Chapter 1

A Brief Economic History of the United States

More than two centuries ago, some Americans believed it was "manifest destiny" that the 13 states on the Eastern Seaboard would one day be part of a nation that stretched from the Atlantic to the Pacific. Was it also our manifest destiny to become the greatest economy in the history of the world?

LEARNING OBJECTIVES

After reading this chapter you should be able to:

1. Summarize America's economic development in the 19th century.
2. Describe the effect of the Great Depression on our economy and evaluate the New Deal measures to bring about recovery.
3. Discuss the impact of World War II on our economy.
4. List and discuss the major recessions we have had since World War II.
5. Summarize the economic highlights of each decade since the 1950s.
6. Differentiate the "new economy" from the "old economy."
7. Assess America's place in history.

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Introduction

"May you live in interesting times," reputedly an ancient Chinese curse, could well describe the economic misfortunes that overtook us in late 2007 and continued for the next couple of years.

- Our worst economic downturn since the Great Depression.
- The bursting of the housing bubble.
- A financial crisis requiring over $16 trillion in loans by the Federal Reserve and the U.S. Treasury.
- The mortgage crisis, threatening some 7 million American families with foreclosure.
- Over 15 million Americans officially unemployed at the bottom of the Great Recession.

Our economy is a study in contrasts. We have poverty in the midst of plenty; we have rapidly expanding industries like computer software and medical technology, and dying industries like shipbuilding, textiles, and consumer electronics; we won the cold war against communism, but we may be losing the trade war against China.

Which country has the largest economy in the world—the United States, China, or Japan? The correct answer is China, right? At least that's what many Americans would answer. Believe it or not, our national output is much greater than that of China and Japan combined.

America is the sole superpower and has one of the highest standards of living in the world. Communism—at least the version that was practiced in the Soviet Union and Eastern Europe—to borrow a phrase from Karl Marx, has been "swept into the dustbin of history."

The baby-boom generation has earned higher incomes than any other generation in history. Indeed, Americans once considered it their birthright to do better than their parents. But that ended about 35 years ago, and a lot of young people are worrying about their futures.

In the decade of the 1990s our economy generated more than 22 million new jobs. But at the end of the first decade of the new millennium, there had been virtually no net gain of jobs.

Let's sum up our economic circumstances in late 2013:

The economic downside

- We are running huge federal budget deficits.
- Our trade deficit has averaged more than $500 billion over the last 5 years.
- We are borrowing nearly $2 billion a day from foreigners to finance our trade and budget deficits.
- Unless Congress acts soon, our Social Security and Medicare trust funds will run out of money well before you reach retirement age.
- When you graduate, you may not be able to get a decent job.
- Our savings rate has averaged less than 3 percent a year since the new millennium.
- The real hourly wage (after inflation) of the average worker is about the same today as it was in 1973.

The American Economy in the 19th Century

> Those who cannot remember the past are condemned to repeat it.
>
> –George Santayana–

What did the great philosopher mean by this? Perhaps he meant that those who do not learn enough history the first time around will be required to repeat History 101. But whatever he meant, it is clear that to understand our economy today, we need to know how it developed over the years.

Agricultural Development

America has always had a large and productive agricultural sector. At the time of the American Revolution, 9 out of every 10 Americans lived on a farm; 100 years later, however, fewer than 1 out of every 2 people worked in agriculture. Today just 1 out of every 500 Americans is a full-time farmer. And yet our farms not only feed America but also produce a huge surplus that is sold abroad.

America had an almost limitless supply of land.

Unlike Europe, 200 years ago America had an almost limitless supply of unoccupied fertile land. The federal government gave away farmland—usually 160-acre plots (one-quarter of a square mile)—to anyone willing to clear the land and farm on it. Although sometimes the government charged a token amount, it often gave away the land for free.

The great abundance of land was the most influential factor in our economic development during the 19th century. Not only did the availability of very cheap or free land attract millions of immigrants to our shores, but it also encouraged early marriage and large families, since every child was an additional worker to till the fields and handle the animals. Even more important, this plenitude of land, compared to amount of labor, encouraged rapid technological development.

Two Economic Conflicts Leading to the Civil War

In the decades before the Civil War, the economic interests of the North and South came into sharp conflict. Northern manufacturers benefited from high protective tariffs, which kept out competing British manufacturers. The Southern states, which had only a small manufacturing sector, were forced to buy most of their manufactured goods from the North and to pay higher prices than they would have paid for British goods had there been no tariff.*

As the nation expanded westward, another conflict reached the boiling point: the extension of slavery into the new territories. In 1860, when Abraham Lincoln had been elected president, most of the land between the Mississippi River and the Pacific Ocean had not yet been organized into states. As newly formed territories applied for membership in the Union, the big question was whether they would come in as "free states" or "slave states." Lincoln—and virtually all the other leaders of the new Republican Party—strenuously opposed the extension of slavery into the new territories of the West.

The Southern economy, especially cotton agriculture, was based on slave labor. The political leaders of the South realized that if slavery were prohibited in the new territories, it would be only a matter of time before these territories entered the Union as free states and the South was badly outvoted in Congress. And so, as Abraham Lincoln was preparing to take office in 1861, 11 Southern states seceded from the Union, touching off the Civil War, which lasted four years, cost hundreds of thousands of lives, and largely destroyed the Southern economy.

The two major consequences of the war were the freeing of 4 million black people who had been slaves and the preservation of the Union with those 11 rebel states. It would take the nation more than a century to overcome the legacies of this conflict.

*Tariffs are fully discussed in the chapter on international trade.

When George Washington was inaugurated in 1789, there were about 4 million people living in the United States. By the time of the War of 1812, our population had doubled. It doubled again to 16 million in 1835 and still again by 1858: Our numbers continued to grow, but at a somewhat slower pace, reaching the 100 million mark in 1915 and the 200 million mark in 1968, and 300 million in 2006.

Although all regions of the United States remained primarily agricultural in the years following the Civil War, New England, the Middle Atlantic states, and the Midwest—with their already well-established iron, steel, textile, and apparel industries—were poised for a major industrial expansion that would last until the Great Depression. In contrast, the South, whose economy was based on the cash crops of cotton, tobacco, rice, and sugar, as well as on subsistence farming, remained primarily an agricultural region well into the 20th century. The South continued to be the poorest section of the country, a relative disadvantage that was not erased until the growth of the Sun Belt took off in the 1960s. (See the box titled "Two Economic Conflicts Leading to the Civil War.")

Southern economic development remained agricultural.

Southern agriculture developed very differently from agriculture in the other regions of the nation. We know, of course, that most of the labor was provided by slaves whose ancestors had been brought here in chains from Africa. On the average, Southern farms were large. By 1860, four-fifths of the farms with more than 500 acres were in the South. The plantation owners raised commercial crops such as cotton, rice, sugar, and tobacco, while the smaller farms, which were much less dependent on slave labor, produced a wider variety of crops.

In the North and the West, self-sufficient, 160-acre family farms were most common. Eventually, corn, wheat, and soybeans became important commercial crops. But in the years following the Civil War, increasing numbers of people left the farms of the North to take jobs in manufacturing.

Bad times for agriculture

Times were bad for agriculture from the end of the Civil War until the close of the century. The government's liberal land policy, combined with increased mechanization, vastly expanded farm output. The production of the nation's three basic cash crops—corn, wheat, and cotton—rose faster than did the nation's population through most of that

American Agricultural Technology

In the 19th century, a series of inventions vastly improved farm productivity. In the late 1840s, John Deere began to manufacture steel plows in Moline, Illinois. These were a tremendous improvement over the crude wooden plows that had previously been used.

Cyrus McCormick patented a mechanical reaper in 1834. By the time of the Civil War, McCormick's reaper had at least quadrupled the output of each farm laborer. The development of the Appleby twine binder, the Marsh brothers' harvesting machine, and the Pitts thresher, as well as Eli Whitney's cotton gin, all worked to make American agriculture the most productive in the world.

The mechanization of American agriculture, which continued into the 20th century with the introduction of the gasoline-powered tractor in the 1920s, would not have been possible without a highly skilled farm workforce. Tom Brokaw described the challenge that farmers faced using this technology:

> Farm boys were inventive and good with their hands. They were accustomed to finding solutions to mechanical and design problems on their own. There was no one else to ask when the tractor broke down or the threshing machine fouled, no 1-800-CALLHELP operators standing by in those days.*

*Tom Brokaw, *The Greatest Generation* (New York: Random House, 1999), p. 92. The "greatest generation" was the one that came of age during the Great Depression and won World War II.

Supply and demand

period. Why did production rise so rapidly? Mainly because of the rapid technological progress made during that period. (See the box titled "American Agricultural Technology.") This brings us to supply and demand, which is covered in Chapter 4 and explains why times were bad for agriculture despite expanded output. If the supply of corn increases faster than the demand for corn, what happens to the price of corn? It goes down. And this happened to wheat and cotton as well. Although other countries bought up much of the surpluses, the prices of corn, wheat, and cotton declined substantially from the end of the Civil War until the turn of the century.

The National Railroad Network

The completion of the transcontinental railroads

The completion of a national railroad network in the second half of the 19th century made possible mass production, mass marketing, and mass consumption. In 1850, the United States had just 10,000 miles of track, but within 40 years the total reached 164,000 miles. The transcontinental railroads had been completed, and it was possible to get virtually anywhere in the country by train. Interestingly, however, the transcontinental lines all bypassed the South, which severely retarded its economic development well into the 20th century.

In 1836, it took travelers an entire month to get from New York to Chicago. Just 15 years later, they could make the trip by rail in less than two days. What the railroads did, in effect, was to weave the country together into a huge social and economic unit, and eventually into the world's first mass market (see the box titled "Mass Production and Mass Consumption").

John Steele Gordon describes the economic impact of the railroads:

> Most East Coast rivers were navigable for only short distances inland. As a result, there really was no "American economy." Instead there was a myriad of local ones. Most food was consumed locally, and most goods were locally produced by artisans such as blacksmiths. The railroads changed all that in less than 30 years.[1]

[1]John Steele Gordon, "The Golden Spike," *Forbes ASAP,* February 21, 2000, p. 118.

Mass Production and Mass Consumption

Mass production is possible only if there is also **mass consumption**. In the late 19th century, once the national railway network enabled manufacturers to sell their products all over the country, and even beyond our shores, it became feasible to invest in heavy machinery and to turn out volume production, which, in turn, meant lower prices. Lower prices, of course, pushed up sales, which encouraged further investment and created more jobs. At the same time, productivity, or output per hour, was rising, which justified companies in paying higher wages, and a high-wage workforce could easily afford all the new low-priced products.

Henry Ford personified the symbiotic relationship between mass production and mass consumption. Selling millions of cars at a small unit of profit allowed Ford to keep prices low and wages high—the perfect formula for mass consumption.

So we had a mutually reinforcing relationship. Mass consumption enabled mass production, while mass production enabled mass consumption. As this process unfolded, our industrial output literally multiplied, and our standard of living soared. And nearly all of this process took place from within our own borders with only minimal help from foreign investors, suppliers, and consumers.

After World War II, the Japanese were in no position to use this method of reindustrialization. Not only had most of their plants and equipment been destroyed by American bombing, but also Japanese consumers did not have the purchasing power to buy enough manufactured goods to justify mass production of a wide range of consumer goods. So the Japanese industrialists took the one course open to them: As they rebuilt their industrial base, they sold low-priced goods to the low end of the American market. In many cases they sold these items—textiles, black-and-white TVs, cameras, and other consumer goods—at half the prices charged in Japan. Japanese consumers were willing to pay much higher prices for what was often relatively shoddy merchandise, simply because that was considered the socially correct thing to do. Imagine American consumers acting this way! Within a couple of decades, Japanese manufacturers, with a virtual monopoly in their home market and an expanding overseas market, were able to turn out high-volume, low-priced, high-quality products. We will look much more closely at Japanese manufacturing and trade practices in the chapter on international trade.

Before railroads, shipping a ton of goods 400 miles could easily quadruple the price. But by rail, the same ton of goods could be shipped in a fraction of the time and at one-twentieth of the cost.

Mass production creates the output of huge quantities of a good at very low cost per unit.

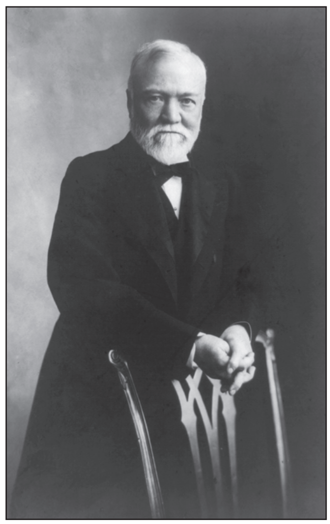
Mass consumption of a good is the purchase of large quantities of that good at very low prices.

The Age of the Industrial Capitalist

The last quarter of the 19th century was the age of the industrial capitalist. The great empire builders—Carnegie (steel), DuPont (chemicals), McCormick (farm equipment), Rockefeller (oil), and Swift (meat-packing), among others—dominated this era. John D. Rockefeller, whose exploits will be discussed in the chapter on corporate mergers and antitrust, built the Standard Oil Trust, which controlled 90 percent of the oil business. In 1872, just before Andrew Carnegie opened the Edgar Thomson works, the United States produced less than 100,000 tons of steel. Only 25 years later, Carnegie alone was turning out 4 million tons, almost half of the total American production. Again, as supply outran demand, the price of steel dropped from $65 to $20 a ton.

The industrial capitalists not only amassed great economic power, but abused that power as well. Their excesses led to the rise of labor unions and the passage of antitrust legislation.[2]

One of the most important changes in our industrial history took place late in the 19th century, with the transition from private electric generators to centralized, utility-based power production. Freed of the need to invest in expensive electric generators,



Andrew Carnegie, American industrial capitalist

[2]See the chapters on labor unions and antitrust in *Economics* and *Microeconomics*.

companies could secure as much electric power as they needed through a simple power-line hookup. Now even the smallest start-up manufacturers could compete with the great industrial capitalists.

Sometime in the 1880s our economy became the largest in the world. Over the course of the next century our lead would continue to grow.

The American Economy in the 20th Century

On the world's technological cutting edge

By the turn of the century, America had become an industrial economy. Fewer than 4 in 10 people still lived on farms. We were among the world's leaders in the production of steel, coal, steamships, textiles, apparel, chemicals, and agricultural machinery. Our trade balance with the rest of the world was positive every year. While we continued to export most of our huge agricultural surpluses to Europe, increasingly we began to send the countries of that continent our manufactured goods as well.

We were also well on our way to becoming the world's first mass-consumption society. The stage had been set by the late-19th-century industrialists. At the turn of the 20th century, we were on the threshold of the automobile age (see the box titled "The Development of the Automobile Industry"). The Wright brothers would soon be flying their plane at Kitty Hawk, but commercial aviation was still a few decades away.

American technological progress—or, if the South can forgive me, Yankee ingenuity—runs the gamut from the agricultural implements previously mentioned to the telegraph, the telephone, the radio, the TV, and the computer. It includes the mass-production system perfected by Henry Ford, which made possible the era of mass consumption and the high living standards that the people of all industrialized nations enjoy today. America has long been on the world's technological cutting edge, as well as being the world's leader in manufacturing.

The Development of the Automobile Industry

Nothing is particularly hard if you divide it into small jobs.

–Henry Ford–

Who was the first automobile manufacturer to use a division of labor and an assembly line? Was it Henry Ford? Close, but no cigar. It was Ransom E. Olds,* in 1901, when he started turning out Oldsmobiles on a mass basis. Still another American auto pioneer, Henry Leland, believed it was possible and practical to manufacture a standardized engine with interchangeable parts. By 1908, he did just that with his Cadillac.

Henry Ford was able to carry mass production to its logical conclusion. His great contribution was the emphasis he placed on an expert combination of accuracy, continuity, the moving assembly line, and speed, through the careful timing of manufacturing, materials handling, and assembly. The assembly line speeded up work by breaking down the automaking process into a series of simple, repetitive operations.

When Ford introduced a moving assembly line—the first ever used for large-scale manufacturing—this innovation reduced the time it took to build a car from more than 12 hours to just 30 minutes. It was inspired by the continuous-flow production methods used in breweries, flour mills, and industrial bakeries, as well as in the disassembly of animal carcasses in Chicago's meat-packing plants. By installing a moving conveyer belt in his factory, Ford enabled his employees to build cars one piece at a time, instead of one car at a time. The new technique allowed individual workers to stay in one place and perform the same task repeatedly on multiple vehicles that passed by them.

Back in 1908, only 200,000 cars were registered in the United States. Just 15 years later, Ford built 57 percent of the 4 million cars and trucks produced. But soon General Motors supplanted Ford as the country's number one automobile firm, a position it continues to hold. In 1929, motor vehicle production peaked at 5.3 million units, a number that was not reached again until 1949.

*In earlier editions I mistakenly attributed these feats—as well as the introduction of the moving assembly line—to Henry Olds. A student, who carefully researched these questions, found that it was Henry Ford who introduced the moving assembly line.

This technological talent, a large agricultural surplus, the world's first universal public education system, and the entrepreneurial abilities of our great industrialists combined to enable the United States to emerge as the world's leading industrial power before the turn of the 20th century. Then, too, fortune smiled on this continent by keeping it out of harm's way during the war. This same good fortune recurred during World War II; so, once again, unlike the rest of the industrial world, we emerged from the war with our industrial plant intact.

America's large and growing population has been extremely important as a market for our farmers and manufacturers. After World War II, Japanese manufacturers targeted the American market, while the much smaller Japanese market remained largely closed to American manufactured goods. Japan—with less than half our population and, until very recently, much less purchasing power than the United States—largely financed its industrial development with American dollars. (See again the box titled "Mass Production and Mass Consumption.")

Henry Ford, American automobile manufacturer

The Roaring Twenties

The postwar boom

World War I ended on November 11, 1918. Although we had a brief depression in the early 1920s, the decade was one of almost unparalleled expansion, driven largely by the automobile industry. Another important development in the 1920s was the spreading use of electricity. In 1917, just one in four homes had electricity; by 1929 nearly three out of every four homes in America had been wired and were now using electrical appliances. The telephone, radio, phonograph, toaster, refrigerator, and other conveniences became commonplace during the 1920s.

The spreading use of electricity

Between 1921 and 1929, national output rose by 50 percent and most Americans thought the prosperity would last forever. The stock market was soaring, and instant millionaires were created every day, at least on paper. It was possible, in the late 1920s, to put down just 10 percent of a stock purchase and borrow the rest on margin from a stockbroker, who, in turn, borrowed that money from a bank. If you put down $1,000, you could buy $10,000 worth of stock. If that stock doubled (that is, if it was now worth $20,000), you just made $10,000 on a $1,000 investment. Better yet, your $10,000 stake entitled you to borrow $90,000 from your broker, so you could now own $100,000 worth of stock.

How to become a millionaire in the stock market

This was not a bad deal—as long as the market kept going up. But, as they say: What goes up must come down. And, as you well know, the stock market came crashing down in October 1929. Although it wasn't immediately apparent, the economy had already begun its descent into a recession a couple of months before the crash. And, that recession was the beginning of the **Great Depression**.

[T]he chief business of the American people is business.
—President Calvin Coolidge

The **Great Depression**, which lasted for the entire decade of the 1930s, was a period of extremely high unemployment, falling prices, and a very low level of economic activity.

Curiously, within days after the crash, several leading government and business officials—including President Hoover and John D. Rockefeller—each described economic conditions as "fundamentally sound." The next time you hear our economy described in those terms, you'll know we're in big trouble.

The 1930s: The Great Depression

> Once upon a time my opponents honored me as possessing the fabulous intellectual and economic power by which I created a worldwide depression all by myself.
>
> –President Herbert Hoover–

The August 1929 recession

By the summer of 1929, the country had clearly built itself up for an economic letdown. Between 1919 and 1929, the number of cars on the road more than tripled, from fewer than 8 million to nearly 27 million—almost one automobile for every household in the nation. The automobile market was saturated. Nearly three out of four cars on the road were less than six years old, and model changes were not nearly as important then as they are today. The tire industry had been overbuilt, and textiles were suffering from overcapacity. Residential construction was already in decline, and the general business investment outlook was not that rosy.

Had the stock market not crashed and had the rest of the world not gone into a depression, we might have gotten away with a moderate business downturn. Also, had the federal government acted more expeditiously, it is quite possible that the prosperity of the 1920s, after a fairly short recession, could have continued well into the 1930s. But that's not what happened. What did happen completely changed the lives of the people who lived through it, as well as the course of human history itself.

The Dust Bowl and the "Okies"

Prices began to decline, investment in plant and equipment collapsed, and a drought wiped out millions of farmers. In fact, conditions grew so bad in what became known as the Dust Bowl that millions of people from the Midwest just packed their cars and drove in caravans to seek a better life in California. Their flight was immortalized in John Steinbeck's great novel *The Grapes of Wrath,* which was later made into a movie. Although most of these migrants came from other states, they were collectively called Okies, because it seemed at the time as if the entire state of Oklahoma had picked up and moved west.

The bank failures

There had been widespread bank failures in the late 1920s and by the end of 1930, thousands of banks had failed and the generally optimistic economic outlook had given way to one of extreme pessimism. From here on, it was all downhill. By the beginning of 1933, banks were closing all over the country; by the first week in March, every single bank in the United States had shut its doors.

Hitting bottom

Herbert Hoover, 31st president of the United States

When the economy hit bottom in March 1933, national output was about one-third lower than it had been in August 1929. The official unemployment rate was 25 percent, but official figures tell only part of the story. Millions of additional workers had simply given up looking for work during the depths of the Great Depression, as there was no work to be had. Yet according to the way the government compiles the unemployment rate, these people were not even counted since they were not actually looking for work.[3]

The Depression was a time of soup kitchens, people selling apples on the street, large-scale homelessness, so-called hobo jungles where poor men and women huddled around garbage-pail fires to keep warm, and even fairly widespread starvation. "Are you working?" and "Brother, can you spare a dime?"[4] were common greetings. People who lived in collections of shacks made of cardboard, wood, and corrugated sheet metal scornfully referred to them as Hoovervilles. Although President Herbert Hoover did eventually make a few halfhearted attempts to get the economy moving again, his greatest contribution to the economy was apparently his slogans. When he ran for the presidency in 1928, he promised "two cars in every garage" and "a chicken in every pot." As the Depression grew worse, he kept telling Americans that "prosperity is just around the corner." It's too bad he didn't have Frank Perdue in those days to place a chicken in every pot.

Herbert Hoover and the Depression

While most Americans to this day blame President Hoover for not preventing the Depression, and then, doing too little to end it, perhaps the single biggest cause of the Depression was that the Federal Reserve let the money supply fall by one-third, causing deflation. And to make things still worse, it did nothing to prevent an epidemic of bank failures, causing a credit crisis.

Why did the downturn reverse itself?

I see one-third of a nation ill-housed, ill-clad, ill-nourished.

—Franklin D. Roosevelt
Second Inaugural Address, January 1937

Why did the downturn of August 1929 to March 1933 finally reverse itself? Well, for one thing, we were just about due. Business inventories had been reduced to rock-bottom levels, prices had finally stopped falling, and there was a need to replace some plants and equipment. The federal budget deficits of 1931 and 1932, even if unwillingly incurred, did provide a mild stimulus to the economy.[5]

Clearly a lot of the credit must go to the new administration of Franklin D. Roosevelt, which reopened the banks, ran large budget deficits, and eventually created government job

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[3]How the Department of Labor computes the unemployment rate is discussed in the chapter on economic fluctuations in *Economics* and *Macroeconomics*. In Chapter 2, we'll be looking at the concept of full employment, but you can grasp intuitively that when our economy enters even a minor downturn, we are operating at less than full employment.

[4]"Brother, Can You Spare a Dime?" was a Depression era song written by Yip Harburg and Jay Gorney.

[5]In Chapter 12 of *Economics* and *Macroeconomics* we'll explain how budget deficits stimulate the economy.

The New Deal

When Franklin D. Roosevelt ran for president in 1932, he promised "a new deal for the American people." Action was needed, and it was needed fast. In the first 100 days Roosevelt was in office, his administration sent a flurry of bills to Congress that were promptly passed.

The **New Deal** is best summarized by the three Rs: relief, recovery, and reform. Relief was aimed at alleviating the suffering of a nation that was, in President Roosevelt's words, one-third "ill-fed, ill-clothed, and ill-housed." These people needed work relief, a system similar to today's workfare (work for your welfare check) programs. About 6 million people, on average, were put to work at various jobs ranging from raking leaves and repairing public buildings to maintaining national parks and building hydroelectric dams. Robert R. Russell made this observation:

> The principal objects of work-relief were to help people preserve their self-respect by enabling them to stay off the dole and to maintain their work habits against the day when they could again find employment in private enterprises. It was also hoped that the programs, by putting some purchasing power into the hands of workers and suppliers of materials, would help prime the economic pump.*

The economic recovery could not begin to take off until people again began spending money. As these 6 million Americans went back to work, they spent their paychecks on food, clothing, and shelter, and managed to pay off at least some of their debts. The most lasting effect of the New Deal was reform. The Securities and Exchange Commission (SEC) was set up to regulate the stock market and avoid a repetition of the speculative excesses of the late 1920s, which had led to the great crash of 1929. After the reform, bank deposits were insured by the Federal Deposit Insurance Corporation (FDIC) to prevent future runs on the banks by depositors, like those experienced in the early 1930s. Also, an unemployment insurance benefit program was set up to provide temporarily unemployed people with some money to tide them over. The most important reform of all was the creation of Social Security. Although even today retired people need more than their Social Security benefits to get by, there is no question that this program has provided tens of millions of retired people with a substantial income and has largely removed workers' fears of being destitute and dependent in their aging years.

The New Deal was a much greater success in the long run than in the short run. While New Deal spending programs did not end the Depression, the reforms it put in place laid the foundation for unprecedented economic growth and broadly shared prosperity in the years after World War II.

*Robert R. Russell, *A History of the American Economic System* (New York: Appleton-Century-Crofts, 1964), p. 547.

programs that put millions of Americans back to work (see the box titled "The New Deal"). Recognizing a crisis in confidence, Roosevelt said, "The only thing we have to fear is fear itself." Putting millions of people back to work was a tremendous confidence builder. A 50-month expansion began in March 1933 and lasted until May 1937. Although output did finally reach the levels of August 1929, more than 7 million people were still unemployed.

The **New Deal** was a massive federal program that provided jobs to the unemployed, raised spending, and created important financial and economic institutions.

By far, the most important reason for the success of the New Deal's first four years was the massive federal government spending that returned millions of Americans to work. This huge infusion of dollars into our economy was just what the doctor ordered. In this case, the doctor was John Maynard Keynes, the great English economist, who maintained that it didn't matter *what* the money was spent on—even paying people to dig holes in the ground and then to fill them up again—as long as enough money was spent. But in May 1937, just when it had begun to look as though the Depression was finally over, we plunged right back into it again.

The recession of 1937–38

What went wrong? Two things: First, the Federal Reserve Board of Governors, inexplicably more concerned about inflation than about the lingering economic depression, greatly tightened credit, making it much harder to borrow money. Second, the Roosevelt administration suddenly got that old balance-the-budget-at-all-costs religion. Government spending was sharply reduced—the budget of the Works Progress Administration was cut in half—and taxes were raised. The cost of that economic orthodoxy—which would have made sense during an economic boom—was the very sharp and deep **recession** of 1937–38.

A **recession** is a decline in real GDP for two consecutive quarters.

Franklin D. Roosevelt, 32nd president of the United States

Tight money and a balanced budget are now considered the right policies to follow when the economy is heating up and prices are rising too quickly, but they are prescriptions for disaster when the unemployment rate is 12 percent.[6]

The ensuing downturn pushed up the official unemployment count by another 5 million, industrial production fell by 30 percent, and people began to wonder when this depression would ever end. But there really *was* some light at the end of the tunnel.

In April 1938, both the Roosevelt administration and the Federal Reserve Board reversed course and began to stimulate the economy. By June, the economy had turned around again, and this time the expansion would continue for seven years. The outbreak of war in Europe, the American mobilization in 1940 and 1941, and our eventual entry into the war on December 7, 1941, all propelled us toward full recovery.

When we ask what finally brought the United States out of the Great Depression, there is one clear answer: the massive federal government spending that was needed to prepare for and to fight World War II.

For most Americans the end of the Depression did not bring much relief, because the nation was now fighting an all-out war. For those who didn't get the message in those days, there was the popular reminder, "Hey, bub, don't yuh know there's a *war* goin' on?"

The country that emerged from the war was very different from the one that had entered it less than four years earlier. Prosperity had replaced depression. Now inflation had become the number one economic worry.

The 1940s: World War II and Peacetime Prosperity

Just as the Great Depression dominated the 1930s, World War II was the main event of the 1940s, especially from the day the Japanese bombed Pearl Harbor until they surrendered in August 1945. For the first time in our history, we fought a war that required a total national effort. Although the Civil War had caused tremendous casualties and had set the South back economically for generations, we had never before fought a war that consumed over one-third of our nation's total output.

At the peak of the war, more than 12 million men and women were mobilized and, not coincidentally, the unemployment rate was below 2 percent. Women, whose place was supposedly in the home, flocked to the workplace to replace the men who had gone off to war. Blacks, too, who had experienced great difficulty finding factory jobs, were hired to work in the steel mills and the defense plants in the East, the Midwest, and the West.

America's industrial might

No more than 2 or 3 percent of the defense plant workers had any experience in this area, but thanks to mass production techniques developed largely by General Motors and Ford, these workers would turn out nearly 300,000 airplanes, over 100,000 tanks, and 88,000 warships. America clearly earned its title "Arsenal of Democracy."

Between 1939 and 1944, national output of goods and services nearly doubled, while federal government spending—mainly for defense—rose by more than 400 percent. By the middle of 1942, our economy reached full employment for the first time since 1929. To hold inflation in check, the government not only instituted price and wage controls but also issued ration coupons for meat, butter, gasoline, and other staples.

During the war, 17 million new jobs were created, while the economy grew 10 or 11 percent a year. Doris Kearns Goodwin attributed "a remarkable entrepreneurial spirit" not only to the opportunity to make huge wartime profits but to a competitiveness "developed within each business enterprise to produce better than its competitors to serve the country." A sign hanging in many defense plants read: "PLEDGE TO VICTORY: The war may be won or lost in this plant."[7]

It was American industrial might that proved the decisive factor in winning World War II. Essentially our production of ships, tanks, planes, artillery pieces, and other war matériel overwhelmed the production of the Germans and the Japanese.

[6]These policies will be discussed in Chapters 12 and 14 of *Economics* and *Macroeconomics*.

[7]Doris Kearns Goodwin, "The Way We Won: America's Economic Breakthrough during World War II," *The American Prospect,* Fall 1992, p. 68.

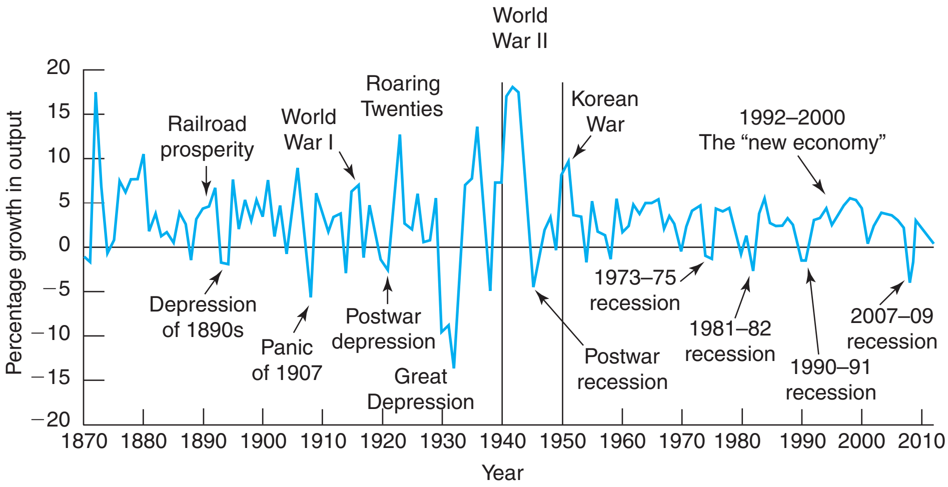

***Figure* 1**

Annual Percentage Growth of U.S. Output of Goods and Services, 1870–2009

Although there were plenty of ups and downs, in most years, output grew at a rate of between 2 and 5 percent. What stands out are the booms during World War I, the Roaring Twenties, the abortive recovery from the Great Depression (in the mid-1930s), World War II, and the relative prosperity since the beginning of World War II. The two sharpest declines in output occurred during the Great Depression and after World War II. The drop after World War II was entirely due to a huge cut in defense spending, but our economy quickly reconverted to producing civilian goods and services, so the 1945 recession was actually very mild.
Sources: U.S. Department of Commerce, and AmeriTrust Company, Cleveland.

Globally, we were certainly at the top of our game. With just 7 percent of the world's population, we accounted for half the world's manufacturing output, as well as 80 percent of its cars and 62 percent of its oil. Our potential rivals, Japan, Germany, France, and the United Kingdom, would need at least 15 years to repair their war-damaged industrial plant and begin competing again in world markets.

The United States and the Soviet Union were the only superpowers left standing in 1945. When the cold war quickly developed, we spent tens of billions of dollars to prop up the sagging economies of the nations of Western Europe and Japan, and we spent hundreds of billions more to provide for their defense. In the four decades since the close of World War II we expended 6 percent of our national output on defense, while the Soviet Union probably expended at least triple that percentage. This great burden certainly contributed to the collapse of the Soviet Union in 1990–91, and our own heavy defense spending continues to divert substantial resources that might otherwise be used to spur our economic growth.

Figure 1 provides a snapshot of U.S. economic growth since 1870. You'll notice that our economy has been pretty stable since the end of World War II. (See also box on next page, "Post-World War II Recessions.") The latter half of the 1940s was largely a time of catching up for the American economy. For years we had gone without, first during the Great Depression, and then, because so much of our resources had been diverted to the war effort. Wartime government posters urged us to:

Use it up,
Wear it out,
Make it do,
Or do without.

Once the war was over, there was a huge increase in the production of not just housing and cars, but refrigerators, small appliances, and every other consumer good that had been allowed to wear down or wear out.

Within a year after the war ended, some 12 million men and several hundred thousand women returned home to their civilian lives. Very little housing had been built

A D V A N C E D WORK

Post–World War II Recessions

Since the closing months of World War II, the United States has had 12 recessions of varying length and severity. The longest and most severe was from December 2007 to June 2009.

February 1945–October 1945

November 1948–October 1949

July 1953–May 1954

August 1957–April 1958

April 1960–February 1961

December 1969–November 1970

November 1973–March 1975 This one was set off by a fourfold increase in the price of oil engineered by the OPEC nations (which we'll talk a lot more about in Chapter 10 in *Economics* and *Macroeconomics*). Simultaneously, there was a worldwide shortage of foodstuffs, which drove up food prices. To make matters worse in this country, we struck a deal to export about one-quarter of our wheat and other grains to the Soviet Union. Output fell about 5 percent, and, to make matters still worse, the rate of inflation remained unacceptably high.

January 1980–July 1980 A doubling of oil prices by OPEC and a credit crunch set off by the Federal Reserve Board of Governors, which had been alarmed by an inflation rate that had reached double-digit levels, pushed us into a very brief, but fairly sharp, recession. When interest rates rose above 20 percent, the Federal Reserve allowed credit to expand and the recession ended.

July 1981–November 1982 This downturn was also set off by the Federal Reserve, which was now determined to wring inflation out of our economy. By the end of the recession—which now held the dubious distinction of being the worst downturn since the Great Depression—the unemployment rate had reached almost 11 percent. But the inflation rate had been brought down, and in late summer 1982, the Federal Reserve once again eased credit, setting the stage for the subsequent recovery. At the same time, the federal government had been cutting income tax rates, further helping along the business upturn.

July 1990–March 1991 After the longest uninterrupted peacetime expansion in our history, a fairly mild downturn was caused by a combination of sharply rising oil prices (due to Iraq's invasion of Kuwait in August 1990 and the ensuing Persian Gulf War), tight money, and a deficit-cutting budget agreement between President George Bush and Congress in October. President Bush himself termed the recovery "anemic," and its slow pace was largely responsible for his loss of the 1992 election to Bill Clinton.

March 2001–November 2001 By mid-2000, it had become apparent that many high-tech stocks in telecommunication, Internet, and computer software companies were overvalued, and consequently, investment in these industries began to sink very rapidly. Excess capacity needed to be worked off before investment would revive. What was very unusual for a recession was that consumer spending, buoyed by low interest rates, mortgage refinancing, and massive federal tax cuts, actually continued to rise throughout the recession. Then, just when recovery seemed likely, the terrorist attacks of 9/11 provided an additional economic shock, depressing the demand for air travel and hotel rooms. To counter the effects of the recession as well as to aid in the recovery from the attacks, the Bush administration pushed through Congress not only a major tax cut and tax refunds, but increased government spending. The recession was one of the mildest on record, and output began to rise in the fourth quarter of 2001.

December 2007–June 2009 The worst economic downturn since the 1930s, the effects of the Great Recession—especially high unemployment and slow economic growth—continued well into 2013. To avert a financial meltdown and to stimulate the economy, the Federal Reserve and the Treasury poured trillions of dollars into the economy.

Tens of millions of Americans had been using their homes like ATMs, taking out hundreds of billions of dollars every year in home equity loans to finance spending on new cars, vacation trips, shopping sprees, paying their children's college expenses, or just filling up their gas tanks. When the housing bubble burst in early 2007, it became increasingly difficult for them to keep borrowing. And the less they could borrow, the less they could spend.

The decline in housing prices had an even more direct economic effect. Hundreds of thousands of construction workers, real estate agents, mortgage brokers, financial service workers, and others with jobs in these economic sectors were thrown out of work.

During 2008 and 2009 employment fell by 8.4 million. In fact, even though our economy began growing in the second half of 2009, employment continued falling through the end of the year.

during the war and the preceding depressed period, so most veterans lived in overcrowded houses and apartments, often with three generations under one roof. The first thing veterans wanted was new housing.

The federal government obligingly facilitated this need for new housing by providing Veterans Administration (VA) mortgages at about 1 percent interest and often nothing down to returning veterans. The Federal Housing Administration (FHA) supplemented the VA program with FHA mortgages to millions of other Americans. Where were these houses built? In the suburbs. By 1945, little land was available in the cities, so **suburbanization** was inevitable.

The **suburbanization** of America began to occur after World War II, when tens of millions of families moved to suburban towns, and villages around our nation's large central cities.

And how would nearly all these new suburbanites get to work? By car. So more highways were needed. Once again, the federal government stepped in. Before long a federally subsidized interstate highway network was being built, along with thousands of state and local highways, parkways, and freeways, as well as local streets and roads.

Hence the late 1940s and the 1950s were one big construction boom. Highway building and home construction provided millions of jobs. The automobile industry, too, was prospering after a total shutdown during the war. In the postwar era, we not only supplied virtually all the new suburbanites with cars, but we also became the world's leading auto exporter.

The returning veterans had a lot of catching up to do. Couples had been forced to put off having children, but after the war the birthrate shot up and stayed high until the mid-1960s. This baby boom and low gasoline prices added impetus to the nation's suburbanization. Why continue to live in cramped urban quarters when a house in the suburbs was easily affordable, as it was to most middle-class and working-class Americans (see the box titled "Levittown, U.S.A")?

The GI Bill of Rights

In 1944 Congress passed the GI Bill of Rights, which not only offered veterans mortgage loans, as well as loans to start businesses, but also provided monthly stipends for those who wanted help with educational costs. By 1956, when the programs ended, 7.8 million veterans, about half of all who had served, had participated. A total of 2.2 million went to college, 3.5 million to technical schools below the college level, and

Levittown, U.S.A.

No man who owns his own house and lot can be a communist.

–William Levitt–

Levittown, Long Island, a tract development of 17,000 nearly identical homes, was built right after World War II, largely for returning veterans and their families. These 800-square-foot, prefabricated homes sold for $8,000 with no down payment for veterans. William Levitt described the production process as the reverse of the Detroit assembly line:

> There, the car moved while the workers stayed at their stations. In the case of our houses, it was the workers who moved, doing the same jobs at different locations. To the best of my knowledge, no one had ever done that before.*

Levittown became the prototype of suburban tract development, and the Levitts themselves built similar developments in New Jersey, Pennsylvania, and Maryland. In 1963, civil rights demonstrations targeted William Levitt's housing development in Bowie, Maryland.

Levitt admitted he had refused to sell houses to black families because, he said, integrating his developments would put him at a competitive disadvantage. Levitt's discriminatory sales policy was no different from most other developers, who did not relent until well into the 1960s, when government pressure forced them to do so.

Of course, racism was hardly confined to developers like Levitt. James T. Patterson, a historian, wrote that the Federal Housing Administration "openly screened out applicants according to its assessment of people who were 'risks.'"† These were mainly blacks, Hispanics, Asians, Jews, and other "unharmonious racial or nationality groups." In so doing, FHA enshrined residential segregation as a public policy of the U.S. government.

In New York and northern New Jersey, fewer than 100 of the 67,000 mortgages insured by the GI Bill supported home purchases by nonwhites.

*Eric Pace, "William J. Levitt, 86, Pioneer of Suburbs, Dies," *The New York Times,* January 29, 1994, p. A1.

†James T. Patterson, *Grand Expectations* (New York: Oxford University Press, 1997), p. 27.

The Consequences of Suburbanization

Suburbanization was the migration of tens of millions of middle- and working-class Americans—nearly all of them white—from our nation's large central cities to newly developed suburban towns and villages. Instead of getting to work by public transportation, these commuters now went by car. Truck transport replaced railroads as the primary way to haul freight. Millions of poor people—the large majority of whom were black or Hispanic—moved into the apartments vacated by the whites who had fled to the suburbs.

Suburbanization left our cities high and dry. As middle-class taxpayers and millions of factory jobs left the cities, their tax bases shrank. There were fewer and fewer entry-level jobs for the millions of new arrivals, largely from the rural South. Throughout the 1950s, 1960s, and 1970s, a huge concentration of poor people was left in the cities as the middle-class workers—both black and white—continued to flee to the suburbs. By the mid-1970s, the inner cities were rife with poverty, drugs, and crime, and had become socially isolated from the rest of the country.

Still other consequences of suburbanization were our dependence on oil as our main source of energy and eventually, our dependence on foreign sources for more than half our oil. Indeed, America's love affair with the automobile has not only depleted our resources, polluted our air, destroyed our landscape, and clogged our highways, but also has been a major factor in our imbalance of trade.*

*The damage we are doing to our nation's environment and to that of our planet is alarming, but discussing it goes beyond the scope of this book. In the chapter on international trade, we have a lengthy discussion of our trade imbalance and how our growing oil imports have contributed to it.

700,000 to agricultural schools. The GI Bill made college affordable to men and women from working-class and lower-middle-class backgrounds and was almost entirely responsible for enrollments more than doubling between 1940 and 1949.

The 1950s: The Eisenhower Years

The economy was further stimulated by the advent of television in the early 1950s, as well as by the Korean War. It didn't really matter what individual consumers or the government spent their money on, as long as they spent it on something.

Eisenhower would end the war and end the inflation.

General Dwight D. Eisenhower, one of the great heroes of World War II, made two key promises in his 1952 campaign for the presidency: He would end the war in Korea, and he would end the inflation we had had since the close of World War II. Eisenhower made good on both promises. Although three recessions occurred during his eight years in office, economic growth, although not as fast as it had been in the 1940s, was certainly satisfactory (see the box titled "The Consequences of Suburbanization").

What may be most significant about the Eisenhower years is what *didn't* happen rather than what did. Eisenhower made no attempt to undo the legacies of the New Deal such as Social Security, unemployment insurance, or the regulatory reforms that had been instituted. The role of the federal government as a major economic player had become a permanent one. By the end of the decade America was well on its way to becoming a suburban nation. In a sense we had attained President Herbert Hoover's 1928 campaign promise of a car in every garage and a chicken in every pot. But we did him one better. In 1950 just 10 percent of all homes had a TV; by 1960 87 percent of all American homes had at least one set.

The Soaring Sixties: The Years of Kennedy and Johnson

When John F. Kennedy ran for president in 1960, the country was mired in the third Eisenhower recession. Kennedy pledged to "get the country moving again." The economy *did* quickly rebound from the recession and the country embarked on an uninterrupted eight-year expansion. An assassin shot Kennedy before he could complete his first term; he was succeeded by Lyndon Johnson, who in his first speech as president stated simply, "Let us continue." A major tax cut, which Kennedy had been planning, was enacted in

1964 to stimulate the economy. That and our growing involvement in the Vietnam War helped bring the unemployment rate down below 4 percent by 1966. But three major spending programs, all initiated by Johnson in 1965, have had the most profound long-term effect on the economy: Medicare, Medicaid, and food stamps.

Our rapid economic growth from the mid-1940s through the late 1960s was caused largely by suburbanization. But the great changes during this period came at a substantial price (see the box titled "The Consequences of Suburbanization"). Whatever the costs and benefits, we can agree that in just two and a half decades, this process made America a very different place from what it was at the close of World War II.

The Sagging Seventies: The Stagflation Decade

Stagnation + Inflation = Stagflation

The 1970s brought Americans crashing back to economic reality. In 1973, we were hit by the worst recession since the 1930s. This came on the heels of an oil price shock: The Organization of the Petroleum Exporting Countries (OPEC) had quadrupled oil prices in the fall of 1973, and by then, too, we were mired in double-digit inflation—an annual rate of increase in prices of at least 10 percent. About the only good thing during this period was that we were able to add a new word to our vocabularies—**stagflation**. The first part of this word is derived from *stagnation*. Our economic growth, which had been fairly rapid for 25 years after World War II, had slowed to a crawl. Usually when this happened, prices would stop rising or at least would slow their rate of increase. But now the opposite had happened: We had a bad case of inflation, which gave us the second part of the word *stagflation*.

Stagflation is a period of either recession or stagnation accompanied by inflation.

Jimmy Carter's economic problems

The president who seemed to have the worst economic luck of all was Jimmy Carter. He presided over mounting budget deficits that, coupled with a rapid growth of the money supply, pushed up the inflation rate to nearly double-digit levels. And then suddenly, in 1979, the Iranian revolution set off our second oil shock. Gasoline prices went through the ceiling, rising from about 70 cents a gallon to $1.25.

Alarmed at the inflation rate, which had nearly doubled in just three years, the Federal Reserve literally stopped the growth of the money supply in October 1979. By the following January we were in another recession, while the annual rate of inflation reached 18 percent. Talk about stagflation!

The 1980s: The Age of Reagan

Ronald Reagan, who overwhelmingly defeated incumbent Jimmy Carter in the 1980 presidential election, offered the answers to our most pressing economic problems. For too long, he declared, we had allowed the federal government to "tax, tax, tax, spend, spend, spend." Big government was not the answer to our problems. Only private enterprise could provide meaningful jobs and spur economic growth. If we cut tax rates, said Reagan, people would have more incentive to work, output would rise, and inflation would subside. After all, if inflation meant that too many dollars were chasing too few goods, why not produce more goods?

Supply-side economics

This brand of economics, supply-side economics, was really the flip side of Keynesian economics. Both had the same objective: to stimulate output, or supply. The Keynesians thought the way to do this was to have the government spend more money, which, in turn, would give business firms the incentive to produce more. The supply-siders said that if tax rates were cut, people would have more of an incentive to work and would increase output.

Personal income taxes were cut by a whopping 23 percent in 1981 (stretched over a three-year period), and business taxes were also slashed. This was the heart of the supply-side program. As it happened, most of the tax cuts went to the wealthy.

In January 1981, it was Ronald Reagan's ball game to win or lose. At first he seemed to be losing. He presided over still another recession, which, by the time it ended, was the new postwar record holder, at least in terms of length and depth. The second-worst recession since World War II had been that of 1973–75. But the 1981–82 recession was a little longer and somewhat worse.

The recession of 1981–82

By the end of 1982, the unemployment rate reached nearly 11 percent, a rate the country had not seen since the end of the Depression. But on the upside, inflation was finally brought under control. In fact, both the inflation and unemployment rates fell during the next four years, and stagflation became just a bad memory.

Still, some very troubling economic problems surfaced during the period. The unemployment rate, which had come down substantially since the end of the 1981–82 recession, seemed stuck at around 6 percent, a rate that most economists consider to be unacceptably high. A second cause for concern were the megadeficits being run by the federal government year after year. Finally, there were the foreign trade deficits, which were getting progressively larger throughout most of the 1980s.

"Read my lips."

In 1988, George H. W. Bush, who had served as Reagan's vice president for eight years and claimed to be a convert to supply-side economics, made this famous presidential campaign promise: "Read my lips: No new taxes." Of course, the rest is history. Bush won the election, and a couple of years later, in an effort to reduce the federal budget deficit, he agreed to a major tax increase. Not only did his words come back to haunt him when he ran for reelection in 1992, but the deficit continued to rise. And to completely ruin his party, we suffered a lingering recession that began in the summer of 1990 and from which we did not completely recover until the end of 1992, with the unemployment rate still hovering above 7 percent.

The State of American Agriculture

Fewer farmers feeding more people

The story of American agriculture is the story of vastly expanding productivity. The output of farm labor doubled between 1850 and 1900, doubled again between 1900 and 1947, and doubled a third time between 1947 and 1960. In 1800 it took 370 hours to produce 100 bushels of wheat. By 1960 it took just 15 hours. In 1820 one farmer could feed 4.5 people. Today that farmer could feed over 100 people.

One of the most dramatic agricultural advances was the mechanical cotton picker, which was introduced in 1944. In an hour, a laborer could pick 20 pounds of cotton. The mechanical picker could pick 1,000 pounds of cotton in the same length of time. Within just four years, millions of the Southern rural poor—both black and white—were forced off the farms and into the cities of the South, the North, and the Midwest.

While agriculture is one of the most productive sectors of our economy, only about 4.5 million people live on farms today, and less than half of them farm full time. Of 2.2 million working farms, just half produce more than $5,000 worth of agricultural products. Despite hundreds of billions of dollars in price-support payments to farmers for crops in the years since World War II, the family farm is rapidly vanishing. This is certainly ironic, since the primary purpose of these payments has been to save the family farm. During the more than seven decades that this program has been in operation, 7 out of every 10 family farms have disappeared, while three-quarters of the payments go to large corporate farms. One by one, the dairy farmers, the poultry farmers, the grain growers, and the feedlot operators are being squeezed out by the huge agricultural combines.

While we have lingering images of family farms, large farms—those with more than $250,000 in sales—now account for more than three-quarters of all agricultural sales. In the mid-1980s, their share was less than half. To keep costs down, especially when growing corn, wheat, and soybeans, a farmer needs a lot of expensive equipment and, consequently, must plant on a huge acreage.[8] In other words, you've got to become big just to survive.

Senator Dick Lugar, who owns a farm in Indiana that grows corn and soybeans, has long been a critic of huge agricultural subsidies. In a *New York Times* op-ed piece,[9] he

[8]The average farm has gone from 139 acres in 1910 to 435 acres today.

[9]Dick Lugar, "The Farm Bill Charade," *The New York Times,* January 21, 2002, p. A15. Lugar, who served six terms, lost the Republican primary in 2012.

blamed the federal government for creating and perpetuating the huge and growing mess in agriculture:

> Ineffective agricultural policy has, over the years, led to a ritual of overproduction in many crops and most certainly in the heavily supported crops of corn, wheat, cotton, rice, and soybeans and the protected speciality products like milk, sugar, and peanuts. The government has provided essentially a guaranteed income to producers of these crops. So those farmers keep producing more crops than the market wants, which keeps the price low—so low that these farmers continually ask the government for more subsidies, which they get.

The farm bill of 2002

Over the period 1995–2012 the producers of corn, soybeans, wheat, rice, and cotton received $203 billion—$15 billion in subsidies in 2012 alone. The law's defenders point out that the European Union gives its farmers $60 billion in annual subsidies, and that to compete in world markets, we need to keep our prices down. So what we and the Europeans are doing is subsidizing the overproduction of agricultural commodities so that we can compete against each other.

American farms are so productive that we often export more than one-third of our corn, wheat, and other crops. And yet millions of Americans go to bed hungry every night. Back in the depths of the Great Depression, hungry Americans resorted to soup kitchens for their only meals. Today some 37 million Americans make use of food pantries, soup kitchens, and other emergency food distribution programs.

on the web

The Environmental Working Group lists the subsidies paid to grain farmers by name and by zip code on its website. If you're interested in how much individual farmers are collecting, go to www.ewg.org, and select "Farming." From there, click on "EWG's Farm Subsidy Database."

The "New Economy" of the Nineties

What exactly *was* the "**new economy**"? And was it really all that new? It was a period marked by major technological change, low inflation, low unemployment, and rapidly growing productivity. Certainly that is a fair description of the 1990s, but one may ask if other decades—the 1920s and the 1960s—might be similarly described. Perhaps judging the appropriateness of the term *new economy* might best be left to the economic historians of the future. But new or not new, the 1990s will surely go down in history as one of the most prosperous decades since the founding of the republic.

The **new economy**, a period which began in the late 1970s and ended at the beginning of the 21st century, was a time of deregulation, lower income tax rates, shrinking federal budget deficits, low inflation, and prosperity.

The new economy could trace its beginnings back to the late 1970s when the federal government began an era of deregulation, giving the market forces of supply and demand much freer reign. In the 1980s federal income tax rates were slashed, allowing Americans to keep much more of their earnings, thereby providing greater work incentives.

We've never been better off, but can America keep the party going?

—Jonathan Alter, *Newsweek,* February 7, 2000

As the decade of the 1990s wore on, the economic picture grew steadily brighter. The federal deficit was reduced each year from 1993 through the end of the decade, by which time we were actually running budget surpluses. Inflation was completely under control, and an economic expansion that began in the spring of 1991 reached boom proportions toward the end of the decade. Optimism spread as the stock market soared, and by February 2000, the length of our economic expansion reached 107 consecutive months—an all-time record. This record would be extended to 120 months—exactly 10 years—before the expansion finally ended in March 2001.

The 1990s was the decade of computerization. In 1990 only a handful of households were on the Internet; by the end of 2000, about 40 percent were connected. Much more significant was the spread of computerization in the business world. Indeed, by the millennium there was a terminal on almost every desk. Planes, cars, factories, and stores were completely computerized. All this clearly has made the American labor force a lot more efficient. Economists, as well as ordinary civilians, believe that our rapid economic growth has been largely the result of computerization of the workplace.

California's Silicon Valley became a hotbed of entrepreneurial innovation. New companies, financed by local venture capitalists, sprang up to perform new economic roles—eBay, Amazon.com, Netscape, Google, Yahoo!, and Excite to name just a few. As these companies went public, their founders became not just millionaires, but often instant billionaires.

"The American Century"

Back in 1941, Henry Luce, the founder of *Life Magazine,* wrote an editorial titled "The American Century." History has certainly proven Luce right. Not only had American soldiers and economic power won World Wars I and II, but we also contained communism from the mid-1940s through the 1980s. With the collapse of the Soviet Union, we were the only military and economic superpower left standing.

Just as no man—or woman—is an island, there are no longer any purely national economies. As we've seen, the United States, which began as 13 English colonies, expanded across the continent, attracted tens of millions of immigrants, and eventually became an economic superpower, importing and exporting hundreds of billions of dollars of goods and services. Over the last three decades, our economy has become increasingly integrated with the global economy.

First there was an exodus of jobs making shoes, cheap electronics, toys, and clothing to developing countries. Next to go were jobs in steel, cars, TV manufacturing, and furniture-making. Then simple service work like writing software code and processing credit card receipts was shifted from high-wage to low-wage countries.

Now white-collar jobs are being moved offshore. The driving forces are digitization, the Internet, and high-speed data networks that span the globe. In the 1990s, hundreds of thousands of immigrants helped ease our shortage of engineers, but now, we are sending routine service and engineering tasks to nations like India, China, and Russia where a surplus of educated workers are paid a fraction of what their American counterparts earn.

The Ominous 00s

From good times to bad

A decade that began with a recession and ended with the worst economic downturn since the Great Depression cannot be called the best of times. Over 15 million people entered our labor force during the decade, but we ended that period with virtually the same number of jobs as we had in 2000. For the first decade since the 1930s, total employment did not grow.

The new economy of the 1990s gave way to the bursting of the dot-com bubble in 2000 and a mild recession in 2001. The subsequent recovery was slow, taking two and a half years for total employment to reach the level it had been at before the recession. But inflation was low and economic growth fairly brisk for the next few years. From the fall of 2005 through the end of 2007 the unemployment rate was at or below 5 percent.

The American consumer had been largely responsible for keeping our economy growing during the 2001–07 economic expansion. Much of that spending was financed by hundreds of billions of dollars a year in home equity loans. Real estate prices were rising rapidly, home construction was booming, and mortgage brokers had relaxed their standards to the degree that they were not even checking the incomes of half the people to whom they granted mortgages. The federal government, which had been running budget surpluses began running budget deficits. Two large tax cuts and the financing of wars in Iraq and Afghanistan were largely responsible for moving us from surplus to deficit. These deficits, like consumer spending, helped spur economic growth.

As long as housing prices were rising, banks and other lenders were willing to extend larger and larger home equity loans. But when the housing bubble burst in mid-2006 and home prices began to decline, lenders were much less willing to extend these loans. In addition, foreclosures began to rise very rapidly, and millions of homeowners discovered that the market value of their homes had sunk below what they owed on their mortgages. Hundreds of thousands just walked away from their homes, mailing their keys to their mortgage brokers.

In December 2007 we entered the 12th recession since the Great Depression. Largely because of the bursting of the housing bubble, our economy had begun to slow during the second half of the previous year. The ranks of the unemployed increased steadily as over 8 million people lost their jobs in 2008 and 2009. In April of 2009, the recession, then 17 months old, was the longest economic downturn since the 1930s. The Great Recession[10] was in fact the worst recession in seven decades.

Most of the blame for our change of economic fortune can be placed on the doorsteps of President George W. Bush and Federal Reserve Chairman Alan Greenspan. In the late summer of 2008 a gathering financial crisis accompanied by what would soon be termed "the Great Recession," had become the number one issue of the presidential campaign between Republican Senator John McCain and Democratic Senator Barack Obama. Greenspan's final term ended in January 2006, and Ben Bernanke had then begun his first four-year term. When Barack Obama took office in January 2009, his primary concern was to avert a complete financial meltdown and another Great Depression.[11]

As the 2012 presidential campaign began to take shape, each of the contenders for the Republican nomination tried to make President Obama's economic stewardship the central issue. The economy he had inherited from the administration of President George W. Bush was in the worst recession since the Great Depression, and we were still mired in a financial crisis, which threatened to bring down our entire financial system. And while that crisis had been averted and the Great Recession had ended, unemployment was still extremely high and our economic recovery was painfully slow.

Mitt Romney, the Republican presidential nominee, tried to run on his record as a well-seasoned businessman who had taken over many failing businesses, often helping them become profitable. He would use his business expertise to fix our flagging economy. But he allowed other issues to obscure his message, and on Election Day the voters gave President Obama four more years to bring about a full recovery.

Our recovery from the Great Recession was slow and halting, and with respect to employment, the poorest recovery from an economic downturn since the 1930s. From the end of the recession in mid–2009 through mid–2013, our annual rate of economic growth was barely above 2 percent. In the summer of 2013, total employment was *still* 2 million lower than it had been in late 2007, just before the recession began. Worse yet, at least another 9 million people had joined the labor force. For the first half of 2013 our unemployment rate was still hovering around 7.5 percent—well above the 5 percent considered full employment.

The federal government, with power split between Democrats and Republicans, seemed growingly incapable of enacting legislation that would help the economy prosper once again. Indeed, there appeared to be something systemically wrong with our economy. At the end of the last chapter of the book, you'll find a section, "Editorial: American Exceptionality," which lists the factors that are causing our economic troubles.

Economics in Action: America's Place in History

> America, America
> God shed his grace on thee
>
> –From the song "America the Beautiful" by
> Katherine Lee Bates–

In the early years of the 20th century, the United States emerged as the world's leading industrial power, with the largest economy and the largest consumer market. By the end of World War I, we had become the greatest military power as well.

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[10]Perhaps the first person to call this "the Great Recession" was Diana Furchtgott-Roth, a former chief economist at the U.S. Department of Labor, in an article, "The Great Recession of 2008?" in *The American,* December 21, 2007, www.american.com/archive/2007/december-12-07/the-great-recession-of-2008.

[11]We'll discuss the Great Recession and the financial crisis in much greater detail in Chapters 12 and 14 of *Economics* and *Macroeconomics.*

Our economic and military roles grew during the next 25 years, and by the close of World War II, the United States and the Soviet Union were the world's only military superpowers. Although Western Europe and Japan eventually recovered from the devastation of the war, the United States continued to be the world's largest economy. Henry Luce was certainly correct in calling the 20th century "The American Century."

At the end of that century, although some economic problems had emerged—namely our huge budget and trade deficits—we were clearly at the top of our economic game. The dot-com bubble had not yet burst, the new economy was in full flower, and most Americans were confident that the party would go on forever. Just 10 years earlier the Soviet Union had dissolved, its Eastern European empire largely allied itself with the West, and even the most ardent militarists agreed that the costly arms race was finally over.

Back in the 19th century, the sun never set on the British Empire, but the drain of two world wars compelled the British to give up their empire. By the mid-20th century, American military bases dotted the globe, and today we have become, to a large extent, the world's policeman. Many observers believe we are overstretched both militarily and economically, and that, consequently, we will be compelled to cut back on these commitments.

Now, in the wake of the dot-com crash, the attacks on 9/11, the wars in Afghanistan and Iraq, the huge budget deficit, a lagging job market, and, of course, a near financial meltdown, the Great Recession, we may well wonder if the 21st, like the 20th, will be an American century. We wonder if Social Security and Medicare will even be there when we retire. And in the meanwhile, will we be able to live as well as our parents did?

I wish I could answer these questions, but as Francis Bacon observed, "A prudent question is one half of wisdom." As you continue reading, each of these questions will be raised again, and hopefully, we'll get closer to their answers.

Key Terms and Concepts

mass production 5	New Deal 9	stagflation 15
mass consumption 5	recession 9	new economy 17
Great Depression 7	suburbanization 13	

Questions for Further Thought and Discussion

1. Describe, in as much detail as possible, the impact of the Great Depression on the lives of those who lived through it. If you know anyone who remembers the 1930s, ask him or her to describe those times.
2. What were the main agricultural developments over the last two centuries?
3. How have wars affected our economy? Use specific examples.
4. Inflation has been a persistent problem for most of the 20th century. What were some of its consequences?
5. In what ways were the 1990s like the 1920s, and in what ways were the two decades different?
6. When our country was being settled, there was an acute shortage of agricultural labor. Over the last 100 years millions of Americans have left the farms. How have we managed to feed our growing population with fewer and fewer farmers?
7. Today America has the world's largest economy as well as a very high standard of living. What factors in our economic history helped make this possible?
8. List the main ways the "new economy" (since the early 1990s) differs from the "old economy."
9. To what degree has our economy recovered from the Great Recession?

Workbook for Chapter 1

Name ______________________ Date ______________________

Multiple-Choice Questions

Circle the letter that corresponds to the best answer.

1. Which statement is true? (LO2)
   a) Twenty-five million Americans were officially unemployed in 1933.
   b) Our economy expanded steadily from 1933 to 1945.
   c) Once the Great Depression began in 1929, our economy moved almost steadily downhill until the beginning of 1940.
   d) None of the above.

2. In the early 19th century, the United States suffered from a scarcity of __________. (LO1)
   a) land and labor
   b) land—relative to labor
   c) labor—relative to land
   d) neither land nor labor

3. Which statement is false? (LO4, 5)
   a) President Eisenhower presided over three recessions.
   b) Our economy has not had an unemployment rate below 5 percent since the early 1940s.
   c) There were six straight years of economic expansion under President Reagan.
   d) None of the above. (All of the above are true.)

4. Which statement is true? (LO4, 5)
   a) There was a great deal of stagflation in the 1970s.
   b) We had full employment for most of the 1980s.
   c) We have had seven recessions since World War II.
   d) None of the above.

5. Each of the following were elements of the New Deal except __________. (LO2)
   a) relief, recovery, reform
   b) a massive employment program
   c) unemployment insurance and bank deposit insurance
   d) a balanced budget

6. Which of these best describes the post–World War II recessions in the United States? (LO4, 5)
   a) They were all very mild, except for the 1981–82 recession.
   b) They were all caused by rising interest rates.
   c) None lasted more than one year.
   d) Each was accompanied by a decline in output of goods and services and an increase in unemployment.

7. At the time of the American Revolution, about __________ of every 10 Americans lived on a farm. (LO1)
   a) 1 c) 5 e) 9
   b) 3 d) 7

8. Between 1939 and 1944, federal government spending rose by more than __________. (LO3)
   a) 100 percent c) 300 percent e) 500 percent
   b) 200 percent d) 400 percent

9. Each of the following was a year of high unemployment except __________. (LO4)
   a) 1933 c) 1944 e) 1982
   b) 1938 d) 1975

10. The year 2012 could be described as having had a relatively __________ unemployment rate and a relatively __________ rate of inflation. (LO6)
    a) low, low c) high, low
    b) high, high d) low, high

11. Between 1929 and 1933, output fell __________. (LO2)
    a) by about one-tenth c) by about one-half
    b) by about one-third d) by about two-thirds

12. The inflation rate declined during the presidency of __________. (LO5)
    a) both Eisenhower and Reagan
    b) neither Eisenhower nor Reagan
    c) Reagan
    d) Eisenhower

13. Which of the following would be the most accurate description of our economy since the end of 2007? (LO6)
    a) We have had virtually no economic problems.
    b) We experienced the worst economic mess since the Great Depression.
    c) Aside from the federal budget deficit, we have no major economic problems.
    d) Our unemployment and inflation rates have generally been relatively low.

14. The transcontinental railroads completed in the 1860s, 1870s, and 1880s all bypassed the __________. (LO1)
    a) Northeast
    b) Midwest
    c) South
    d) mountain states
    e) Far West

15. Compared to our economic history between 1870 and 1945, our economic history since 1945 could be considered __________. (LO4, 5)
    a) much more stable
    b) about as stable
    c) much less stable

16. The longest economic expansion in our history began in __________. (LO5)
    a) the spring of 1961
    b) the winter of 1982
    c) the spring of 1991
    d) the fall of 1993

17. The age of the great industrial capitalists like Carnegie, Rockefeller, and Swift was in the __________. (LO3)
    a) second quarter of the 19th century
    b) third quarter of the 19th century
    c) fourth quarter of the 19th century
    d) first quarter of the 20th century
    e) second quarter of the 20th century

18. __________ completely changed the face of the United States in the 25 years following World War II. (LO5)
    a) Almost constant warfare
    b) Suburbanization
    c) Welfare spending
    d) The loss of jobs to Japan, India, and China

19. Medicare and Medicaid were inaugurated under the administration of __________. (LO5)
    a) Franklin D. Roosevelt
    b) Harry S. Truman
    c) Dwight D. Eisenhower
    d) John F. Kennedy
    e) Lyndon B. Johnson

20. Most of the recessions since World War II lasted __________. (LO4)
    a) less than 6 months
    b) 6 to 12 months
    c) 12 to 18 months
    d) 18 to 24 months
    e) 24 to 36 months

21. Which statement is true? (LO5)
    a) President Eisenhower attempted to undo most of the New Deal.
    b) There was a major tax cut in 1964.
    c) The federal budget deficit was reduced during President Lyndon Johnson's administration.
    d) None of the above.

22. There was a major tax cut in __________. (LO5)
    a) both 1964 and 1981
    b) neither 1964 nor 1981
    c) 1964, but not in 1981
    d) 1981, but not 1964

23. Our economic growth began to slow markedly __________. (LO5)
    a) in the early 1940s
    b) in the early 1960s
    c) in the early 1970s
    d) between 1982 and 1985

24. During World War II most of the people who got jobs in defense plants were __________ who had __________ experience building planes, tanks, and warships. (LO3)
    a) men, substantial
    b) men, no
    c) women, substantial
    d) women, no

25. In the 1970s, our economy suffered from __________. (LO5)
    a) inflation but not stagnation
    b) stagnation but not inflation
    c) inflation and stagnation
    d) neither inflation nor stagnation

26. There were no recessions during the administration of __________. (LO4, 5)
    a) Dwight D. Eisenhower
    b) Ronald Reagan
    c) Bill Clinton
    d) George W. Bush

27. Our longest uninterrupted economic expansion took place mainly in the decade of the __________. (LO5)
    a) 1940s
    b) 1950s
    c) 1960s
    d) 1970s
    e) 1980s
    f) 1990s

28. In the 1990s our economy has generated more than __________ million additional jobs. (LO5, 6)
    a) 5
    b) 10
    c) 15
    d) 20

29. What set off the Great Recession? (LO4, 6)
    a) the bursting of the housing bubble
    b) the sharp decline in oil prices
    c) the escalation of the war in Iraq
    d) a surge in imports from China

30. Which statement is the most accurate? (LO2)
    a) The South had some very substantial economic grievances against the North in the years immediately preceding the Civil War.
    b) The South seceded from the Union when President Lincoln proclaimed that he was freeing the slaves.
    c) Aside from slavery, Southern and Northern agriculture were very similar.
    d) Most of the nation's industries were relocated from the North and Midwest to the South in the years immediately following the Civil War.

31. The massive shift of population and industry out of the large central cities from the late 1940s through the 1960s was caused by __________. (LO5)
    a) wars
    b) the mechanization of agriculture
    c) suburbanization
    d) immigration
    e) fear of nuclear war

32. Each of the following was a major contributing factor to suburbanization except __________. (LO5)
    a) low-interest federal loans
    b) a federal highway building program
    c) the pent-up demand for housing
    d) the baby boom
    e) federal subsidies for public transportation

33. Which statement is true? (LO2, 6)
    a) Although our economy was not performing well, college graduates from the class of 2012 received more job offers than any other graduating class in history.
    b) The economic downturn that began in December 2007 is the longest since the 1930s.
    c) Until the time of the Great Depression, the United States was primarily an agricultural nation.
    d) There were no recessions during the presidency of George W. Bush (January 2001–January 2009).

34. Who made this statement? "Once upon a time my opponents honored me as possessing the fabulous intellectual and economic power by which I created a worldwide depression all by myself." (LO2)
    a) Franklin D. Roosevelt
    b) Herbert Hoover
    c) John F. Kennedy
    d) Ronald Reagan
    e) Bill Clinton

35. Which statement is the most accurate? (LO6)
    a) The 21st century will almost definitely be another "American Century."
    b) The 21st century, rather than the 20th, will be called "The American Century."
    c) The 21st century will definitely not be an "American Century."
    d) Although we got off to a rocky start, this century may well turn out to be another "American Century."

36. Our most rapid job growth was in the period from __________. (LO5, 6)
    a) 2000 to 2005
    b) 1995 to 2000
    c) 1978 to 1983
    d) 1953 to 1958

37. If you could blame just one person or group of people who caused the Great Depression, which one of the following would you choose? (LO1)
    a) President Herbert Hoover
    b) President Franklin Roosevelt
    c) the Federal Reserve Board
    d) the bankers

38. Each of the following happened during the Great Recession *except* __________. (LO6)
    a) a financial crisis
    b) the loss of more than 8 million jobs
    c) a sharp rise in the inflation rate
    d) a sharp decline in our output of goods and services

39. Which of the following is the most accurate statement? (LO7)
    a) Like the 20th century, the 21st century will definitely be "the American Century."
    b) Although we have had some recent problems, our economy is strong enough to continue to support our present global military commitments indefinitely.
    c) The United States is a fading economic and military power, and will soon be overtaken by its rivals.
    d) It is far too soon to say whether or not the 21st century will be another "American century."

40. Which statement is the most accurate? (LO4, 6)
    a) We have had the world's largest economy for more than 120 years.
    b) Our economy is slightly larger than China's economy.
    c) Until the Great Recession of 2007–09, we had not had a serious economic downturn since the Great Depression.
    d) The first decade of the 21st century was one of the most prosperous in our history.

41. During the years 2008 through 2012 we have had relatively __________ unemployment and relatively __________ inflation. (LO6)
    a) low, low
    b) high, high
    c) high, low
    d) low, high

42. In the presidential campaign of 1992, candidate Bill Clinton's campaign coined the slogan "It's the economy, stupid!" Which 2012 presidential candidate might have benefited most by using the same slogan? (LO6)
    a) Barack Obama
    b) Mitt Romney
    c) George W. Bush
    d) Joe Biden
    e) Hillary Clinton

Fill-In Questions

1. The low point of the Great Depression was reached in the year __________. (LO2)
2. In 1790, about __________ of every 10 Americans lived on farms. (LO1)
3. The worst recession we had since World War II began in (month, year) __________. (LO4)
4. The country with the world's largest output is __________. (LO1)
5. In 1933, our official unemployment rate was __________ percent. (LO2)
6. Bills providing for Medicare and Medicaid were passed during the administration of President __________. (LO5)
7. Today one full-time American farmer feeds about people __________. (LO5)
8. During President Dwight D. Eisenhower's two terms, there were __________ recessions. (LO4, 5)
9. Rapid technological change in agriculture during the first half of the 19th century was brought on mainly by __________. (LO1)
10. The main factor in finally bringing us out of the Great Depression was __________. (LO2, 3)
11. Since the end of World War II there have been __________ recessions. (LO4)
12. The quarter century that was completely dominated by the great industrialists like Andrew Carnegie and John D. Rockefeller began in the year __________. (LO1)
13. Passage of the __________ in 1944 enabled nearly 8 million veterans to go to school. (LO3)
14. The __________ century was termed "The American Century." (LO6)