After the largely evolutionary changes in the government’s role during the Progressive Era and the emergency expansion of that role during World War I, government activity continued to grow along its long-term path. While many of the temporary wartime programs were being phased out, other programs continued to expand. Governments were building a rapidly expanding network of roads and highways that could accommodate the increasing use of the automobile, and districts and states continued to add high schools. Meanwhile, lobbyists from a variety of interest groups and reform movements were sowing the seeds for later expansions. In many ways, however, the decade of the 1920s was the calm before the storm, as the Great Depression soon encouraged drastic changes in the landscape of government and the economy.

Just prior to the stock market crash of 1929, the economy turned downward. Despite optimism after the crash that the economy would soon recover, it continued its downward slide into the worst depression in American history. By 1933 real output in the United States was 30 percent below its 1929 peak, and prices had fallen dramatically. Unemployment rates eventually peaked above 25 percent in 1933 but remained above 10 percent for the entire decade of the 1930s. Ironically, given the shift toward increased government involvement in the economy, federal macroeconomic policies likely contributed significantly to the depth of the Depression.

As the Depression deepened, President Herbert Hoover, a strong Progressive in his own right, experimented with a variety of new policies that called on the government to combat the growing problems. His most prominent effort was the establishment of the Reconstruction Finance Corporation (RFC). Modeled on the War Finance Corporation of World War I, the RFC sought to resurrect the economy by means of massive loans to banks, railroads, industry, and governments. Hoover’s
actions met with little success in counteracting the downward slide, and the 1932 elections swept Franklin Delano Roosevelt and a large Democratic congressional majority into office.

The U.S. economy had always rebounded from sharp downturns, but after four years of continued decline, this downturn seemed different, and notions that market economies could be self-correcting were dismissed with increasing frequency. Problems could be found in nearly every nook and cranny of the economy. State and local governments, which had long held responsibility for providing aid to those in trouble, were overwhelmed. Citing a peacetime emergency, the administration rolled up its sleeves and within the First Hundred Days in office established a “New Deal” for America. Identify a problem and the Roosevelt administration offered a program to solve it. The programs had laudable goals: raising farm incomes, raising wages, helping the unemployed, stimulating industrial output by raising prices, offering liquidity to housing markets, providing insurance for bank deposits, building social overhead capital—such as dams, roads, sewers, and public buildings—and still more. Yet the many programs at times worked at cross purposes. For example, programs designed to raise farm prices by limiting acreage contributed to greater unemployment in the farm sector and certainly made life more difficult for consumers of farm products.

The New Deal programs went through several transformations. In 1935 the Supreme Court declared the Agricultural Adjustment and the National Industrial Recovery Acts unconstitutional in the Butler and Schechter Poultry cases, eliminating major features of Roosevelt’s farm programs and industrial policy. Further, the federal government’s role in providing relief to the unemployed and indigent was revamped. The federal government continued to provide temporary work relief through the Works Progress Administration, while the Social Security Act of 1935 established long-term programs for old-age pensions and state-federal administration of unemployment insurance and welfare policy.

During the 1930s the role of government, in particular the role of the federal government, in the economy ratcheted upward in ways unanticipated by the Progressives of the early 1900s. Several New Deal emergency programs were temporary and were phased out during or after World War II. Some were successful based on several standards of measurement. Others were failures best not repeated. In the end the New Deal established a legacy of social insurance programs, regulations, and procedures that are largely still in place today. Many have served as the bases on which new programs have been built.
Macroeconomic Policy during the 1930s

A leading aspect of economic thought developed during the twentieth century was an explicit role for federal government in macroeconomic policy. In the Employment Act of 1946 the U.S. Congress gave the federal government the explicit responsibility to use monetary and fiscal policy to help smooth the path of economic growth, maintain full employment, and avoid inflation. The nation’s central bank, the Federal Reserve System (known as the Fed), handles the reins of monetary policy, and Congress, subject to the presidential veto, determines fiscal policy through its decisions about spending and taxation. The implicit use of fiscal and monetary policy stretches back to the early days of the century, and macroeconomic policy used during the 1930s has long dominated discussions of the Great Depression. The formation of the Federal Reserve System in 1913 established a full-blown central bank armed with policy tools that could influence the money supply. Meanwhile, the Keynesian ideas of using government spending and taxation to stimulate the economy were being developed as the Depression progressed.

The Central Bank Policy as a Contributor to the Great Depression

The Holy Grail among American economists is an explanation of the cause of the Great Depression that is convincing to the profession at large. Numerous explanations have been proposed. Some argue that economies tend to be cyclical, with both short-term fluctuations and long Kondratieff cycles, and that at various times every thirty to ninety years, there is a downturn of biblical proportions. Others emphasize a sharp decline in investment and construction following the booms of the 1920s. Still others emphasize a decline in consumption, particularly of durable goods, that might have been fueled in part by the uncertainties in the stock market. Most scholars, however, agree that the monetary policies of the Federal Reserve to some degree contributed to the decline of the early 1930s, although there is still disagreement about the magnitude of the Fed’s actions and the reasons why its policy was misguided.

Milton Friedman and Anna Schwartz originated the argument that the Fed bears significant responsibility for the tremendous drop in output between 1929 and 1933. In the Federal Reserve Act of 1913, the Fed was given the responsibility of creating an “elastic” currency. Although the concept of an elastic currency was vague, most observers thought that the Fed was expected to help solve liquidity crises during bank runs. By the 1920s the Fed had two effective tools for influencing the money supply: the discount rate at which member banks borrowed
from the Fed to meet their reserve requirements and open-market operations. The open-market operations involved the purchase or sale of existing bonds. Reductions in the discount rate and purchases of bonds contributed to increases in the money supply. Thus, if the Fed was focused on problems with bank failures and unemployment within the U.S. economy, its optimal strategy was to lower the discount rate and purchase bonds.4

Yet it also had to pay attention to the gold supply in the United States. The nation generally adhered to the international gold standard, which was essentially a promise that the Federal Reserve and U.S. banks would pay out an ounce of gold for every $20.67 in Federal Reserve notes received in international transactions. To remain on the gold standard, the Fed was required to provide adequate U.S. gold reserves to make this promise credible. If changes in the relative attractiveness of the dollar led the nation’s supply of gold to fall below the appropriate level, the Fed was expected to take action to make the dollar more attractive. At the time the standard policies used in response to gold outflows included raising the discount rate and selling (or at least reducing purchases of) existing bonds.

The Federal Reserve’s attempts to slow the speculative boom in stocks contributed to slowing the money supply between 1928 and 1929. Over the following four years there were a series of negative shocks to the money supply, including the stock market crash in 1929, banking crises in 1930–31, 1931, and 1932–33, and Britain’s abandonment of the gold standard in November 1931. The Fed’s response to these crises is best described as too little, too late. Had the Fed offset the early crises quickly with much larger open-market purchases of bonds and faster cuts in the discount rate, it could have limited the damage and prevented the rapid decline in the money supply. The economy would have been in a much better position when the next crises hit or some of the later crises would have been prevented or softened significantly. The Fed’s boldest move, an open-market purchase of $1 billion in bonds in the spring of 1932, would have been extremely effective in 1930, but two years later it essentially served to close the drain after most of the water had already run out.5

Why was the Federal Reserve so recalcitrant? Friedman and Schwartz argued that it lacked strong leadership of the right kind. Benjamin Strong, a powerful advocate for a focus on protecting the domestic economy as the head of the New York Federal Reserve Bank, had died in 1928. Although his replacements at the New York Fed argued for
expansive bond purchases in the early 1930s, they were overridden by the rest of the Fed's policymakers, who tended to hold the Austrian view that such interference would prolong the problems.

Not all agree that the Fed changed directions with the death of Strong. Statistical comparisons of Federal Reserve policy in the 1920s and 1930s suggest that the Fed seemed to be responding to domestic and international changes in largely the same way in both decades. The Fed likely failed to recognize that the problems of the Great Depression were so large that they required the Fed to take much greater action to save banks and stimulate the money supply. For example, the Fed allowed thousands of banks to fail during the 1920s because they believed them to be weaker banks that normally would not survive in a market economy. The banks that failed in the early 1930s, having survived through the 1920s, were generally stronger, and the Fed did not realize that many were failing owing to extraordinary circumstances.6

Some of the Fed’s actions might best be understood by examining its international role in defending the gold standard. Until 1933 the Fed maintained a strong commitment to the international gold standard, a commitment that tied its hands. Although the money supply and the economy were continuing to decline, the outflows of gold that occurred when Britain left the gold standard in 1931 and during the banking crisis in March of 1933 led the Fed to raise the discount rate. Once the United States left the gold standard in 1933, it was freer to focus on domestic policy and the money supply, and the economy began to recover. This same pattern was repeated throughout the world. In country after country, central banks that sought to maintain the gold standard saw their domestic economies sink. As each left the gold standard, its economy rebounded. By leaving the gold standard, the United States received a substantial flow of gold into the American economy caused by the devaluation of the dollar to $35 per ounce of gold and by political developments in Europe that stimulated the money supply.7

In addition to leaving the gold standard, the Roosevelt administration sought to ease the pressure on banks in March 1933 by declaring a national “Bank Holiday.” During a series of bank runs between October 1932 and March 1933, thirty states declared bank holidays, which took the pressure off the deposits in states where the banks were closed but increased runs by depositors in the states where banks remained open. During the national Bank Holiday all banks and thrift institutions were temporarily closed, and auditors examined the banks. Banks declared to be sound were reopened shortly afterward. Conservators
were appointed to improve the positions of the insolvent banks, and the Reconstruction Finance Corporation was given the power to subscribe to stock issues from the reorganized banks. These seals of approval conferred on the reopened banks helped change expectations about the solvency of the bank system. With the benefit of hindsight, the appropriate choices for the central bank now seem more obvious, although there are still debates about the effectiveness of different policies. Recognize, however, that the Federal Reserve was less than twenty years old, and its administrators were relatively inexperienced as central bankers. Learning from the mistakes of countries with a longer history of central banking was of little use, because nearly every other central bank in the world was making the same mistakes.

And the Fed still had more lessons to learn. The Banking Act of 1935 reorganized the Federal Reserve System and also gave it direct administrative control over the reserve requirements for its member banks. Under the fractional reserve system member banks were required to hold a share of deposits with the Fed as backing for their deposits. By 1935 the economy had been moving through two years of recovery. The real GDP growth rate was very rapid, in large part because the economy was starting from a base that was 36 percent below the 1929 level. The number of unemployed persons had dropped significantly, although they still composed more than 15 percent of the labor force. Noting that banks were holding reserves above and beyond the reserve requirements, the Fed began to be concerned about the possibility of inflation. If the banks started lending out their excess reserves, the Fed worried, the increase in the money supply, which would be multiplied via successive loans, would lead to rapid inflation that would halt the recovery. Feeling that the recovery was far enough along, the Federal Reserve doubled reserve requirements in three steps between 1935 and 1937. It had not recognized that the banks were holding the excess reserves in order to protect themselves against bank runs. Recent experience had given them little confidence that the Fed would act as a lender of last resort. Therefore, the banks increased their reserves to make sure that they kept roughly the same cushion. The policy contributed to a reduction in the money supply, a spike in unemployment, and a decline in real GDP growth in 1937–38.

**Federal Fiscal Policy: Spending and Taxation at the National Level**

During the Great Depression with its severe worldwide problems, John Maynard Keynes developed his seminal theories about the impact
of government spending and taxation on income and wealth. Keynes actively discussed his ideas with his colleagues during the early 1930s, and they were published in *The General Theory of Employment, Interest, and Money* in 1936. The theories of the classical economists suggested that periods of high unemployment would lead to downward adjustments to wages in the labor markets and prices in product markets that would naturally cause the economy to return to an equilibrium at full employment. Keynes argued that wages were sometimes “sticky” in a generally downward direction and that long-term contracts between workers and employers, union strength, and a host of factors might prevent wages from falling. Similarly, product prices might not always adjust. As a result, the economy might settle into a new long-term equilibrium in which resources would not be fully employed. One solution to the problem was for governments to stimulate the economy by increasing government spending or reducing tax collections. These moves would lead to budget deficits that could move the economy back toward a new equilibrium in which all resources would be fully employed.

During the New Deal the Roosevelt administration embarked on an ambitious spending program, more than doubling the Hoover administration’s federal spending in real terms (1958 dollars) from an average of $7.3 billion in the period 1930–32 to an average of $15.7 billion in the period 1934–39 (see figure 13.1). The increase was so large that it seems obvious that Roosevelt was following the Keynesian prescriptions for a depressed economy. But closer study casts significant doubt on that interpretation. Keynes published an open letter to Roosevelt in the *New York Times* in December 1933 suggesting that Roosevelt practice stimulative spending policies. They met in 1934, but most observers believed that Keynes had little impact on the president’s thinking. Although Keynes’s ideas were in circulation by 1933, the lag between academic advances and their use in policy tends to take decades. In fact, Keynes once claimed: “Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribblers of a few years back.” Several of Roosevelt’s advisers also argued for using government programs as a stimulus, but they followed a different logical path for their arguments.10

Roosevelt was following a far more conservative path because he, like Hoover, sought to avoid leaving the federal budget too far out of balance. As a result, average federal tax collections also more than doubled between 1930 and 1939 from $4.7 billion to $11.8 billion. The Revenue Act of 1932, passed by the Hoover administration, had sharply raised
rates for the less than 10 percent of the households that were paying federal taxes during the 1930s. Individuals earning between two and three thousand dollars saw their effective tax rates rise from 0.1 percent to 2 percent in 1932. Those earning more than $1 million experienced a rate increase from 23.1 to 57.1 percent. The Roosevelt administration could have opted to lower the rates but only made slight adjustments during the rest of the decade, lowering them a bit for those earning less than ten thousand dollars and raising them a bit for those earning more than one hundred thousand dollars.

As a result, the federal budget deficit was never very large relative to economic shortfalls during the 1930s. Writing in 1941, Alva Hansen, a major figure in aiding the diffusion of Keynesian thought in the economics profession, stated, “Despite the fairly good showing made in the recovery up to 1937, the fact is that neither before nor since has the administration pursued a really positive expansionist program. . . . For the most part the federal government engaged in a salvaging program and not in a program of positive expansion.” Figure 13.1 bears this out. It shows the federal budget deficit in billions of 1958 dollars from 1929 through 1941. After running surpluses in 1929 and 1930, the Hoover
government ran budget deficits of 4.7 billion and $3.5 billion in 1931 and 1932. The Roosevelt administration ran one surplus in 1937 and deficits in other years ranging from $2 billion in 1933 to $7.5 billion in 1936. The peaks in both administrations were probably not attempts to establish a Keynesian stimulus package. In 1931 and 1936 Congress passed large-scale payments to veterans over the vetoes of Hoover and Roosevelt, and these composed the bulk of the budget deficit.¹¹

As a share of GNP, these budget deficits pale in comparison to some periods during the postwar era. Budget deficits during the 1930s never reached more than 3.9 percent of GNP in any one year. This was true even though the GNP had fallen drastically. Based on this metric, in the 1980s Ronald Reagan looked far more Keynesian than Roosevelt because budget deficits exceeded 5 percent in some years during the Reagan era.

The ultimate goal of any stimulus program is to reach full employment. Figure 13.1 also shows the difference between real GNP (in 1958 dollars) in each year and the 1929 full-employment peak of $203.6 billion. If these were attempts at Keynesian stimuli aimed at returning to full employment, the budget deficits were mere cupfuls of dollars that would have barely filled the target bucket. Real GNP in 1933 was $62.1 billion below its 1929 level, whereas the real budget deficit was only $2 billion. In 1934 a $5 billion dollar deficit was matched with a GNP shortfall of $49.3 billion; in 1935 the $4.5 billion deficit was offsetting a $34.1 billion shortfall. The figures look strongest in 1936, when a 7.5 billion deficit was matched with a $10.6 billion GNP shortfall. Keynesians argue that budget deficits have multiplier effects. For these deficits to be meaningful for returning to full employment, the multiplier effects would have had to be almost ten, yet the most ardent Keynesians find multipliers of only around two.

One of the Keynesian concepts was the balanced budget multiplier: a dollar increase in government spending matched by a dollar increase in taxation would lead incomes to rise by a dollar. Thus, we should look at government spending relative to the GNP shortfalls. Yet the real government spending estimates in the 1933 to 1936 period range from $8.7 billion in 1933 to $13.1 billion in 1934 and 1935. In 1936, the year of the veterans’ bonus, real spending peaked at $18.1 billion. These figures pale in comparison to the shortfall in national income.¹²

Any impact that the federal deficits had in promoting recovery had to compete with the contractionary changes in state and local government budgets after 1933. Prior to 1933, state and local governments
generally held nearly full responsibility for relief of the indigent and the unemployed. By 1933 they were overwhelmed by these and other responsibilities in the midst of a sharp decline in their revenues. A number were forced to run short-term deficits in the early 1930s. Yet state constitutions generally require balanced year-to-year budgets. To repay the budget shortfalls and also the debt issued during the early 1930s, state and local governments began raising taxes and establishing new taxes after 1933. The problem was further exacerbated when the federal government dumped responsibility for direct relief to “unemployables” back onto the state and local governments in 1935 after two years of extensive spending. Thus, in the latter half of the 1930s, they were often running small surpluses.

Not all taxes were designed to raise revenue. The Smoot-Hawley Tariff Act of 1930 raised taxes on imports substantially on top of a 1922 increase in an attempt to protect American manufacturers from competition from foreign imports. International trade was a small enough percentage of the American economy at the time that most economists ascribe to the tariff a secondary role as a contributor to the Depression in the United States, but it had far worse implications at the international level. The Smoot-Hawley tariff was matched by a series of protectionist measures enacted by countries throughout the world. As each nation tried to protect its home production interests by means of higher tariffs and restrictions on imports, world trade spiraled downward. By 1933 the total imports for seventy-five countries had fallen to roughly one-third of the level seen in 1929.

The Roosevelt administration contributed to a recovery in world trade by relaxing these tariff barriers. The Reciprocal Trade Agreement Act of 1934 freed the administration to sign a series of tariff reduction agreements with key trading partners. Agreements with Canada, several South American countries, Britain, and key European trading partners loosened the trade restrictions markedly. As a result, American imports rose from a twenty-year low in 1932–33 to an all-time high by 1940.13

The Reconstruction Finance Corporation: The Transition Agency

Because the Federal Reserve System did too little and too late in the early 1930s, the Hoover administration sought another way to inject liquidity into the economy by forming the Reconstruction Finance Corporation (RFC) in February 1932. The RFC was modeled after the War Finance Corporation of World War I. Its first moves included making loans to four thousand banks, railroads, credit unions, and mortgage
loan companies to provide assets that would jumpstart commercial lending. Among the most important programs was the provision of loans to troubled banks in an attempt to provide them with enough liquidity to survive bank runs. Recent studies suggest that these initial loans were not successful because repayment of the RFC loans were given first priority over depositors and other lenders when the borrowing banks failed. As a result, banks had to hold the assets that they could sell most easily to insure repayment of the RFC loans. These assets could not then be used to repay depositors when the bank failed. When the RFC began to accept more risk by purchasing preferred stock in the troubled banks, it was more successful at staving off failures.¹⁴

The Roosevelt administration immediately saw uses for the RFC and gave the off-budget corporation extraordinary leeway. The RFC retained control of a large supply of funds that could be loaned out and had the authority to borrow still more funds without having to constantly return to Congress for new appropriations. As the loans were repaid, the RFC continually had new funds to loan out again. The president and Congress quickly came to love the RFC because it gave them so much flexibility. James Olson describes the breadth of its activity: “By the mid-1930s, the RFC was making loans to banks, savings banks, building and loan associations, credit unions, railroads, industrial banks, farmers, commercial businesses, federal land banks, production credit associations, farm cooperative, mortgage loan companies, insurance companies, school districts, and livestock credit corporations” (Olson 1988, 43–44). Perhaps more important, the RFC became the banker to many New Deal programs, providing loans or startup working capital to the Public Works Administration (PWA), the Home Owners’ Loan Corporation (HOLC), the Farm Credit Administration (FCA), the Federal Housing Administration (FHA), the Rural Electrification Administration (REA), and the Works Progress Administration (WPA).

It is clear that the RFC was central to the operation of Roosevelt’s New Deal. Its record at stimulating recovery is somewhat mixed. Hoover’s original goal for the RFC was to expand commercial credit to 1929 levels, but this probably unobtainable short-term goal was not met until the end of the 1930s. As one example, RFC loans to railroads and industries did contribute to delaying bankruptcies. Yet the delay of bankruptcies may have been a mixed blessing. On the plus side, the delays gave financial institutions more time to reduce their holdings of railroad bonds and avoid more banking crises. On the minus side, the delays may have retarded needed maintenance and capital
expenditures. When railroads were in trouble they tended to cut back on maintenance of their rolling stock and rails and other capital equipment. One advantage of bankruptcies is that they forced railroads that could be viable again to make the proper investments in order to attract the necessary capital for reorganization. A recent study suggests that railroads that received RFC support continued to delay these types of expenditures when compared with the railroads that went through bankruptcy proceedings.\textsuperscript{15}

The RFC was designed to be a temporary emergency agency, and by 1939 there were extensive discussions about winding it down. The Nazi invasion of France in 1940 led to a transformation of the RFC into a wartime agency that more closely resembled its ancestor the War Finance Corporation. The RFC established a series of companies to stockpile materials and products considered strategic for national defense, finance construction of new defense plants, and provide loans for housing construction for defense workers and made a wide variety of loans to businesses taking part in the war effort. At the end of the war the RFC finally was wound down.

**Emergency Relief and Public Works Programs**

Federal spending during the 1930s was less about macroeconomic stimulus in the modern sense of the word and more about solving the harsh problems that had arisen during the Depression. One of the central problems was determining how to aid the huge numbers of unemployed and discouraged workers. Prior to the Depression, the federal government had assumed virtually no responsibility for the provision of relief payments to low-income people and the unemployed. Unemployment and poverty were seen as local problems best dealt with by state and local governments and charities. As these relief structures became overwhelmed by unprecedented levels of unemployment in the early 1930s, views of the federal role shifted. The Hoover administration worked within the existing framework by authorizing the Reconstruction Finance Corporation in 1932 to lend up to $300 million to cities to provide relief. Originally, these loans were meant to be repaid at three percent interest via reductions in future highway apportionments, but the RFC was allowed to write them off in 1938.\textsuperscript{16}

By the time Roosevelt took office in March 1933, unemployment rates had surged well past 20 percent. Arguing that the Great Depression was a national peacetime emergency, the federal government temporarily took over the lion’s share of the responsibility for relief.
the First Hundred Days the Roosevelt administration established the Federal Emergency Relief Administration (FERA). The FERA distributed federal monies to the states, which, in turn, distributed the monies to local areas, which administered the payments to households. The FERA program offered either direct relief payments (with no work requirement) or work relief that required a family member to work for the funds. The amounts paid were determined by a “budget-deficit” principle. Local administrators compared the household’s income to a hypothetical budget for a family that size and the maximum amount of relief would be determined by its deficit. The actual payments often fell short of the maximum when relief officials, faced with large caseloads and limited funds, cut payments to provide relief for more families.17

By November 1933 the administration was wary about the still-large number of unemployed people given the anticipation of a harsh winter. As a short-term fix, the Civil Works Administration (CWA) was established to immediately put people to work on public jobs, ranging from “make-work” activities to maintenance jobs such as raking leaves to the building of roads and schools. By December 1933 the CWA employed 3.6 million people. Eligibility for CWA employment was based on the budget-deficit principle, but the CWA wage payments were not specifically tied to the size of the household deficit. It was closed down in March 1934, and most of those employed were eventually transferred to FERA projects. Between July 1933 and July 1935, the FERA and the CWA distributed roughly $3.5 billion in relief to families throughout the United States.

In mid-1935 the Roosevelt administration redesigned the federal government’s role in providing relief. It continued to provide work relief for unemployed persons who were employable in the Works Progress Administration but returned much of the responsibility for direct relief of “unemployables” to state and local governments. Applicants for aid were still certified by state and local officials, who continued to consider a family’s budget deficit when assessing its need for relief employment. The WPA then hired certified people and paid them a wage for a restricted number of hours each month. Dissatisfied with its lack of control over work relief under the FERA, the federal government administered WPA more centrally. Yet the WPA, like FERA, faced a mixture of pressures as administrators decided how to distribute spending across the nation. State and local governments lobbied for funds, and federal administrators appear to have paid attention to local economic distress and political necessities. Roosevelt saw all of these emergency relief programs as temporary. Even though some officials
wished to make them permanent features of the economy, the WPA was phased out by the end of 1942.\textsuperscript{18}

The relief grants were composed of an unusual mixture of transfer payments, work, and the building of public projects. They were more closely associated with the workhouses of the past than to the modern welfare state, although they operated on a dramatically larger scale. In 1933 the administration could simply have relied on making direct relief payments without a work requirement. At that time, however, the vast majority of Americans considered collecting government payments to be a badge of shame. The pre-Depression attitudes that the poor (but not disabled) were responsible for their own fate still held sway even as it became obvious that many hardworking people had lost their jobs. One of the harshest outcomes of the Depression was the loss of confidence among the populace, which learned that it was not enough to work hard to maintain a comfortable life. Long after the Depression ended, this loss of confidence continued to influence the choices and attitudes toward risk of the generations who lived through the era. The trade of work for relief payments was considered less shameful, although even then a number of people were hesitant to accept the government’s largesse. Harry Hopkins, the head of the FERA, the CWA, and later the WPA, preferred work relief, which “provided a man with something to do, put money in his pocket, and kept his self-respect.”\textsuperscript{19}

In the administration’s view the work relief programs were not revolutionary. They were explicitly designed so as not to go beyond the public sector into the private sector. The projects were traditional government projects such as building and maintaining public buildings, schools, parks, roads, and sanitation facilities. Production of manufactured goods, creation of stores, and other private-sector activities were off-limits. Further, the work relief pay was designed to be below-market wage rates to encourage workers to seek private employment. To combat fears that private jobs would end quickly, the WPA assured people that they would be accepted back on work relief if they lost their private job. Even so, a significant percentage of workers stayed on work relief jobs for periods as long as a year and in some cases several years.\textsuperscript{20}

As an alternative to work relief, the federal government (and state and local governments) might have funded public projects in the usual way, either directly hiring employees at market wages or contracting with construction firms that hired their workers in the private market. Hopkins and his aides appear to have rejected this alternative for several reasons. First, they wanted to provide relief as quickly as possible to a
large number of struggling households. Had the work relief funds been used to fund public projects in the usual way, the same budget would have directly helped fewer people and built fewer projects. Second, Roosevelt saw the work relief as temporary emergency funding. All the bills authorizing the funds had the word emergency in their titles, and these programs all ended when the Depression was over. Further, the people on work relief were still considered unemployed in the official statistics until they obtained private jobs. Although Roosevelt occasionally delighted in tweaking conservative big businessmen, he was sensitive to the traditional boundaries between private and public employment. He resisted many efforts by more socialistic advisers to see work relief as a permanent institution designed to help the unemployed. Instead, he proffered the public assistance and social insurance mechanisms established under the Social Security Act as his long-term legacy.21

The public works grants included expenditures by the Public Works Administration, the Public Buildings Administration (PBA), the Public Roads Administration (PRA), and the Tennessee Valley Authority (TVA). The PWA was established under the National Industrial Recovery Act of 1933, and the PBA and PRA were rearrangements of existing federal agencies that had offered grants to states and cities to build roads and federal structures outside Washington, DC. These grants were also used largely to employ workers, but the focus was less on hiring the unemployed than on building such large-scale forms of civil infrastructure as dams, roads, schools, and sanitation facilities. Consequently, the planning stages of the projects were longer and the labor policies were more like non-Depression norms. Public works projects paid substantially better wages than the relief projects, were freer to hire a broader class of skilled workers, and were required to hire only a proportion of people from the relief rolls. By the end of the 1930s, the PWA, the WPA, the PRA, and the PBA had been rolled into the Federal Works Agency (FWA). In 1942, the PWA and WPA had been terminated and the PBA and PRA’s duties were distributed to new agencies.22

How successful were the public works and relief programs at achieving their goals? On the surface they were wildly successful. The works programs marshaled resources that put millions of people to work during the worst and longest depression in American history. The WPA records at the National Archives are filled with box after box of personal letters to Roosevelt and Harry Hopkins thanking them for helping their families survive and get back on their feet. Many of the roads, buildings, post offices, and public works built by these agencies in every
county in America are still in place or renovated versions of the original projects bear their stamp.

On a more cynical level, the programs succeeded by helping Roosevelt and Democratic congressmen remain in office. In 1938 WPA administrator Harry Hopkins allegedly declared to friends that “we shall tax and tax and spend and spend and elect and elect.” Hopkins claimed that he had never made such a statement, but plenty of contemporaries considered it to be the underlying truth. Millions of Americans could claim that the Roosevelt administration had provided them with funds, a work relief job, or in-kind benefits during their time of need, a fact that was easily remembered on Election Day.23

There is another counterfactual standard against which these projects should be measured. How much better did the local economies perform in response to work relief and public works projects than they would have had the projects not been established? This is a more difficult question to answer because it involves trying to construct a hypothetical history of the era. It is a relevant question, however, when trying to assess the true impact of the projects and whether such projects might be effective in the future. The impact of public works and relief spending might have been mitigated by several factors. There was likely to be some “fiscal drag” to the extent that such spending led to higher incomes that generated more federal income taxes and greater consumption of goods on which excise taxes were charged. There is also the potential for “crowding out” of local activities. For example, local governments might have used federal funds to build projects that they had already planned to build in the near future. To obtain federal funds, state and local authorities often had to propose projects for federal funding. Thus, the New Deal funds might have moved the projects forward by one or two years as opposed to creating something that would never have been built. To some extent the public works and work relief opportunities might have forced private companies to pay higher wages to attract workers to new opportunities, which in turn would have retarded private employment. Certainly, there were complaints by private employers to the WPA that this was happening. Given the extremely high levels of unemployment, it might seem as if the federal projects would have simply soaked up the unemployed and thus such crowding out of private activity would not have been great. This is an empirical question that scholars are just now beginning to answer.24

In the past two decades, a number of economists have used the geographic variation in New Deal spending to measure the effect of the
New Deal programs. The results still tell a relatively optimistic story for public works and relief programs, although there may have been some crowding out of private activity. In the labor market the relief programs may have reduced employment in private industry. Studies of cross-sectional data that provide a snapshot of the country in a single year suggest that areas with greater relief employment did not see crowding out of private employment. But studies using panel data, which allow for variation both across geographic areas and over time, find some crowding out. At the state level, for every relief job created the private sector shed half of a private job; therefore, the net gain was half a job.

The relief jobs may have helped workers in ways that, oddly enough, caused the official measures of unemployment to rise. High unemployment rates often discourage workers from seeking work. These “discouraged” workers are not considered unemployed under standard definitions of unemployment, which require that someone be actively seeking work. Meanwhile, during the 1930s relief workers were treated as unemployed in the official statistics. As a result, when a relief job became available and was filled by a discouraged worker, the number of unemployed persons in the official statistics rose by one. Hence we see the odd result that the creation of an additional relief job could make the official unemployment statistics look worse during the 1930s.25

The impact of public works and relief programs extended well beyond the labor market. An added dollar of public works and relief spending in a U.S. county was associated with an increase in retail sales of roughly forty to fifty cents between 1933 and 1939. Given typical ratios of retail sales to income, this suggests that incomes in the county grew roughly eighty-five cents at the mean when a dollar was added to public works and relief spending. Counties with greater levels of such spending appeared to be more attractive to workers because these counties experienced more in-migration during the 1930s. Greater relief spending also reduced property crime rates in cities during the Depression.26

By putting resources into the hands of struggling families and by building public works that contributed to better public health, the relief and public works programs also may have staved off a potential rise in infant mortality rates during the 1930s. Improvements to public health in the early 1900s had led to sharp declines in infant mortality through the early 1930s, but in the heart of the Depression the decline stalled temporarily. Studies of the experience of black and white infants throughout the South and a panel of cities across the entire United States suggest that the relief and public works programs contributed to a decrease in infant mortality rates. In cities greater relief spending also reduced suicides,
homicides, and deaths due to diarrhea, infections, and parasites. The relief expenditures associated with preventing a death from these causes ranged from $840,000 to roughly $9 million in year 2000 dollars. This is approximately the value of life found in labor market studies and is a substantially smaller cost than the cost of many modern safety programs. Increases in relief spending also helped offset the sharp decline in the birth rate that occurred during the heart of the Depression.27

The Farm Programs

The situation for farmers in some ways may have been more dire than in cities and industries. An expansion of farms during World War I had followed a golden era of farm prices in the early 1900s. As the Europeans recovered from the war in the early 1920s, demand for American farm products declined, and the farm sector went through a difficult shakeout in the early 1920s. After a decade of troubles farmers were hit still harder by the Great Depression.

Since the Gilded Age farmers had been protesting their plight and seeking ways to limit output and raise prices. The large number of American farmers and the competition from foreign producers had combined to prevent the farmers from successfully combining forces to limit output. By the 1920s they had begun pressing the federal government to limit production. In 1927 and 1928 Congress passed versions of the McNary-Haugen bill designed to raise farm prices without supply controls, but each was vetoed by the president. In 1929 the federal government began experimenting in a small way with a program in which the Federal Farm Board purchased output from producers who limited production. The Roosevelt administration responded to farmers’ pleas during the First Hundred Days by establishing a series of measures that became the basis for the nation’s modern farm programs.28

The goal was to limit supply and thus raise the ratio of farm prices to nonfarm prices to levels seen during the golden era just prior to World War I. The centerpiece of the New Deal program was the rental and benefit program administered by the Agricultural Adjustment Administration (AAA). For a wide variety of farm products the AAA offered agreements to farmers that paid them to take land out of production. The funds for the program came from a tax on farm output at the location where it was first processed, for example, at the cotton gin for cotton. Farmers were not required to accept the agreements, but the AAA set attractive terms and actively marketed the programs through county agents and local boards of farmers. In the tobacco and cotton programs federal decision makers added a degree of coercion to the
system by levying heavy taxes on any production beyond designated limits. As a result, the sign-up rates ranged between 70 and 95 percent for most types of crops. In 1935 the program was nullified by the U.S. Supreme Court United States v. Butler on grounds that the processing tax used to finance the program was unconstitutional. Farm interests that had warmed to the AAA pressed the Roosevelt administration to enact a similar program that would overcome the constitutional objections. Soon thereafter, a new AAA was established that made payments to curtail land use, adjust production, and conserve the soil under the Soil Conservation and Domestic Allotment Act.29

Many farmers also benefited from a wide range of loan programs. The Commodity Credit Corporation (CCC) lent funds to farmers for crops in storage with terms that contributed to keeping prices high. When repayment time came, if crop prices exceeded the target level, the farmer would sell the crop on the market and repay the government loan. If crop prices were below the target, the farmer gave the crop to the government as payment of the loan. In the 1930s the CCC set the target prices above market prices, so the program operated as a price support program. The program has continued to the present day.

Farmers had long lobbied for federal intervention to provide cheaper and more adequate sources of credit. With the National Farm Loan Act of 1916 and the establishment of Federal Intermediate Credit Banks (FICBs) in 1923, the federal government had developed a farm credit system with two types of land banks: those that aided in mortgage lending and those that would purchase nine-month to three-year bank loans, which freed up more funds for the banks to expand lending for seed, provisions, and other short-term needs. By 1932 the land banks held about one-seventh of the total outstanding farm-mortgage debt, although the joint-stock land banks were liquidating because they had never generated sufficient capital to operate profitably. The intermediate credit banks had not succeeded in generating the amount of short-term credit desired by farmers. As the Hoover administration ended, the land bank system expanded its lending power. But the true boom in farm lending resulted when the Farm Credit Administration was created in 1933 to revamp and administer the entire farm credit system. Within two years the FCA programs had lent out more than had been lent in the prior sixteen years. Consequently, the federal government was involved in more than half of farm mortgages by the mid-1930s.30

The AAA and most loan programs were primarily oriented toward large farmers but also distributed smaller amounts of funds in programs
designed to eliminate areas of persistent rural poverty. The original FERA legislation called for aid to low-income farmers in the form of relief, the Resettlement Administration moved some farmers to better land, and loans and grants from other programs were provided to aid small family farms. These farm programs were later transferred to the Farm Security Administration when it was formed in 1937.31

Chapter 15 deals with the long-term effects of the farm programs. Observers of the short-term impact in mid-1930s were unsure whether the AAA’s practice of paying farmers to take land out of production was effective in raising prices. Several studies suggest that farmers took the lowest-quality land out of production first and then found ways to raise the productivity on other acreage by using more fertilizers and adopting new technologies (such as tractors) as labor-saving devices. Efforts to determine the AAA’s impact have been confounded because a series of major climatic disasters, including droughts in some areas, floods in others, and the Dust Bowl, coincided with the program’s introduction and also contributed to drops in production and higher prices.32

Given that the programs were voluntary, the AAA likely benefited the farmers who accepted the production agreements. But it might well have had an adverse effect on the incomes of farm laborers, tenants, and sharecroppers. The program was strongly oriented toward larger farms. Although sharecroppers and tenants were supposed to be eligible for AAA payments, in some areas they did not receive their full share and some were demoted to wage labor. Further, farmers receiving AAA payments were required to remove land from production, likely causing the demand for farm labor to fall and leading to lower incomes for farm workers. Recent studies of the impact of the AAA grants on retail sales growth and on net migration at the county level during the 1930s suggest that the gains to recipients of the grants were offset by losses to farm workers, croppers, and tenants. Greater payments did not lead to faster growth in general economic activity during the 1930s, and counties with more AAA spending tended to experience more net out-migration than other parts of the country. In the South, where, according to observers, the impact on low-income farmers was greatest, areas with higher AAA spending experienced higher infant mortality for both black and white families. The association was stronger for black families than for white ones.33

On the positive side, the AAA helped prevent recurrences of the Dust Bowl of the 1930s, in which high winds combined with drought and soil erosion to create enormous dust clouds that blew through areas of Kansas, Colorado, Oklahoma, and Texas. Inadequate efforts to
prevent soil erosion by the large numbers of small farmers who had first settled the area in the homesteading period helped create the problem. Each of the small farmers had little incentive to use methods to prevent soil erosion. Such efforts cut the amount of their production below a level that would allow them to farm profitably, while the benefits of their efforts would have accrued to their neighbors and not to them. The AAA, in particular the retooled Soil Conservation version in operation after 1935, encouraged the development of large farms and required farmers receiving benefits to use techniques that cut soil erosion. One sign that these changes were effective was that the same climactic conditions of strong winds and terrible droughts hit the region again in the 1970s, but no Dust Bowl developed.\textsuperscript{34}

The National Recovery Administration: A Misguided Experiment

Just as they offered programs to reorganize the farm sector, Roosevelt’s advisers sought to develop new institutions that would revive the industrial sector. Some saw the problem as lack of supply caused by “destructive” competition that had sent prices lower, driving many firms out of business and reducing surviving firms’ incentives to produce. Coal companies, farmers, and others in troubled sectors had lobbied Congress or protections from such competition during the 1920s. Meanwhile, the Roosevelt administration needed solutions for the demand-side problems that continued to haunt the economy. After all, higher prices meant that consumers would buy less. To counteract the price effect and stimulate purchasing, the Roosevelt administration followed in the footsteps of the Hoover administration and sought ways to keep wages high so that workers and consumers would have higher incomes. Realizing that high wages might contribute to unemployment, the administration sought to spread the work by reducing the number of hours worked per person. It was hoped that less exhausted workers would increase their hourly productivity, so that monthly earnings would not be reduced much.

This logic was the basis for the National Industrial Recovery Act (NIRA) of 1933. The act established the National Recovery Administration (NRA) to foster the development of “fair” codes of competition in the various industries. Industrialists, workers, and consumers in each industry met to establish rules for minimum prices, quality standards, and trade practices. The workers were to be protected by minimum wages, limits on hours, and rules related to working conditions. Section 7a of the NIRA established standard language for the codes that
gave workers the right to bargain collectively through the agent of their choice. Once approved by the NRA the codes were to be binding to all firms in the industry, even those not involved in the code-writing process.

It is quite clear in hindsight that creating the NRA was a disastrous policy. United States law had always banned cartels and price-fixing agreements in restraint of trade. Suddenly, the federal government was giving industry leaders antitrust exemptions as well as carte blanche to establish the basis for competition. Effective cartels require an enforcer because in the long run cartel arrangements tend to fall apart; each firm has an incentive to raise output and find ways to break their agreements by lowering prices and improving quality. To put it bluntly, the federal government had become the enforcer of cartel agreements in the majority of industries in America. Adam Smith’s observation that “people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance raise prices” seems to have held true for many of the NRA code negotiations (Smith 1937, 128). The codes in quite a few sectors were largely written by the leaders of trade associations in each industry with some influence by consumers because relatively few industries had a strong union presence. Many small firms complained that the codes favored the large firms that had been so influential in writing them. Cartel agreements do raise prices, but they do so by limiting output. Wholesale prices jumped 23 percent in two years although consumer prices were much slower to rise, and industrial production was still slow to recover.

The Roosevelt administration did want workers in the industries to share in the economic profits generated by the codes. It is unclear, however, that their wages rose enough to overcome the higher industrial prices they would pay. With regard to job sharing engendered by limits on hours, the NRA was just as likely (if not more) to contribute to unemployment as to solve it. Given that the Roosevelt administration tried so many policies simultaneously, it is difficult to isolate the impact of the NRA. Yet recent studies that perform policy simulations with and without the NRA suggest that the NRA might well have substantially slowed the recovery from the depths of the Depression.35

Even the businessmen who anticipated benefiting the most from the NRA restrictions were not uniformly satisfied. In industries with greater diversity among the participants, the process of writing the codes was often fraught with controversy, and many firms considered the codes illegitimate and thus felt free to violate them. Firms signaled that they
were following the codes by displaying the symbol of the NRA, a blue eagle, but town gossip suggested that a number of violators were displaying the symbol just as prominently. The Supreme Court struck down the NRA as unconstitutional in the *Schechter Poultry* case in 1935. Unlike the AAA, there was little support for reenacting the NRA, and the Roosevelt administration let it die.36

**The Geographic Distribution of Federal Funds: Promoting Relief, Recovery, and Reform, or Politics as Usual?**

From the beginning the New Deal was controversial. In a famous Fireside Chat, Roosevelt proclaimed that the New Deal would promote “relief, recovery, and reform.” Conservatives, critics, and big businessmen charged the New Dealers with the more cynical purpose of using government programs to build patronage and to “buy” voters to ensure the continuation of the Democrats’ hegemony over the federal government. Over the course of the past thirty-five years scholars have been examining these claims by closely examining the geographic distribution of New Deal funds. The variation in spending per person across the states is striking, ranging from highs for the decade of nearly $900 per person in the mountainous West to lows of roughly $100 per person in some southern regions. The United States is an economically diverse country and there was substantial regional variation in the extent of the downturn, so we might expect the spending figures to vary. Among the patterns that drew attention was the relatively small amount received by southern states, although southern per capita incomes were the lowest in the nation and some southern states experienced among the worst of the downturns.37

Many modern programs have explicit formulas that determine the distribution of spending via matching grants and specific counts. The inner workings of the emergency New Deal programs are more difficult to fathom. Explicit formulas for matching funds written into the FERA legislation were largely deemed unworkable after the first three months. Senate testimony from FERA administrators about the distribution of funds offers a long list of factors that were considered but little guidance as to the weights each factor was given. Similarly, the WPA matching requirements were routinely ignored, and the shares of funds provided by state and local governments varied widely.

Therefore, scholars of the New Deal have turned to statistical analysis of the geographic patterns. More than thirty years of study suggest that the funds were distributed in response to a complex mix of factors, although there is not full agreement about how much weight to give to
each factor. The rhetoric of the Roosevelt administration suggested that they were seeking to promote recovery, relief, and reform. Many studies, but not all, find evidence that the administration promoted recovery and relief by spending more in areas with higher unemployment and in areas where the economic downturn from 1929 to 1933 was more pronounced. Relatively few find signs of reform or redistribution of income because areas with more long-term poverty tended not to receive extra funds. Most programs required that state and local governments develop and help fund projects in order to obtain federal grants. Some areas received substantially less funding if leaders were leery of possible strings attached to New Deal largesse or because they did not press as aggressively for funding. Areas with more federally owned land tended to receive more funds as the administration sought to enhance the value of the federal lands.

Nearly every study finds that political considerations were important to the Roosevelt administration. More funds per capita were distributed in areas that were more likely to swing toward voting for Roosevelt and areas where high voter turnout suggested strong political interest. The administration appeared to be innovative in its use of radio to reach the public, and there is evidence that more funds were spent in areas where more families had radios. Some studies find that the administration might also have been rewarding districts that had long voted for the Democratic presidential candidate. Since Congress holds the purse strings, the distribution of New Deal funds was likely influenced by the congressional power structure. There is some evidence that members of important committees and congressional leaders were effective at helping their constituents obtain more New Deal funds.

The nation’s political leaders rarely talk about the overall distribution of the federal budget when promoting their solutions to problems. They instead describe how they develop specific programs to deal with each issue. Recent studies of specific programs suggest that the determinants of the geographic patterns were quite different from program to program. The New Deal seemed to offer something for everybody. The relief programs spent more in areas where the downturn was more problematic and also appeared to spend more in areas with lower incomes. Meanwhile, the large-scale farm programs appear to have been targeted mainly at aiding large farms, with smaller amounts devoted to helping small farmers and tenants.

Federal loan and mortgage insurance programs operated by the RFC, the HOLC, and the FHA, tended to be targeted at areas with higher incomes. To obtain loans the recipients had to have money to help ensure repayment. The administration worried that a record of substantial
loan defaults would lead the public to call a halt to existing loan programs and prevent the creation of future programs.

At the program level, there is evidence that political maneuvering played a role in determining the distribution of funds at the margin. But political success did not mean that the Roosevelt administration needed to focus strongly on cynically manipulating the elections by targeting spending on swing states. By operating the relief programs and spending money where the problems were greatest, the administration could do well in the upcoming elections by also doing good for those in trouble.

One of the central worries of handing out such large sums around the country was the potential for corruption. Many of these programs had to be set up from scratch in less than three months. The Civil Works Administration was set up in two weeks. The potential for skimming of funds was enormous, particularly given the past record of scandals at all level of governments. Roosevelt knew that for the New Deal to be a success, scandals had to be minimized, or else the result would be disaster for his administration. He would bear the blame while reaping little reward from petty corruption by others. Thus, mechanisms were established to try to limit corrupt activity. The relief programs, for example, included an investigations division charged with the task of examining the hundreds of boxes of complaints, investigating them more thoroughly, and then providing support to the Attorney General's office when prosecution was warranted. The investigations considered complaints ranging from charges that a local relief administrator had hired a relief worker for lawn work around her home to charging the governor of North Dakota with fraud. Cynics and critics of the New Deal might argue that the division was investigating everybody except Roosevelt's administrators. Yet the establishment of an investigative division as part of the basic structure of a program was certainly not common in state and local government structures at the time. Further, there is evidence that when the federal government exerted more control of programs, the programs were more likely to work toward the administration's stated goal. When the federal government exerted more control over how monies were distributed within states with the move from the FERA to the WPA, the distribution of funds within states became more carefully targeted at relief, recovery, and reform.38

Long-Term Legacies of the New Deal

By the end of World War II, many of the New Deal agencies—the emergency relief and public works programs, the RFC, and the NRA—
had been shut down. Yet the New Deal left a series of lasting legacies, in addition to the farm programs, that remain in place today. Under the Roosevelt administration’s aegis, workers’ collective bargaining rights were expanded, federal limits on wages and hours were instituted, financial markets were more strongly regulated, and the federal government became involved in an extensive public assistance and social insurance network.

**Labor Policy**

Although the NRA’s cartel-like features were not reenacted after the agency was eliminated, the Roosevelt administration sought to maintain its high-wage policies via legislation that reestablished the rules for union recognition and the passage of a minimum wage law. The National Labor Relations (Wagner) Act of 1935 reconstituted from section 7a of the NIRA the right of workers to bargain collectively via their own representatives. Prior to the 1930s public policy concerning unionization had focused on the “at will” doctrine. Either the employer or the worker could terminate the employment relationship. Thus, employers had the right to refuse to negotiate with union representatives and the right to refuse to recognize a union even in cases where the vast majority of workers had unionized. Under New Deal legislation workers had the right to hold elections to seek unionization status. When a majority of workers voted to accept union representation, the employer was required to recognize the union and enter into a collective bargaining agreement. In addition, employers could no longer establish company unions as alternatives to independent organizations. The National Labor Relations Board (NLRB) was established to oversee union elections and the collective bargaining process.

The New Deal policies dramatically changed the landscape of the workplace, and union organization expanded rapidly during the 1930s using a mixture of recognition strikes and union elections. In some cases before and during the 1930s, when the press for union recognition met staunch resistance from employers, strikes could turn violent. One of the benefits of the NLRB policies was to regularize the union recognition process, and the incidence of violent strikes has diminished sharply since.39

The Fair Labor Standards Act (FSLA) of 1938 established a federal role in setting a national minimum wage, overtime requirements, and child labor restrictions. During the Progressive Era, proponents of wage and hour limits for male workers had long been frustrated by
court decisions preventing limits on male labor contracts and by a federal structure in which states were considered responsible for labor issues. Under the New Deal federal responses became widespread. After the demise of the NRA, which had been struck down for delegating too much of Congress’s authority to private groups in setting the codes of competition, proponents of limits on wages and hours turned their attention to Congress. Supreme Court cases decided after the famous attempt by Roosevelt to pack the court gave reformers more confidence that national labor market policies would survive Court scrutiny.

The passage of the FLSA is a classic example of an interest group struggle in which a significant subset of employers joined with union leaders and reformers to impose limits on other employers. The proposed minimum wage was expected to raise the wages of low-wage workers, who tended to be younger, less skilled, black, and located in the South. High-wage employers who supported the legislation anticipated gains from imposing higher wages on competitors who had relied on low wages. They readily joined reformers and unions in calling for the end of the payment of “substandard” and “oppressive” wages. After the bill was first reported out of committee in July 1937 it went through many revisions before passage in 1938. A series of compromises made the bill more palatable to interests that had been on the fence, including elimination of regional differences in the minimum wage and limits on the authority of the administrative body. The pattern of votes on the various versions of the bill show that Democrats and legislators from areas with high-wage industries, more unionization, and more advocates of teenage workers voted for the FLSA. Meanwhile, those from areas with more retail trade and low wages tended to vote against it. Congressmen from agricultural areas were more likely to oppose the bill in anticipation that the exemption for agriculture might eventually be lifted. Many southern legislators actively opposed the FLSA because the South, a low-wage region, would be most heavily affected by the legislation. Yet they were not unanimously opposed. Hugo Black of Alabama was the Senate sponsor of the bill, and Claude Peppers of Florida and Lister Hill of Alabama were ardent supporters who worked to move the bill out of committee.

The FLSA imposed a national minimum wage, although agricultural workers, domestic workers, and employers not involved in interstate commerce were exempted from the act. The introduction of the minimum wage had its largest effects in the South. Some observers suggest that it was a key factor in an increase in southern wages that helped
close the gap in regional wages. An in-depth description of the law’s impact on two key southern industries, lumber and seamless hosiery, illustrates its other immediate effects, which are best illustrated by comparing the choices of southern firms, for which the minimum wage was higher than the prevailing wage, with those of firms in the North, where it was not. The seamless hosiery firms followed the classic predictions of economists. When northern firms were expanding employment, southern firms reduced employment, particularly for knitters in low-wage plants, as they shifted toward new mechanized production processes that reduced the need for labor.

The story in the lumber industry is more complex but still supports the standard predictions of economists. War-related government purchases of lumber fueled a large boom in lumber output. As a result, southern lumber firms actually increased employment after the introduction of the minimum wage, but output from higher-wage northern areas rose substantially faster. Southern employment likely would have risen less or declined except for three factors. The boom in demand led southern firms to begin cutting in forests where labor-saving devices were less effective, the majority of southern lumber firms actively avoided the law by dropping out of interstate commerce to become exempt from the FLSA, and others illegally paid less than the minimum.

The FLSA is a major legacy of the New Deal. The provision of time-and-a-half pay for overtime hours worked by hourly workers has become a major feature of employment arrangements. The minimum wage provisions have long been a source of controversy both among economists and in the public policy arena. Chapter 11 discusses the debates about the minimum wage in the postwar era.40

**Financial Regulations**

Roosevelt’s Bank Holiday and the RFC bank loans were temporary solutions to bank panics. The stock market crash and the vast array of problems in the banking and construction industries, however, led to pressures for more permanent solutions, including a wide variety of regulations and the development of new financial institutions that still exist today. The Securities and Exchange Commission (SEC) was established to monitor the stock markets, reporting requirements for firms issuing stock, and insider trading and to enforce rules governing market trades.

To preclude future bank runs on deposits, the Roosevelt administration established the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) to
provide federal government insurance of deposits up to a set limit. Small banks that were not members of the Federal Reserve System played an important role in promoting the FDIC and heavily influenced its initial rate structure. Banks paid the FDIC insurance rate on all deposits, but protection was given only to the first $5,000 in each account. This structure meant that larger banks with larger deposits were providing subsidies to the smaller banks.

Until the late 1970s, FDIC and FSLIC insurance were considered key factors in the absence of bank runs. The demise of savings and loans in the 1980s led to reexamination of the history of government deposit insurance, and people are more wary of the institution today. Studies of the state governments’ experiments with deposit insurance in the early 1900s suggest that the state programs often created more problems than they solved. The main problem was moral hazard. Knowing that their deposits were insured, bankers had incentives to make riskier loans, which in turn increased the likelihood of bank failures and government bailouts of the banks. For government deposit insurance to work well, the insurer had to monitor the quality of the banks’ loans and investments and raise insurance rates for banks that took riskier actions. Alternatively, the government as insurer had to impose limits on the banks’ actions before providing insurance. The FDIC and FSLIC appeared to be working well in preventing bank failures when financial institutions were tightly regulated through the late 1970s, but the savings and loan industry was experiencing declines in income and net worth that led to potential insolvencies that would have overwhelmed the FSLIC’s reserves. The savings and loans’ intense lobbying of the FSLIC and Congress postponed restructuring of the industry. In 1980 and 1982 banks, savings and loans, and other financial institutions successfully pressed for deregulation that would allow them more latitude in making loans and investments and in the interest payments they could offer depositors. Meanwhile, the account coverage limit was raised from $40,000 to $100,000. Ultimately, the combination of aggressive investment strategies by the savings and loans and insufficient discipline by the FSLIC led to a crisis that shook the industry.41

During the 1930s the problems faced by financial institutions were intimately linked with housing loans. In an attempt to provide liquidity to housing markets and enhance the quality of many banks’ loan portfolio, the Home Owners’ Loan Corporation was established. Between 1933 and 1936 HOLC funds were used to refinance more than $3 billion in mortgage loans already on the verge of foreclosure. In 1934 the
Federal Housing Administration was formed to offer federal insurance for mortgage loans both for new and existing homes and for repair and reconstruction. In 1938 the Federal National Mortgage Administration (Fannie Mae) began providing a secondary market for mortgage loans in which banks could sell the loans as assets and then use the funds to make new mortgages.

Both the HOLC and the FHA carefully vetted the loans that they refinanced and insured to avoid a large cascade of defaults. As a result, the programs were primarily targeted at people with higher income or who clearly were faced with only short-term difficulties. The long-term impact of the FHA and Fannie Mae was probably much greater than their short-term effects because they contributed to a permanent restructuring of mortgage lending. Prior to the 1930s most mortgage loans had been five-year loans on which the borrower paid interest during the life of the loan. At the end of the loan period the borrower repaid the entire principal or sought to roll the loan over for a new term. Borrowers typically could borrow only up to 50 percent of the value of their home. The New Deal housing programs chose loan structures that had been used for only a small share of loans in the 1920s. The length of the loans was extended to fifteen or twenty years (today they range up to thirty years) with lower down payment requirements and amortized repayment schedules in which the borrower made the same monthly payment over the term of the loan with no balloon at the end. It is possible that the changes in payment structures contributed to a reduction in defaults associated with the inability to pay balloon payments, and the programs may have increased liquidity in housing markets.

The Social Security Act of 1935:

Federal Social Insurance and Public Assistance

Roosevelt saw the FERA programs for direct relief and work relief as temporary emergency measures. When the New Deal emergency relief programs were revamped with new legislation in 1935, the federal government returned responsibility for unemployables to state and local governments and focused instead on using work relief in its emergency programs. Recognizing that the existing state and local relief meant that there was quite large variation in opportunities for direct relief and in the way it was organized, the administration sought to reorganize certain forms of state and local relief into a federal system that allowed states to operate their own programs within federal guidelines and with some funds from the federal government. The Aid to Dependent
Children (ADC), Aid to the Blind (AB), and Old-Age Assistance (OAA) programs essentially took over the roles played by the parallel state programs. Once all of the states had passed enabling legislation allowing them to join the system, the new federal-state combination insured that low-income persons in these categories had nationwide access to public assistance. The program, however, gave states latitude in setting benefit levels and some of the eligibility requirements for aid.

A similar state-level flexibility was established for unemployment insurance (UI) programs. Prior to the Depression, UI had met with the least success in state legislatures of any social insurance program proposed by the Progressives. Although they were liable for workplace accidents, employers under common law had never been liable for aiding their unemployed workers. Several studies have shown that, at the time, workers in industries that suffered from layoffs and unemployment generally received higher wages to compensate for this risk. Several states had rejected bills requiring compulsory unemployment insurance prior to the Depression, but the number of states considering unemployment compensation rose as unemployment soared. Roosevelt’s campaign promises had included unemployment insurance provided under state laws. By 1934, when the Social Security Act was being developed by the Committee on Economic Security (CES), only Wisconsin had adopted an unemployment insurance system. Several other states passed similar bills in 1935. Although the CES strongly considered a national bill, the long-standing precedent of state control over labor issues and fears that a system run exclusively by the national government might not survive constitutional scrutiny led them to choose a joint federal-state arrangement. The final Social Security Act established a basic structure for all state unemployment insurance programs. Employers pay a tax that goes into an unemployment reserve fund for each state that is managed by the national government. In enabling legislation the states established the benefits to be paid, the maximum benefit payment, eligibility requirements, and the maximum duration of unemployment.

One of the major features of U.S. unemployment insurance is experience rating. The states adopted a wide variety of experience rating systems, but the basic principle is the same. Employers who lay off a higher share of their workers and impose more burdens on the UI system are expected to pay higher taxes. In comparison with other unemployment systems around the world, experience rating is unique, but it is designed to solve the same moral hazard problems that arise under workers’ compensation, deposit insurance, and other forms of insurance. In a sense, the UI reserve fund is a common pool. In the absence of experience
rating, employers faced with a downturn in their business face extra
temptation to lay off workers rather than to continue paying wages to
underutilized workers and losing profits. Although they may have to pay
higher wage rates to compensate workers for the increased layoffs, by
dumping a disproportionate share of their workers into the UI system,
they force other employers to subsidize the higher wage rates. With ex-
perience rating the employer faces additional taxes when he lays off too
many workers and thus has less incentive to dump workers onto UI. In
fact, studies of UI that compare the experience rating systems in differ-
ent states and that compare northern states with Canada, which has no
experience rating, show that greater experience rating serves to reduce
seasonal unemployment fluctuations.\textsuperscript{42}

The basic UI system established under the Social Security Act has
been largely unchanged since the New Deal. In comparison with the
rest of the world, the U.S. system is unique in that the states offer a wide
variety of benefit levels, the unemployment taxes are experience-rated,
and there are limits on the duration of benefits. Had UI been adopted
at a later date, some argue, the system might have been a national one,
because a series of Supreme Court decisions and other national policies
have moved away from the long legacy of emphasis on state hegemony
over labor markets. But in some ways this idiosyncratic UI system may
have been beneficial in dealing with the shocks to the global economy.
A number of studies suggest that relatively low unemployment benefits,
limited duration of benefits, and experience rating have made unem-
ployment less attractive to workers in the United States than in Europe
and have given U.S. labor markets much more flexibility in responding
to downturns. The state systems may also have given the diverse regions
of the nation more flexibility in designing systems that better fit their
economies.

The centerpiece of the Social Security Act of 1935 was the establish-
ment of a federal old-age retirement system. There was a loose prece-
dent for the federal government's involvement in old-age pensions. The
Civil War disability pension had expanded its eligibility requirements so
broadly that the infirmities of old age were largely covered, so that a sub-
stantial share of the elderly in the North in the early 1900s were receiv-
ing federal military pensions. In 1925 a trust fund had been established
to pay an average bonus of $1,000 to World War I veterans in 1945. As
the Depression worsened, veterans began calling for early payment of
the bonus. Events surrounding a march on Washington in 1932 had cul-
minated in troops led by Douglas MacArthur destroying a tent encamp-
ment constructed by protesting veterans. Veterans continued to press
for payment after Roosevelt was elected, and Congress finally voted a payment over his veto in 1936. In the meantime pundits such as Francis Townsend were calling for substantial old-age pensions that proved popular among the American public. The popularity was somewhat surprising because the details called for about 40 percent of GDP to be distributed to the elderly. Huey Long’s press for “Share the Wealth” programs raised fears that he would siphon votes away from Roosevelt in the 1936 election. These were the proximate political causes, but there was a broad recognition that the share of elderly in the U.S. population was rising and was expected to continue to rise. Because the elderly were more likely to be infirm and less able to work, the pension program was seen as a means of keeping the elderly off of public assistance rolls.

In seeking to establish an old-age retirement program, the Roosevelt administration had two options: an insurance model or a social adequacy model. In the insurance model people would pay premiums into a retirement fund, which would be invested. When people retired they would receive benefits based on the accumulated monies in the retirement fund. The benefits from such a model would have tended to be relatively low given the proposed premiums to be paid. Some considered the benefits to be inadequate to offset poverty in old age and instead proposed that the government provide a subsidy to overcome what they considered society’s failure to provide enough income to adequately provide for old age.

Roosevelt himself demanded the insurance principles when the program was being considered because he was uncertain of the need for old-age pensions and worried about saddling future generations with a large debt load. The initial plan tried to split the difference, providing a subsidy for the elderly as of 1940 who had not had time to accumulate much in the funds and then making the transition to the insurance plan. By 1939 it became clear that splitting the difference would not work. The Social Security Act was amended to become a pay-as-you-go plan funded by taxes on earnings for wage and salary workers and the self-employed.43

Under a pay-as-you-go system the government collects taxes from current workers and pays benefits to the retirees, but no explicit contract ties the taxes paid during the person’s working life to the benefits received. When the taxes collected exceed the benefits paid, the government does “invest” the surplus in a trust fund. But the trust fund is composed of the government’s promises to itself to collect enough taxes to pay benefits to retirees at some future date.
Neither the tax rates nor the benefit rates have been set in stone. In 1940 workers and employers were each paying 1 percent of earnings for the old-age program, and the retirees received benefits equal to roughly one-fourth of the average earnings of those paying taxes. Because the ratio of retirees to workers was less than one per hundred, the system started with a surplus and the early retirees received payments that far surpassed their contributions to the system. Over the course of the past six decades tax rates and benefits have been restructured several times. Retirement benefits are now about 40 percent of average earnings for workers. Continued declines in the number of workers relative to retirees have led Social Security taxes to rise so that workers and employers each now pay rates of more than 5 percent. Because the retiree’s share of the population is expected to continue to rise, we can expect some mixture of Social Security tax increases, cuts in benefits, and restructuring of the program over the next few decades.

Conclusion

In 1933 the U.S. economy was in the heart of a horrendous depression. Hoover’s attempts to offset the economic decline barely retarded the slide into oblivion. Banks had been failing everywhere, and a new round of panics was just around the corner. Claiming that “We have nothing to fear but fear itself,” Roosevelt fearlessly plunged ahead. In his First Hundred Days Roosevelt, using both hands, threw just about every policy his advisers and Congress could think of at the emergency. You name it and the Roosevelt administration tried it: aid for the destitute and the unemployed, public works projects, bank holidays, loans, reorganizations of industry, farm programs (see table 13.1). Some programs ran at cross-purposes with others, worsening problems that the other programs were assigned to resolve.

There were so many changes and so many programs and so many problems that it is hard to sort out how successful the New Deal programs were at resolving these issues. It is quite clear that the U.S. government was a novice at macroeconomic policies because many fiscal and monetary policy moves appear inadequate in hindsight. Of course, even today there is substantial disagreement among leading economists about how effectively monetary and fiscal policy can influence real output. So we remain more advanced novices with some conflicting opinions about the experiences under our belt.

At the operational level many of the programs seem to have worked reasonably well. In a short time the Roosevelt administration established
<table>
<thead>
<tr>
<th>Agency or regulation</th>
<th>Enacted</th>
<th>Permanent or temporary</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Adjustment Administration</td>
<td>1933</td>
<td>permanent</td>
<td>Promoted higher farm prices through restrictions on output</td>
</tr>
<tr>
<td>Civil Works Administration</td>
<td>1933</td>
<td>temporary</td>
<td>Made grants for work relief jobs for public works and provided maintenance for public buildings and parks</td>
</tr>
<tr>
<td>Commodity Credit Corporation</td>
<td>1933</td>
<td>permanent</td>
<td>Provided loans that guaranteed minimum farm prices</td>
</tr>
<tr>
<td>Fair Labor Standards Act</td>
<td>1938</td>
<td>permanent</td>
<td>Established federal minimum wage and work hour restrictions for workers involved in interstate commerce</td>
</tr>
<tr>
<td>Farm Credit Administration</td>
<td>1933</td>
<td>permanent</td>
<td>Provided loans and grants to farmers to provide relief and better farming opportunities</td>
</tr>
<tr>
<td>Farm Security Administration</td>
<td>1937</td>
<td>temporary</td>
<td>Regulated interstate communications</td>
</tr>
<tr>
<td>Federal Communications Commission</td>
<td>1934</td>
<td>permanent</td>
<td>Insured interstate communications</td>
</tr>
<tr>
<td>Federal Deposit Insurance Corporation</td>
<td>1933</td>
<td>permanent</td>
<td>Provided grants for relief payments (direct and as work relief) to households with inadequate income</td>
</tr>
<tr>
<td>Federal Emergency Relief Administration</td>
<td>1933</td>
<td>temporary</td>
<td>Issued bonds to help finance farm mortgage and improvement loans</td>
</tr>
<tr>
<td>Federal Farm Mortgage Corporation</td>
<td>1933</td>
<td>permanent</td>
<td>Provided federal insurance for home mortgages</td>
</tr>
<tr>
<td>Federal Housing Administration</td>
<td>1934</td>
<td>permanent</td>
<td>Purchased FHA-insured mortgages to provide liquidity in banking markets</td>
</tr>
<tr>
<td>Federal National Mortgage Association</td>
<td>1938</td>
<td>permanent</td>
<td>Provided federal insurance of savings and loan deposits</td>
</tr>
<tr>
<td>Federal Savings and Loan Insurance Corporation</td>
<td>1934</td>
<td>permanent</td>
<td>Provided loan funds to aid banks in refinancing troubled mortgage loans</td>
</tr>
<tr>
<td>Home Owners Loan Corporation</td>
<td>1933</td>
<td>temporary</td>
<td>Monitored and adjudicated disputes over collective bargaining agreements</td>
</tr>
<tr>
<td>National Labor Relations Board</td>
<td>1935</td>
<td>permanent</td>
<td>Oversaw development of industrial competition codes</td>
</tr>
<tr>
<td>National Recovery Administration</td>
<td>1933</td>
<td>temporary</td>
<td>Provided grants for constructing federal government buildings</td>
</tr>
<tr>
<td>Public Buildings Administration</td>
<td>1932</td>
<td>permanent</td>
<td>Provided grants for building public highways</td>
</tr>
<tr>
<td>Public Roads Administration</td>
<td>1932</td>
<td>permanent</td>
<td>Provided grants and loans to build large-scale public works</td>
</tr>
</tbody>
</table>
Table 13.1 (Continued)

<table>
<thead>
<tr>
<th>Agency or regulation</th>
<th>Enacted</th>
<th>Permanent or temporary</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Works Administration, Housing Division</td>
<td>1933</td>
<td>temporary</td>
<td>Provided grants and loans for the building of public housing projects.</td>
</tr>
<tr>
<td>Reconstruction Finance Corporation</td>
<td>1932</td>
<td>temporary</td>
<td>Provided loans for banks, railroads, industry, local governments; served as backer for many New Deal programs.</td>
</tr>
<tr>
<td>Resettlement Administration</td>
<td>1935</td>
<td>temporary</td>
<td>Provided loans and grants to farmers to provide relief and better farming opportunities.</td>
</tr>
<tr>
<td>Rural Electrification Administration</td>
<td>1935</td>
<td>permanent</td>
<td>Provided loans to extend electricity service to rural areas and farmers.</td>
</tr>
<tr>
<td>Securities and Exchange Commission</td>
<td>1933</td>
<td>permanent</td>
<td>Regulated financial markets.</td>
</tr>
<tr>
<td>Social Security Administration, Aid to Dependent Children</td>
<td>1935</td>
<td>permanent</td>
<td>Gave federal and state funds to provide aid to children who lost parents.</td>
</tr>
<tr>
<td>Social Security Administration, Old-Age Assistance</td>
<td>1935</td>
<td>permanent</td>
<td>Provided federal and state aid to the blind.</td>
</tr>
<tr>
<td>Social Security Administration, Old-Age Pensions</td>
<td>1935</td>
<td>permanent</td>
<td>Provided federal and state relief funds for indigent seniors.</td>
</tr>
<tr>
<td>Tennessee Valley Authority</td>
<td>1933</td>
<td>permanent</td>
<td>Large-scale project building dams to create reservoirs and provide electric power.</td>
</tr>
<tr>
<td>U.S. Housing Administration</td>
<td>1937</td>
<td>permanent</td>
<td>Established loans for public housing projects.</td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>1935</td>
<td>permanent</td>
<td>Established state and federal insurance funds to provide benefits to unemployed workers.</td>
</tr>
<tr>
<td>Works Progress Administration</td>
<td>1935</td>
<td>temporary</td>
<td>Provided grants for work relief jobs on smaller-scale public projects.</td>
</tr>
</tbody>
</table>

Note: Temporary implies that program was ended after the Depression with no transfer of duties to other programs.

organizations designed to distribute funds to state and local governments and to millions of people. Given the difficulties of establishing any successful organization, some of the agencies were service operations miracles. A great many people directly benefited from work relief and the new federal-state public assistance programs. Huge numbers of roads, public buildings, and public works were constructed. Lives were saved by better public health programs. Banks stopped failing at
such a high rate. The unemployment rate lurched downward and GNP eventually returned to the peak of 1929, getting set to take off once the economy had pushed past the harsh economic realities of World War II.

Yet a simple relation of better times with the presence of the programs is not enough to effectively measure the impact of the policies. When we ask the counterfactual question of how the economy would have fared without the New Deal policies, the answer is more complex. At no time in American economic history has the economy failed to rebound and soar to new heights within a few years, so there is a natural expectation that a rebound would have occurred. Of course, the administration followed these policies because after four years of sharp decline, no end to the decline appeared in sight. The situation was so complex with so many things happening at once, it is hard to sort out the successes and failures. Talented and very intelligent scholars of the New Deal find plenty of room for disagreement about its short-term effects. Some have argued that the sheer volume of policies and changes in direction, along with anticipation that new policies might be adopted, created so much uncertainty that it retarded economic growth. Nearly every economist considers the cartel-like features of the National Recovery Administration to have been a misguided experiment that retarded the benefits of competition in markets. In the farm sector the new policies led to gains for farm owners but may well have harmed farm workers, tenants, and croppers. Studies that try to control for the fact that policies were put in place to counteract economic problems in a number of cases find that some of the New Deal programs made positive contributions, but their impact was not nearly as large as the surface comparisons suggest.  

The New Deal had tremendous long-range consequences for government in the American economy. The degree to which the role of government was ratcheted up during the peacetime “crisis” of the 1930s, was a central event that led Robert Higgs (1987) to develop his theories of the government ratchet effect. Higgs’s theory does not imply that there was no retrenchment of government activity. Work relief programs, the RFC, the HOLC, the NRA, and other temporary arrangements were phased out, but much of the New Deal legacy remains. The ratchet effect implies that after the crisis ends, the long-term expansion of the government’s role begins again, but at a new and higher base. By its end the New Deal had established a federal network of social insurance and public assistance programs, federal oversight and insurance of large parts of the financial industry, substantial changes in the rules under which labor markets operated, a whole network of programs in the
farm sector, and many more programs. Succeeding generations have tinkered with some of these roles. In response to the increasing sophistication of financial markets and institutions, financial regulation was scaled back during the late 1970s. Yet even in this area there have been few serious challenges to the idea that the government has some role in regulating these markets. The mere mention of elimination of social insurance and public assistance programs would be political suicide. The debates focus instead on better ways to make them work in a context where they have become a growing share of the national economy. The farm programs, which are the bane of market-oriented economists and a worldwide sticking point in trade negotiations, seem to have infinite lives. Despite an ever-shrinking farm sector and scandals about the wealth of those receiving farm subsidies, the politicians who come to office suggesting their demise often end up expanding the programs.

Only a very small percentage of the American public today participated in the pre–New Deal economy, and for this group the experience of the Depression forever influenced their views of the role of government. Given that nearly all Americans have spent a lifetime with the long-standing New Deal institutions, it is unlikely that they will be eliminated lightly. Even the many critics of specific policies recognize that the debate is hardly ever devoted to eliminating the New Deal programs. The discussion instead focuses on how to make these programs work better in a mixed economy.

Notes

2. See chapter 5.
3. For discussions of long cycles see Schumpeter 1939. Scholars who emphasize declines in investment and consumption include Field (1992) and Gordon (1974), while Romer (1990) and Temin (1976) emphasize the sharp declines in consumption. See Cole and Ohanian 1999, Bordo, Erceg, and Evans 2000, and Chari, Kehoe, and McGratton 2003 for assessments of the impact of monetary policy shocks, fiscal policy shocks, and technology shocks as determinants of the path of macroeconomic activity. Their models predict the drop in income from 1929 to 1933 well but predict a much more rapid recovery than actually occurred. For recent efforts to explain the slow recovery, see Cole and Ohanian 2004, Harrison and Weder 2003, and Romer 1992.

6. For the Austrian view, see Rothbard 2000. The statistical study of Federal Reserve policy in the 1920s and 1930s was performed by Wheelock (1992).

7. Barry Eichengreen (1992) is a leading proponent of the view that remaining on the gold standard was a problem for the United States and a series of other countries. See also Temin and Wigmore 1990.


9. This description is based on Friedman and Schwartz 1963. For a view that puts less emphasis on the Fed’s role, see Romer 1992.

10. Barber (1996, 52, 83–84) discusses the relation between Keynes and Roosevelt. He also offers extensive discussions of the economic thinking of policymakers in the Roosevelt administration. The quotation is from Keynes 1964, 383.


12. Learning the extent to which fiscal policy is stimulative involves more complex calculations than the ones described here. See Brown (1956) and Peppers (1973), who find that the New Deal deficits were even less stimulative than the raw numbers shown here suggest. In fact, Peppers argues that Hoover was following more stimulative fiscal policies than was Roosevelt. The discussion of state and local government budgets in the chapter is based on their work as well.

13. For historical comparisons of the impact of tariff rates, see Irwin 1998. Kindleberger (1986, 170) and Atack and Passell (1994, 602) describe the international trade developments of the 1930s.

14. The descriptions in this section are based on Olson 1988 and Jones 1939, 1951. Jones was the director of the RFC.

15. The discussion of the RFC’s impact on railroad investments is based on Mason and Schiffman 2004. The impact of the RFC on bank failures is discussed in Mason 2001.

16. The federal government had established programs for disability payments to military veterans, workers’ compensation for federal employees, and retirement pensions for federal workers. See chapter 12 in this volume. For discussion of the RFC relief loans see Jones 1951, 178.

17. Another New Deal relief program was the popular Civilian Conservation Corps, which provided short-term jobs to youths who moved to camps where they worked to conserve natural resources and returned a portion of earnings to their families.

18. The best description of the operation of the WPA is found in Howard 1943. A large number of statistical studies describe the distribution of the New Deal relief funds, including most recently Fleck 1999a, 1999b, and 2001a, Stromberg 2004, and Fishback, Kantor, and Wallis 2003, which summarizes the results of many studies of all New Deal programs. After 1935 the federal
government did not completely stop providing direct relief to “unemployables” because the Social Security Act of 1935 introduced joint state-federal versions of some earlier state programs such as old-age assistance, aid to dependent children (replacing mothers’ pensions), and aid to the blind.


21. In fact, Hopkins succeeded in obtaining a substantially larger share of the total public works and relief budgets in part because he pleased Roosevelt by helping so many people much more quickly than Harold Ickes had with the PWA monies. In part Hopkins did this by breaking large projects that might have been built by the PWA into subprojects (Schlesinger 1958, 283–96).


23. The Hopkins quotation is from McJimsey 1987, 124.

24. The cross-sectional studies of the relation between relief and employment were performed by Wallis and Benjamin (1981) and Fleck (1999b), and the panel study of employment across states across time was done by Wallis and Benjamin (1989).

25. Darby (1976) showed that the definition of relief workers as unemployed had significant implications for measures of unemployment in the 1930s, while Fleck (1999b) established the one-to-one relation between relief jobs and measured unemployment.

26. The retail sales and migration studies were performed by Fishback, Horrace, and Kantor (2005, 2006). The crime study is by Johnson, Kantor, and Fishback (2003).

27. The results for the mortality and birth measures can be found in Fishback, Haines, and Kantor (2001, forthcoming).

28. Libecap (1998, 188–99) describes the development of farm programs from 1870 to the present. For a long-term view of the farm programs see chapter 15.

29. United States v. Butler, 297 U.S. 1 (1936). For a detailed description of the first three years of the AAA, see Nourse et al. 1937. The AAA’s efforts to curtail hog and cotton production generated enormous controversy in 1933. The program required farmers to destroy six million pigs and plow under roughly ten million acres of cotton. An enormous outcry arose although most of the pigs were purchased by the Federal Surplus Relief Corporation and distributed to households on relief (Chandler 1970, pp. 218).

30. The paragraph is based on Halcrow 1953, 342–43.

31. For more discussion of this program, see Alston and Ferrie 1999.

32. For discussions of the impact of the AAA on crop output, see Libecap 1998, 193nn. Its effects on reducing problems with the Dust Bowl are discussed in Hansen and Libecap 2004.

34. The effects of the AAA on reducing problems with the Dust Bowl are discussed in Hansen and Libecap 2004.

35. Bellush (1975) offers a good administrative history of the NRA. Cole and Ohanian (2004) find that the high-wage policies and retrenchment in anti-trust action associated with the NRA and the Roosevelt administration’s post-NRA policies significantly slowed the recovery.

36. Alexander (1997) and Alexander and Libecap (2000) discuss the problems the industries had in establishing the codes of “fair” competition and the reasons why businesses did not press for a new NRA when it was declared unconstitutional. In A. L. A. Shechter Poultry Corp. v. United States, 295 U.S. 495 (1935), the Supreme Court struck down the National Industrial Recovery Act because Congress had delegated too much authority to the executive branch.


38. For discussions of corruption, see Fishback, Kantor, and Wallis 2006.

39. See Freeman 1998. The Norris-LaGuardia Act of 1932 had also smoothed the path for union recognition. During the Progressive Era a number of states had limited the use of antitrust laws to treat unions as illegal combinations in restraint of trade, prevented contracts in which workers pledged not to join unions (yellow-dog contracts), and limited the use of injunctions in labor disputes.

40. The political economy of the Fair Labor Standards Act is discussed in Seltzer 1995, 1997. See also Fleck 2002 for a discussion of political issues. Wright (1986) suggests that the minimum wage helped raise southern wages to levels closer to wages in the rest of the country.

41. White (1998) provides an excellent summary of the New Deal banking policies. The studies of state deposit insurance and problems in the banking industry were performed by Alston, Grove, and Wheelock (1994), Wheelock (1992), White (1983), Calomiris and White (2000), and Richardson and Chung (2003). White (1998) and Kane (1991) offer good descriptions of the problems with savings and loans. Another problem, known as adverse selection, also arises in the deposit insurance markets. When insurers cannot tell the difference between risky and safe bankers easily, setting of insurance rates can be difficult. Say a state offered deposit insurance at a rate based on the average probability of failure. If bankers were not required to purchase deposit insurance, the state insurance fund was likely to attract primarily bankers facing higher-than-average risk. Consequently, this adverse selection of bankers would lead to problems with the solvency of the fund. When states began offering deposit insurance, there was a potential problem in that riskier bankers might have been more likely to move into the state.

42. This discussion is based on work by Baicker, Goldin, and Katz (1998). For modern comparisons of labor markets and unemployment institutions across countries see Blau and Kahn 2002.

44. Higgs (1997) and Smiley (2002) have recently laid out the uncertainty argument.

References


Price Fishback


