

Lecture 14: The Great Depression, Part II

ECON 43370: Financial Crises

Prof. Eric Sims

University of Notre Dame

Fall 2026

Policy Responses

The Great Depression was catastrophic

Academic consensus: it was mostly due to policy blunders (e.g., Fed not intervening earlier)

The Depression itself gave rise to a dramatic change in the relationship between the federal government and the macroeconomy

It also gave birth to a new school of economic thought that dominated for years and is still popular: Keynesianism

Immediate Policy Reactions (Monetary)

National banking holiday: March 6-13, 1933 (Emergency Banking Act, March 9)

Expanded powers for the Reconstruction Finance Corporation (RFC)

Bank recapitalization via RFC and the Fed

Established Federal Deposit Insurance Corporation (initial protection up to \$2,500)

Executive Order 6111 (April 20, 1933): restrict gold flows and stopped domestic redemption of currency for gold

- Gold Reserve Act (January 30, 1934): formalizing prohibition on gold redemption, fixed a new gold price of \$35 per ounce (up from \$20.67; significant devaluation).

Fireside Chat, March 12, 1933



Some Great Quotes

“The bank puts your money to work to keep the wheels of industry and agriculture turning” (pg. 2)

“On the spur of the moment it was, of course, impossible to sell perfectly sound assets of a bank and convert them into cash except at panic prices far below their real value” (pg. 2)

“A bank that opens on one of the subsequent days is in exactly the same status as the bank that opens tomorrow” (pg. 3)

“Confidence and courage are the essentials of success in carrying out our plan. You people must have faith; you must not be stampeded by rumors or guesses. Let us unite in banishing fear” (pg. 4)

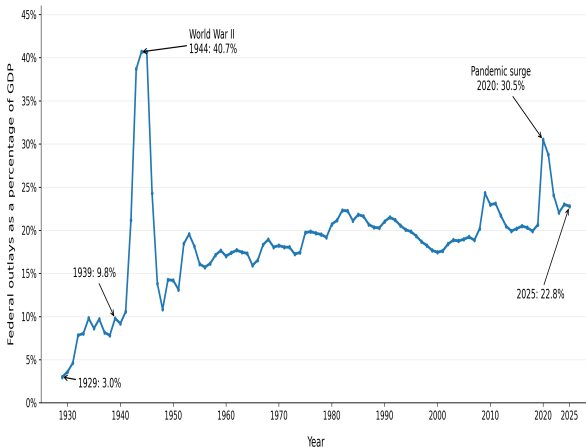
The New Deal

FDR promised a “new deal” focused on **relief**, **recovery**, and **reform**

- Relief: direct assistance and public-employment and public-works programs
- Recovery: policies aimed at banking and mortgage distress, agricultural and industrial policies
- Reform: securities market regulation, Social Security, unemployment insurance, stronger collective bargaining

Federal Government Outlays as a Share of GDP

United States | Annual observations, 1929-2025 | No projections



Source: OMB and Federal Reserve Bank of St. Louis, FRED series FYOWGDA188S; retrieved October 12, 2026.

FRED construction: fiscal-year federal net outlays divided by calendar-year nominal GDP; not the OMB fiscal-year-GDP ratio.

Federal spending only. The continuous series begins in 1929; 2025 is its latest annual observation.

Did the New Deal Work?

The New Deal was too big and disparate a package and set of policies to really answer this question

Banking stabilization and monetary recovery receive substantial credit. Bank runs ended, leaving gold allowed for “reflation”

Relief and spending helped, but were not a complete cure

Larger disputes and industrial and wage policies (e.g., reduced competition hurt recovery)

Recovery was substantial but incomplete: a second recession in 1937-38 and unemployment remained above 10 percent throughout the decade

It really took WWII mobilization to “end” the Great Depression

The Birth of Keynesianism

Keynes' *The General Theory* was published in 1936

The culmination of development of his own ideas over the preceding years, motivated in large by the experience of the global Great Depression

- Depressions reflect reductions in aggregate demand (not supply)
- The economy may not quickly correct itself
- Monetary policy and cheap credit likely insufficient if confidence is low
- The government can and should replace missing private demand through fiscal expansion
- Do not withdraw support too soon

Keynes' Letter to FDR (February 1, 1938)

This letter was written against the backdrop of the “second” recession of the 1930s in 1937-38

Keynes argues that the recovery has been stalled by curtailed “public works and other investments”

He calls for large-scale investment in housing, utilities, and transportation

“Durable investment must come increasingly under state direction”

“I regard the growth of collective bargaining as essential”

Restoring demand would help to restore confidence

Fishback (2017)

The New Deal was a collection of programs, not one policy

It really wasn't "Keynesian stimulus" in that deficits were limited

Fishback focuses on local effects of different policies

- Public works and relief spending had multipliers around one, increased consumption, attracted migrants, reduced crime, but did little for private employment
- Agricultural Adjustment Administration (AAA) had benefits to large farmers, with small overall local effects
- Loans to banks and railroads from the RFC were relatively unsuccessful, but recapitalizations worked better
- Programs targeting homeownership were pretty successful

Fiscal Multipliers

Aggregate resource constraint:

$$Y = C + I + G + NX$$

The fiscal multiplier is $\frac{dY}{dG}$. Do not reason from accounting identities!

Deficit: $G - T$. Tax multiplier: $\frac{dY}{dT}$

Basic theory:

- $\frac{dY}{dG} \geq 0$
- $\frac{dY}{dG}$: $> 1?$ $< 1?$
- $\frac{dY}{dT} \leq 0$

The Econometric Problem

Suppose you want to estimate something like the multiplier via regression:

$$Y_t = \beta_0 + \beta_1 G_t + \varepsilon_t$$

What's the problem here?

Cross-Sectional Variation

Suppose you have panel data: observations across locations (e.g., states) and time:

$$Y_{i,t} = \beta_0 + \beta_1 G_{i,t} + \beta_2 X_{i,t} + \beta_3 S_i + \beta_4 t_t + \epsilon_{i,t}$$

- β_3 : location fixed effects
- β_4 : time effects
- β_5 : time-varying, location-varying things

Regional vs. Aggregate Multipliers

Does β_1 from the panel regression identify “the” aggregate multiplier, $\frac{dY}{dG}$?

No, not in general!

It might be informative in certain cases (e.g., small open economy, or situation where monetary policy is held fixed)