In 1935 Roosevelt "lost patience with corporation leaders, and younger New Dealers came to the fore who shared his reluctance to make concessions to conservative business opinion.... The men around Roosevelt were now highly sceptical of the ability of business to act in the national interest" (Badger 1989, 96). Ignoring the opposition of business groups such as the U.S. Chamber of Commerce and the National Association of Manufacturers, in 1935 FDR supported the Social Security Act, the National Labor Relations Act, the Banking Act, and the Public Utilities Holding Company Act as well as a host of other laws, including soak-the-rich taxes, opposed by most business groups.

Accepting his party's nomination for the presidency in 1936, Roosevelt railed against the "economic royalists" allegedly seeking a "new industrial dictatorship" (quoted in Leuchtenburg 1963, 183–84). Privately he opined that "businessmen as a class were stupid, that newspapers were just as bad; nothing would win more votes than to have the press and the business community aligned against him" (Leuchtenburg 1963, 183). Just before the election of 1936, in an address at Madison Square Garden, he fulminated against the magnates of "organized money...[who were] unanimous in their hate for me" and declared, "I welcome their hatred." To uproarious applause, he threatened: "I should like to have it said of my second Administration that in it these forces met their master" (quoted in Leuchtenburg 1963, 184).

In 1935, 1936, and 1937 the Roosevelt administration requested tax legislation aimed at punishing the wealthy. The so-called Wealth Tax of 1935 (part of the Revenue Act) ultimately included a graduated corporation income tax, a tax on intercorporate dividends, increases of estate and gift taxes, and increases of surtaxes on incomes greater than $50,000 that ranged up to a top rate of 75 percent. In 1936 FDR sought to tax retained corporate earnings in lieu of all other corporate income taxes. Congress approved a graduated surtax on corporate earnings, based on the percentage of earnings retained, and increased the tax rate on intercorporate dividends. The overall effect was to raise corporate income taxes. The 1937 tax act closed a variety of "loopholes," including the use of personal holding companies to avoid taxes.[5] These soak-the-rich efforts left little doubt that the president and his administration intended to push through Congress everything they could to extract wealth from the highincome earners responsible for making the bulk of the nation's decisions about private investment. According to economic historian Elliot Brownlee (1985, 417), "the tax reform of 1935–37, more than any other aspect of the New Deal,…stimulated business hostility to Roosevelt.… [B]usiness opponents of New Deal tax reform charged that Roosevelt's taxes, particularly the undistributed profits tax, had caused the recession [of 1937–38] by discouraging investment" (417).[6]

Although Congress reversed in 1938 and 1939 some of the tax provisions most offensive to investors, Roosevelt continued to rail against businessmen who, as he said in a 1938 speech, "will fight to the last ditch to retain such autocratic control over the industry and finances of the country as they now possess" (quoted in Brownlee 1996, 81). Although historians emphasize the president's defeats with respect to taxation in the late 1930s, contemporary businessmen must have appreciated the reality of increased taxation: in fiscal 1940, with the depression still lingering, the federal government collected 57 percent more total revenue than it had in the prosperous year 1927 (U.S. Bureau of the Census 1975, 1122, Series Y568).

Meanwhile other developments heightened the perceived threat to established private property rights. Early in 1937 FDR brought forth his plan to pack the Supreme Court. Although he failed to gain congressional support for this scheme, which many perceived as "a naked bid for dictatorship" (Anderson [1949] 1979, 430), the intimidated justices, weary of public contempt and worried that their constitutional power might be undercut, finally capitulated. Beginning in 1937 the Court abandoned its employment of the doctrine of substantive due process under which, since the 1890s, it had struck down state and federal government interferences with private contracting. Subsequently the Court, increasingly composed of FDR's appointees, upheld state minimum wage laws, the Social Security Act, the National Labor Relations Act, indeed the entire panoply of New Deal regulatory measures, under an interpretation of the Interstate Commerce Clause so sweeping that it embraced virtually all economic activity (Siegan 1980, 184–204; Ely 1992, 119–34). In the face of this "monumental change in the Court's attitude toward

5. On the tax laws, see Witte (1985, 100–108), Brownlee (1985, 415–18), and Brownlee (1996, 74–82).

6. For evidence that the undistributed profits tax did have harmful effects on resource allocation, with costs "borne disproportionately by young, growing firms," see Calomiris and Hubbard (1995, quotation on p. 477). For the effect of the tax on business expectations, see Roose (1954, 212–16).

property rights and entrepreneurial liberty" (Ely 1992, 132), investors correctly perceived that the strongest bulwark against the government juggernaut had evaporated, exposing them to whatever legislative and executive incursions the political process might generate.

Simultaneously, wielding the new powers granted them by the National Labor Relations Act, labor unions carried out their most rapid surge of organizing. Membership rose from 3.8 million in 1935 to between 8.7 and 10.2 million (sources differ) in 1941—the latter of the 1941 figures representing 28 percent of nonagricultural employment (U.S. Bureau of the Census 1975, 177–78). As union power increased, unions became a major force in the New Deal coalition, and Democratic politicians and officeholders across the country increasingly deferred to them. In the starkest demonstration of their new power, unionists began sit-down strikes, occupying employers' facilities and refusing either to work or to leave until their demands were met. President Roosevelt declined to use force to eject the sit-down strikers; likewise, many state and local officials would not enforce the law against this willful trespassing on private property. As historian William E. Leuchtenburg (1963) observed, "Property-minded citizens were scared by the seizure of factories, incensed when strikers interfered with the mails, vexed by the intimidation of nonunionists, and alarmed by flying squadrons of workers who marched, or threatened to march, from city to city" (242).

In 1937 and 1938 Roosevelt's attempt to reorganize the executive branch of government seemed to many of his opponents still another attempt on the part of a would-be dictator "to subvert democratic institutions" by "importing European totalitarianism into the United States" (Leuchtenburg 1963, 277, 279). As described by historian Charles Schilke (1985), "the capstone of the reorganization was to be the transformation of the advisory National Resources Board into a vigorous statutory National Resources Planning Board to engage in continuous central planning and program coordination" (356). Not surprisingly, business leaders "argued that reorganization legislation would erode business confidence and impede recovery." After the House of Representatives defeated the president's reorganization bill in 1938, FDR introduced a watered-down replacement in 1939, which gained quick enactment (Brinkley 1995, 21–23). This law, "the last major New Deal measure before the Second World War," nonetheless "represented a significant shift in power from Congress to the presidency," and Roosevelt used it skillfully to create the Executive Office of the President and an Office of Emergency Management (Schilke 1985, 355), both of which proved instrumental in the president's maneuvering to bring the United States into World War II (U.S. Bureau of the Budget 1946, 14–16, 22).

Further disturbing business confidence, the federal government in June 1938 created the Temporary National Economic Committee (TNEC). A product of the misguided idea that "monopolies" had brought about or sustained the depression (Roose 1954, 142–43), the TNEC interrogated 552 witnesses between December 1, 1938, and March 11, 1941, and ultimately published a report of forty-three volumes. The main accomplishments of the committee were to showcase the rudimentary Keynesian ideas of economists such as Alvin Hansen and Lauchlin Currie and to heighten business suspicions that the government intended to launch an antitrust jihad (May 1985, 419–20). At the time, critics of the TNEC investigation regarded it as "an important, if ominous, event" (Brinkley 1995, 123). Raymond Moley, a member of FDR's Brains Trust who had become estranged from the New Deal, described the TNEC in 1940 as a "time bomb"—in the words of historian Alan Brinkley, "sputtering along misleadingly but certain to produce unwelcome, radical results" (Brinkley 1995, 123).

The fear seemed well justified, given the frenetic activities of Thurman Arnold, who took charge of the Antitrust Division of the Department of Justice in 1938. Despite having written a book mocking the antitrust laws, Arnold proceeded to lead an unprecedented attack on business concentration and trade practices, enormously expanding the number of prosecutions (Brinkley 1995, 111). In retrospect, one may be tempted to view this crusade as little more than an insignificant spasm of a bewildered administration seeking to shift the blame for the recession of 1937 to 1938. But contemporaries could not know, as we do, that the crusade would peter out in 1941 and 1942, when the managers of the wartime economy used their prerogatives to shield companies from antitrust actions on grounds of military necessity (Brinkley 1995, 120–21).

In contemplating the state of mind of investors between 1935 and 1940, one ought to recall just how radically the government's policies with respect to industrial structure and business practices had shifted. As late as 1935 the National Recovery Administration was still enforcing the comprehensive cartelization of all American industry. Just three years later an unprecedented hurricane of antitrust enforcement swept over business shores.

In a recent evaluation of the New Deal's effects on the recovery, economic historian Gene Smiley (1994) notes that businesses "were further discouraged from investing by the new capital market regulations generated by the Securities and Exchange Act, the government's entry into the utility industry through the TVA, the continued tax increases (particularly the undistributed corporate profits tax) and rhetoric about the need to equalize incomes." By these and a multitude of other policy changes, the Roosevelt administration "abruptly and dramatically altered the institutional framework within which private business decisions were made, not just once but several times" (136), with the result that regime uncertainty was heightened and recovery substantially retarded. Fearon (1987) concurs that "shifts in government policy and the bitterness of the exchanges between business and Roosevelt were not likely to encourage an expansion in investment" (210).

In these conclusions, economic historians only echo the observations of one of America's leading investors, Lammot du Pont, in 1937:

> Uncertainty rules the tax situation, the labor situation, the monetary situation, and practically every legal condition under which industry must operate. Are taxes to go higher, lower or stay where they are? We don't know. Is labor to be union or nonunion?… Are we to have inflation or deflation, more government spending or less?… Are new restrictions to be placed on capital, new limits on profits?… It is impossible to even guess at the answers. (quoted in Krooss 1970, 200)

Poll Data, 1939–1941

The evidence summarized in the preceding section establishes, at least, that a variety of political and legal developments in the latter half of the 1930s gave investors ample reason to fear that their private property rights were at great risk of further attenuation and might conceivably be destroyed completely. But such evidence, by its very nature, is somewhat selective and bears only indirectly on the question at issue—whether regime uncertainty truly troubled investors. Can we somehow gain direct access to the actual expectations of more than a handful of select or fortuitous testifiers?

To the extent that public opinion surveys succeed in their objectives, we can. Modern polling, based on scientific sampling, dates from the mid1930s. By 1939 the polling organizations had begun to ask questions that bear more or less directly on the state of business confidence and businesspeople's expectations regarding the property-rights regime. Of course, poll data present a variety of well-known difficulties (Bennett 1980, 64–93); they can never settle a question conclusively. Still, they offer some definite advantages over alternative sorts of evidence, and one would be cavalier to dismiss them peremptorily, as economists usually do. On other occasions, poll data have demonstrated remarkable explanatory power (Higgs and Kilduff 1993), and I propose to give them another hearing here.

Although most of the poll data I shall cite rest on the responses of businesspeople alone, some polls of the general public merit attention as well, if only to establish that the views of businesspeople were not wildly aberrant. In the spring of 1939 a nationally representative poll by the American Institute of Public Opinion (AIPO) asked: "Do you think the attitude of the Roosevelt administration toward business is delaying business recovery?" In March, 54 percent said yes, 26 percent no, and the rest had no opinion. In May, 53 percent said yes, 31 percent no, and the rest had no opinion (Cantril 1951, 64).

Also in May 1939, a nationally representative AIPO poll asked: “Do you think that ten years from now there will be more government control of business than there is now or less government control of business?” Of the respondents, 56 percent expected more government control, 22 percent less, 8 percent neither more nor less, and 14 percent didn’t venture an opinion (Cantril 1951, 345).

Clearly, a majority of the general public believed the Roosevelt administration’s stance vis-à-vis business was delaying recovery, and they expected government control of business to increase over the next decade, which presumably would further impede recovery.

In May 1939, *Fortune* pollsters asked a national sample of business executives: “With which of these two statements do you come closest to agreeing? (1) The policies of the administration have so affected the confidence of businessmen that recovery has been seriously held back; (2) businessmen generally have been unjustly blaming the administration for their troubles.” Of the executives responding, 64.8 percent agreed with the first statement, 25.6 percent with the second, and 9.6 percent said they didn’t know (Cantril 1951, 64).

When the government began to mobilize the economy for war in the second half of 1940, many business managers were reluctant to become contractors for the War and Navy Departments. In an October 1940 *Fortune* poll, the 58.8 percent of responding business executives who reported that they knew others who had “any reservations about rearmament work” were singled out for a follow-up question and presented with seven alternative reasons for such reservations. Of the seven options, the following reason received the most assent (77.3 percent chose it): “Belief that the present administration in Washington is strongly antibusiness and a consequent discouragement over the practicability of cooperation with this administration on rearmament” (Cantril 1951, 346). Evidently, many business executives so distrusted the Roosevelt administration that they would rather forgo potentially lucrative munitions contracts than deal with the administration.

In December 1940 the *Fortune* pollsters asked business executives a related question: “Do you think that present conditions are such that business as a whole is now justified in making constructive commitments for expansion?” Of the respondents, 13 percent said yes, 26 percent no, and 61 percent said “only in war industries” (Cantril 1951, 337). Even at an advanced stage of the recovery, businesspeople who viewed civilian investment as unjustified outnumbered those regarding it as justified by 2-to-1.

In May 1941 the *Fortune* pollsters asked a national sample of business executives: “If you consider lack of mutual confidence between government and business a major or secondary factor [in the slow pace of rearmament], do you feel that the government is more to blame, business is more to blame, both equally to blame?" Of the respondents, 77.8 percent put the greater blame on government, 1.9 percent put it on business; 14.3 percent blamed government and business equally; and 6 percent gave another answer or no answer at all (Cantril 1951, 347).

In the same sample, respondents "critical of defense progress" were asked to rate eleven specified "factors…contributing to the trouble." One of the factors was "longstanding lack of mutual confidence between government and business," which was rated as a "major cause" by 41.8 percent of the respondents, "secondary" by 21.1 percent, and "unimportant" by just 7.7 percent (0.9 percent said "don't know," and 28.5 percent did not answer). The only factor selected by more of the respondents as a major cause—43.5 percent picked it—was "methods of placing government orders, red tape, delays," which itself was another form of blaming the government (Cantril 1951, 347).

In November 1941, just before the Japanese attack on Pearl Harbor propelled the United States into total war, the *Fortune* pollsters asked a sample of business executives a question that bears quite directly on the regime uncertainty at issue in this article. The question was "Which of the following comes closest to being your prediction of the kind of economic structure with which this country will emerge after the war?" The respondents were presented with four options, as follows (the percentage of respondents selecting that option as the closest to their own prediction is shown in brackets):

> (1) A system of free enterprise restored very much along the prewar lines, with modifications to take care of conditions then current. [7.2 percent]
>
> (2) An economic system in which government will take over many public services formerly under private management but still leave many opportunities for private enterprise. [52.4 percent]
>
> (3) A semi-socialized society in which there will be very little room for the profit system to operate. [36.7 percent]
>
> (4) A complete economic dictatorship along fascist or communist lines. [3.7 percent] (Cantril 1951, 175)

These responses constitute an extraordinary testimony to the fears of business executives on the eve of the war. Almost 93 percent of them expected the postwar regime to be one that would further attenuate private property rights to a greater or lesser degree. More than 40 percent expected a regime in which government would dominate the economy—options (3) and (4). If these poll data are even approximately indicative of the true expectations of American investors, then it is astonishing that the recovery of investment had proceeded as far as it had.

The Changing of the Guard, 1940–1945

After the outbreak of war in Europe in 1939, if not before, President Roosevelt focused his time and energy on foreign and military affairs. Effective U.S. rearmament, even if only to serve as the "arsenal of democracy," required the cooperation of businesspeople, especially those in control of the nation's biggest corporations. As Henry Stimson, a pillar of the eastern Republican establishment, observed in 1940, "If you are going to try to go to war, or to prepare for war, in a capitalist country, you have got to let business make money out of the process or business won't work" (Stimson and Bundy 1947, 166).

To accommodate the business titans, FDR enlisted their leadership in a succession of mobilization committees, boards, and agencies (Higgs 1993; Hooks 1991, 165–77; Riddell 1990; Brinkley 1995, 175–200). In June 1940 Roosevelt established a firm foundation under his coalition with big business by naming Stimson as secretary of war and publisher Frank Knox, who had been the Republican candidate for vice-president in 1936, as secretary of the navy. Beneath these men, top operational authority would be exercised by Under Secretary of War Robert P. Patterson, formerly a corporate lawyer and federal judge, and Under Secretary of the Navy James V. Forrestal, formerly a Wall Street investment banker. Under such leadership, the armed services, which quickly became the greatest buyers in industrial history, were not likely to manage their procurements in a fashion hostile to business, and they did not do so (Smith 1959; Higgs 1993). By the middle of 1942 more than 10,000 business executives had taken positions in federal war agencies. Roosevelt, who created many of the mobilization agencies by executive order, "believed that businessmen would respond more readily to direction from other businessmen than to orders from what they considered a hostile federal government" (Brinkley 1995, 190). Besides, only business managers had the practical knowledge required to run the war economy—politicians, lawyers, and economists have rather severe limitations when it comes t o organizing the production of battleships, bombers, and tanks.

Leading New Dealers correctly perceived that as FDR transformed himself from Dr. New Deal to Dr. Win the War, he was not only "ceding power to the corporate world" but "freezing out those within the government who had been struggling to expand the role of the state in managing the economy" (Brinkley 1995, 180). From 1940 on, the ranks of the most stalwart New Dealers grew thinner and thinner. As described by historian Alan Brinkley (1995), "[v]irtually none of them moved into important positions in the war bureaucracies; many of them lost their positions in the civilian agencies in which they had been serving. By the end of 1943, the liberal diaspora was nearly complete. Almost no real 'New Dealers' remained" (145). Here Brinkley exaggerates—the liberals of the extreme Left did not disappear from the government—but his description of the overall change is surely correct. To the extent that "personnel is policy," the administration became much less threatening to investors as the war years passed.

Simultaneously, support for business-threatening policies was dwindling in Congress. After the election of 1936, the Democrats held 76 seats in the Senate. After each of the next four elections, however, the number declined, and after the election of 1944 only 56 senators were Democrats. Despite some reversals, the trend was similar in the House of Representatives. The Democrats held 331 seats after the election of 1936 but only 242 after the election of 1944. The margin in the House had been even narrower after the election of 1942, when Republican victories in just six more districts would have given the GOP a majority. After 1938 the Conservative Coalition, composed of Republicans and conservative Southern Democrats, held sufficient power in Congress to stymie most efforts to extend the New Deal domestically (Porter 1985, 73). In the elections of 1946 the Republicans finally regained control of both houses of Congress.

Roosevelt's death on April 12, 1945, removed from the presidency an enormously shrewd and resourceful leader who had for the past decade expressed a hostility bordering on hatred for investors as a class. Many businesspeople, among others, had feared that FDR harbored dictatorial ambition; some believed that he ultimately did exercise arbitrary power in some if not all areas—for instance, his unconstitutional "destroyer deal" of 1940 in which, without congressional approval, he gave away fifty warships of the U.S. Navy to a foreign power. His demise must have enhanced the confidence many investors felt in the future security of their remaining private property rights.

Harry S Truman, who became president when FDR died, was a New Dealer himself, but hardly one of Roosevelt's stripe or stature. Hence he posed much less threat to investors. Truman looked askance at the type of New Dealers who had devised much of the administration's program during the heyday of the Second New Deal in the mid1930s—the intellectual wheeler-dealers variously known as "the liberal crowd," "the long-haired boys," or "the Harvard crowd," whose leading lights included Tom Corcoran, Ben Cohen, William O. Douglas, Thurman Arnold, Jerome Frank, James Landis, Leon Henderson, Mordecai Ezekiel, Alvin Hansen, and, above all, Felix Frankfurter. As president, Truman "lent intermittent support to reform, but never to the centralized and professionalized administration central to the New Deal." In 1945 and 1946 he "fired or accepted resignations from a host of New Dealers, including Henry Wallace and Harold Ickes" and "filled the spots vacated by crusading New Dealers with cronies from Missouri, centrists, and businessmen" (Hooks 1991, 200–201). Just before the war, in discussing the New Deal, Schumpeter had pointed out that "the personnel and methods by which and the spirit in which a measure or set of measures is administrated, are much more important than anything contained in any enactment" (1939, 1045). Much of the New Deal legislation remained on the statute books, but under Truman's leadership, top federal officials posed a much reduced threat to investors in comparison to that perceived from 1935 through 1940. Investors might not like the Truman administration, but they could live with it. As Roose (1954) observed, in the postwar years there were still uncertainties, "but one of these uncertainties is not the type of economy in which business decisions are to be made" (256).

Poll Data, 1944–1945

Unfortunately, the poll data relevant to the question of regime uncertainty are far fewer for the late war and postwar years than they are for the years immediately preceding the war. That disparity may itself testify to the diminished salience of the issue. Pollsters are not likely to ask questions about people's expectations concerning future changes of regime when hardly anybody expects such changes to occur. Nevertheless, a few questions that bear on the issue were posed.

One, which is somewhat ambiguous, the *Fortune* pollsters posed to a sample of business executives in May 1944, after the war-command economy had been operating in its full-fledged form for more than two years. The question was "In general, does it seem to you that after the war the prospects of your company will be better, or worse, or about the same as they were before?" In reply, 51.2 percent said better, 8.5 percent worse, 36.8 percent about the same, and 3.5 percent didn't know what to say (Cantril 1951, 1121). Obviously, the respondents might have interpreted differently the phrase "prospects of your company," and even if they all understood it as referring to, say, profitability, their responses do not necessarily bear a tight relation to their regime expectations. Still, it is difficult to believe that such responses would have been made if the respondents had still held the gloomy regime expectations they expressed in polls taken just before the U.S. declaration of war.

Two other questions, asked shortly after Roosevelt's death, bear more directly on regime expectations. In May 1945, AIPO pollsters asked: "Do you think Truman will be more favorable or less favorable toward business than Roosevelt was?" Of the business and professional respondents, 60 percent expected Truman to be more favorable, 7 percent less favorable, 18 percent the same, and 15 percent had no opinion (Cantril 1951, 887).

In the same poll, respondents were asked: "Do you think Truman will be more favorable or less favorable toward labor unions than Roosevelt was?" Of the business and professional respondents, 5 percent expected Truman to be more favorable, 55 percent less favorable, 20 percent the same, and 20 percent had no opinion (Cantril 1951, 887–88). Not surprisingly, responses to this question form the mirror image of responses to the previous question. Taken together, these responses indicate that business and professional people felt much less threatened by Truman than they had by Roosevelt.

Evidence from these polls matches the conclusions Herman Krooss (1970) reached on the basis of his less systematic survey of the opinions expressed by business leaders: "For most business leaders, the mood during the first couple of years after V-J Day was one of cautious confidence and optimism" (219), a far different mood from that of business leaders between 1935 and 1941.

Evidence from Financial Markets

If investors truly feared for the future security of their private property rights, they should have met the Great American Challenge: "Put your money where your mouth is." Did investors manifest their fears by their actions in the financial markets?

The stock market provides some evidence. After plunging from a peak in 1929 to a trough in 1932, stock prices climbed substantially during Roosevelt's first term as president. Between 1932 and 1936 the annual average real value of the S&P Index of Common Stock Prices increased by 110 percent.[7] Still, the real value of the S&P index in 1936 remained substantially below its value in either 1928 or 1930, not to speak of its peak value in 1929. With the onset of the recession in 1937, stock prices fell. Except for a slight reversal in 1939, they continued to fall for five years. The real S&P index for 1941 was only 57 percent as high as its value for 1936. These stock-price movements are broadly consistent with the concurrent political events described earlier, although the little crest in 1936 to 1937 seems somewhat incongruent. It is noteworthy that even after the economy's recovery from the recession of 1937 to 1938 had become obvious to everyone, the stock market continued to slide, which suggests that longer-term pessimism was outweighing the brighter near-term prospect for profits.

Unfortunately, a change in stock prices, in itself, tells us nothing about whether the change reflects altered expectations with respect to profits at one point in the future or another. Obviously, if the profits expected in the near term were to increase sufficiently, investors would bid up stock prices even though they had simultaneously revised downward somewhat their expectations of later profits. Evidently such expectations motivated investors from

7. The data source is the U.S. Bureau of the Census (1975, 224, Series F5, and 1004, Series X495). My price index is the GNP deflator.

1935 to 1937, when, in economist Alvin Hansen's words, "Business men avoided as much as possible long-term capital commitments" (quoted by Roose 1954, 174; see also Friedman and Schwartz 1963, 495).

The investment data confirm Hansen's assessment. We can divide gross private domestic investment into three components that correspond to differing lengths of the newly created capital's expected economic life: gross private new construction (the longest lived); gross private producers durables (intermediate); and additions to business inventories (the shortest lived). During the last five years of the 1920s, on average, these components constituted the following proportions of private investment: 0.62, 0.32, and 0.06, respectively.[8] During the business recovery in progress during the first three years of the Second New Deal (1935–37), however, the proportions were 0.38, 0.44, and 0.18, respectively, showing a marked shift away from the longest-term investments. The proportions remained much the same during the second business recovery of the Second New Deal (1939–41), when they were 0.45, 0.40, and 0.15, respectively. Clearly the real investments made during the first and second Roosevelt administrations remained far more concentrated in short-term assets than the investments made during the latter half of the 1920s.

In contrast to the stock-market data, evidence from the corporate bond market permits a more discriminating assessment of changes in expectations. By examining changes in the yield of bonds of various terms to maturity, we can identify how investors changed the discount rate they applied to contracted interest payments payable at different points in the future.

In the late 1920s and early 1930s, the first-quarter nominal yields of high-grade corporate bonds of various terms to maturity differed little and fluctuated in a narrow range. After 1932, nominal yields began to fall and, most significant for present purposes, a wide spread opened between the yields of bonds with short terms to maturity and those with longer terms to maturity. By 1935 the yield of a bond with one year to maturity was only 1.05 percent, and such yields remained below 1 percent from 1936 through 1942 (U.S. Bureau of the Census 1975, 1004). Yields of bonds with longer terms to maturity did not fall nearly so much.

Figure 3 permits a visual assessment of the effective risk premium on bond payoffs in the more remote future. As the figure shows, virtually no such premium existed from 1926 through 1934. All observations are for the first quarter of the year.[9] Between 1934 and 1936, yields of longer-term bonds increased sharply relative to the yield of a bond with one year to maturity. In 1936, bonds with five years to maturity had a yield *three times* that of a bond

8. These and the following proportions are computed from data in Swanson and Williamson (1972, 70).

9. The data source is the U.S. Bureau of the Census (1975, 1004, Series X487–491).

with one year to maturity. The yield multiple was more than four for a bond with ten years to maturity; five for a bond with twenty years to maturity; and more than five for a bond with thirty years to maturity.

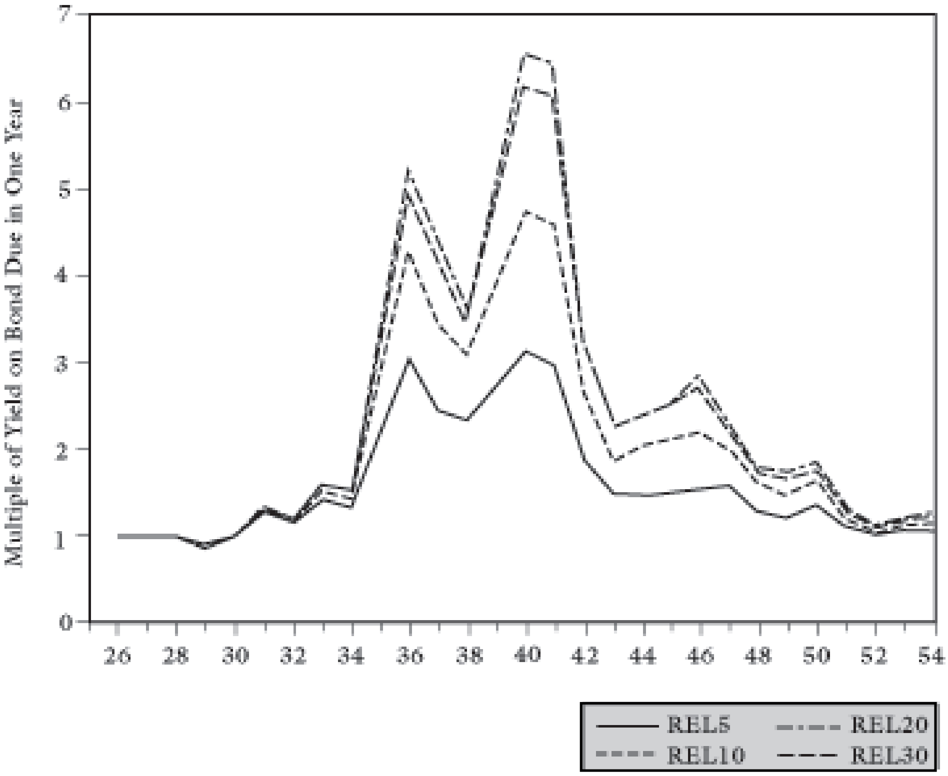

Figure 3. Relative Yield on High-Grade Corporate Bonds, by Term to Maturity, First Quarter, 1926–1954

Although the yield multiples of longer-term bonds fluctuated from year to year, they remained at extraordinarily high levels from 1936 through the first quarter of 1941. By the first quarter of 1942, however, the yield multiples had dropped precipitously. By 1943 they had returned to their 1934 levels and, despite rising slightly between 1943 and 1946, tended downward thereafter. By the early 1950s the yield multiples were about the same as they had been in the early 1930s.

The bond-yield data displayed in figure 3 tell a dramatic story. Investors' confidence in their ability to appropriate the longer-term interest payments and principal repayments promised by the country's most secure corporations plummeted between early 1934 and early 1936. Confidence remained at an extremely depressed level from 1936 through the first quarter of 1941. It then improved rapidly, despite the country's becoming a declared belligerent in the greatest war of all time. The correspondence of these financial data with the political events and opinion data described in this article is truly striking.[10]

Conclusion

It is time for economists and historians to take seriously the hypothesis that the New Deal prolonged the Great Depression by creating an extraordinarily high degree of regime uncertainty in the minds of investors.

Of course, scholars have had their reasons for not taking the idea seriously. For a long time, historians have viewed the statements of contemporary businesspeople about "lack of business confidence" as little more than routine grumbling—sure, sure, what else would one expect Republican tycoons to have said? Historians generally report such statements as if they were either attempts to sway public opinion or unreflective whining.

Since World War II, economists, with only a few exceptions, have overlooked regime uncertainty as a cause of the Great Duration for other reasons, such as the availability of standard macroeconomic models whose variables do not include the degree of regime uncertainty and, even if one wanted to incorporate it into an existing model, the absence of any conventional quantitative index of such uncertainty. Somewhat inexplicably, most economists regard evidence about expectations drawn from public opinion surveys as scientifically contemptible. Moreover, economists crave general models, equally applicable to all times and places, and so they resist explanations that emphasize the unique aspects of a specific episode such as the Great Depression.

In opposition to these professional inclinations, one can offer several goods reasons to take seriously the idea that the regime uncertainty created by the Second New Deal contributed significantly to causing the Great Duration. First, the Great Depression was not just another economic slump. In depth and duration it stands far apart from the next most severe depression in U.S. history, that of the 1890s. We are talking about history, not physics; unique events may have unique causes. Second, the hypothesis about regime uncertainty makes perfectly good economic sense. Nothing in the logic of the expla-

10. Some critics have insisted that the yield spreads shown in figure 3 reflect nothing more than a "flight to liquidity" that drove the prices of short-term bonds up (and therefore their yields down) relative to the prices of longer-term bonds. They point to the fact that the drop in short-term yields accounts for most of the spread that appeared after early 1934. I am not persuaded by this explanation, because (1) a flight to liquidity should have expressed itself much sooner, especially as the financial system was crumbling from 1930 through the first quarter of 1933; (2) a flight to liquidity cannot account for the large spread that opened between, say, the yield on bonds with five years to maturity and the yield on bonds with ten years to maturity (the former being hardly "liquid"); and (3) the drastic narrowing of the spreads between early 1941 and early 1942 seems very difficult to attribute to any sudden disappearance of the alleged flight to liquidity.

nation warrants its dismissal or disparagement. Third, given the unparalleled outpouring of business-threatening laws, regulations, and court decisions, the oft-stated hostility of President Roosevelt and his lieutenants toward investors as a class, and the character of the antibusiness zealots who composed the strategists and administrators of the New Deal from 1935 to 1941, the political climate could hardly have failed to discourage some investors from making fresh long-term commitments. Fourth, there exists a great deal of direct evidence that investors did feel extraordinarily uncertain about the future of the property-rights regime between 1935 and 1941. Historians have recorded countless statements by contemporaries to that effect; and the poll data presented earlier confirm that in the years just before the war most business executives expected substantial attenuations of private property rights ranging up to "complete economic dictatorship." Fifth, investors' behavior in the bond market attests in a striking way that their confidence in the longer-term future took a beating that corresponds exactly with the Second New Deal.

Finally, this way of understanding the Great Duration meshes nicely with a proper understanding of the Great Escape after the war. The Keynesians all expected a reversion to depression when the war ended. Most businesspeople, in sharp contrast, "did not think that there was any threat of a serious depression" after the war (Krooss 1970, 217). The businesspeople forecasted far better than the Keynesian economists: the private economy blossomed as never before or since. Official data, which understate the true increase because of mismeasurement of the price level, show an increase of real nongovernment domestic product of 29.5 percent from 1945 to 1946 (U.S. Council of Economic Advisers 1995, 406). Private investment boomed and corporate share prices soared in 1945 and 1946 (Higgs 1992, 57–58). None of the standard explanations can account for this astonishing postwar leap, but an explanation that incorporates the improvement in the outlook for the private-property regime can account for it.

From 1935 through 1940, with Roosevelt and the ardent New Dealers who surrounded him in full cry, private investors dared not risk their funds in the amounts typical of the late 1920s. In 1945 and 1946, with Roosevelt dead, the New Deal in retreat, and most of the wartime controls being removed, investors came out in force. To be sure, the federal government had become, and would remain, a much more powerful force to be reckoned with (Higgs 1987; Hughes 1991). But the government no longer seemed to possess the terrifying potential that businesspeople had perceived before the war. For investors, the nightmare was over. For the economy, once more, prosperity was possible.

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