



Subject: What made the Great Depression “Great”?  
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What was the defining characteristics of the Great Depression? It was persistently high levels of unemployment. The national unemployment rate averaged 17.9% from 1930 to 1940, nearly four times its average of 4.6% from 1900 to 1929. The unemployment rate surged to 24.9% in 1933 from just 3.2% in 1929, and remained at double digit levels until 1940. Wartime mobilization finally pushed the unemployment rate from 14.6% in 1940 to a low of 1.2% in 1944. To be sure, the initial declines in overall economic activity were steep, with real GDP falling by one-quarter from 1929 to 1933. The recovery starting in early 1933 was quite robust, with an annual average gain in real GDP of 9.5% over the next four years; most of the gains were attributed to personal consumption and business investment spending, not to expanded government spending. Indeed, total government spending ranged from 11.0% to 16.1% of GDP from 1930 to 1940 (it was 20.2% in 2008), and Federal spending ranged from 2.0% to 6.6% (it was 7.5% in 2008). With rapid increases in government spending starting in 1941, unemployment quickly decreased due to both added wartime production as well as the diversion of workers into the armed forces. Government spending was so massive (at its peak in 1944 it accounted for nearly half of GDP) that it overwhelmed the more normal determinants of demand. With such extraordinary government spending, even a personal saving rate that averaged 22.0% from 1941 to 1944 still meant that GDP grew on average by 15.0% per year. While it can be expected that the savings rate will increase in 2009 and 2010, the negative impact on overall GDP will be offset to some extent by increased government spending. Moreover, instead of the past lump sum tax rebates, paying out the tax cuts in smaller amounts more frequently over an extended period was designed to foster increased spending rather than savings. Despite this stratagem, the personal savings rate is still likely to increase to about 6% or higher over the next several years.

While the economy is likely to record its worst performance since the Great Depression, it is not reasonable to expect that the current situation will rival the 1930's disaster. Nor would it be reasonable to expect that when economic growth returns it will be as robust as in the mid 1930's. Nonetheless, the key characteristic of the current downturn is likely to be persistently high unemployment, posting continued increases long after the decline in GDP ends. The unemployment series in the table below, unlike all of the other series, represents an estimate of employment conditions prior to the establishment of the official measures in 1941. The unemployment series, estimated by Stanley Lebergott, is widely used despite its flaws; the most serious is that it did not assume any cyclical component to labor force participation rates, which causes an over-estimate of the peak unemployment rates and an under-estimate of the troughs. The difference at the peaks could mean that the peak rate was about five percentage points lower, a peak of about 20% instead of 25%. Other changes in the measurement methodology by BLS in more recent years may mean that current rates need to include discouraged workers to be comparable with the older estimate; if a broad definition of discouraged workers were used it would raise the recent official rates by about one percentage point. Even the most pessimistic current forecasts would not make even a broadened definition of unemployment comparable to a revised 1930's peak. Nonetheless, like the Great Depression, the current downturn may become part of economic folklore that has as much an impact on savings preferences as the 1930's affected prior generations. This legacy will not be due to the financial failures as much as to loss of economic optimism due to persistently high unemployment.

**Economic Performance Measures, 1930 - 1944**

	Real GDP % Δ	Contributions to Overall Real GDP Growth				Government Spending as Percent of GDP			Real Disposable Income % Δ	Saving Rate %	CPI % Δ	Unemployment Rate %
		Consumption	Investment	Net Exports	Government	Total	Federal	State & Local				
1930	-8.6	-3.99	-5.23	-0.31	0.93	11.0	2.0	9.0	-6.4	4.1	-2.7	8.9
1931	-6.4	-2.35	-4.32	-0.22	0.47	12.9	2.5	10.5	-3.5	3.9	-8.9	15.9
1932	-13.0	-7.02	-5.34	-0.20	-0.44	14.8	3.1	11.8	-13.2	-0.9	-10.3	23.6
1933	-1.3	-1.79	1.15	-0.11	-0.53	15.4	4.1	11.3	-2.9	-1.5	-5.2	24.9
1934	10.8	5.71	2.78	0.33	1.98	15.9	5.0	10.9	9.6	1.0	3.5	21.7
1935	8.9	4.81	4.51	-0.84	0.43	14.9	4.6	10.2	9.7	4.3	2.6	20.1
1936	13.0	7.74	2.53	0.24	2.50	15.6	6.7	8.9	12.5	6.3	1.0	17.0
1937	5.1	2.75	2.58	0.46	-0.66	13.9	5.5	8.4	3.4	6.0	3.7	14.3
1938	-3.4	-1.18	-4.24	0.89	1.09	16.0	6.6	9.4	-5.7	2.0	-2.0	19.0
1939	8.1	4.15	2.43	0.07	1.41	16.1	6.5	9.5	8.3	4.5	-1.3	17.2
1940	8.8	3.80	4.01	0.53	0.45	14.8	6.4	8.5	6.6	5.7	0.7	14.6
1941	17.1	5.03	2.93	-0.65	9.81	20.9	14.2	6.8	15.0	12.2	5.1	9.9
1942	18.5	-1.48	-6.54	-1.21	27.75	38.7	33.4	5.3	12.5	24.1	10.9	4.7
1943	16.4	1.59	-2.59	-1.18	18.59	47.7	43.6	4.2	4.7	25.6	6.0	1.9
1944	8.1	1.49	0.75	0.01	5.87	47.9	44.1	3.8	3.6	26.1	1.6	1.2