

## **The New Deal (1933-1939)**

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### **Abstract**

Franklin Roosevelt's New Deal created the most dramatic peace-time expansion of government in American economic history. It established the basic structures for modern federal/state social welfare programs, farm programs, labor policies, regulations of many range of industries, and government insurance of deposits and mortgages. Roosevelt experimented with a cartel-like industrial policy that was declared unconstitutional by the Supreme Court. The emergency public works and relief programs built a large number of roads, dams, and other public works, and employed millions of the unemployed. Recent studies suggest that the impact of the New Deal varied greatly by program.

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When Franklin D. Roosevelt became president in March 1933, real output had fallen 30 percent from its 1929 peak and the unemployment rate exceeded 25 percent. Within his first hundred days in office Roosevelt and the Democratic Congress established an incredible array of programs, a virtual 'alphabet soup' of acronyms. More programs were added under the First New Deal until 1935 when the Supreme Court declared the National Recovery Administration's (NRA) codes of 'fair' competition for industry and the Agricultural Adjustment Administration (AAA) farm program unconstitutional. A Second New Deal re-established the farm program in the name of soil conservation, strengthened the role of unions in collective bargaining, and established the basic structure of most of America's current social insurance and public assistance programs.

After Roosevelt took office, the federal government, often in conjunction with state and local governments, built a huge number of roads, dams, sanitation facilities, schools, public housing projects, and other public works. The federal government expanded regulation of banking, finance, labor, and a host of other markets, insured and refinanced housing loans, and made extensive loans to numerous private and public entities. In the decades following the 1930s, several waves of historians have provided narratives and interpretations of the New Deal and introductions to their work can be found in collections edited by Dubofsky (1992), Braemen, Bremner and Brody (1975),

and Hamby (1969). The recent trends in New Deal studies include a series of studies by economists and economic historians (Fishback, et. al. 2007; Bordo, Goldin, and White (1998).

Searching for an over-arching theme for the programs is a daunting task. The doubling of annual federal spending between the Hoover and Roosevelt years tempts many to describe the New Deal as Keynesian expansionary policy. But the Roosevelt administration ran relatively small budget deficits, as federal tax collections also more than doubled. In a brief meeting and a letter to the *New York Times* Keynes had encouraged Roosevelt to follow an expansionary policy, but the levels of government spending and the small budget deficits pale in comparison with the fall in output to be counteracted (Barber, 1996; Brown, 1956; Peppers, 1973, Romer, 1992).

One goal appeared to have been to raise prices and wages, as each industry established cartel-like NRA codes that stifled price cutting, labor policies promoted unionization and high wages, and farm policies offered price guarantees while cutting output. Ultimately, Roosevelt and his advisors were pragmatists faced with terrible economic problems of nearly every kind. They established agencies and programs meant to try to solve nearly each and every one. At times the programs operated at cross-purposes. Higher farm and industry prices worsened the plight of the unemployed and other consumers. The pressure to raise wages exacerbated the unemployment problem, and the NRA codes limited output growth. The administration made constant adjustments in policies, creating a climate of uncertainty about the regulatory environment that left businesses wary of making new investments (Higgs, 1997).

## **New Deal Monetary, Banking, and International Policy**

Many economists argue that monetary policy contributed significantly to the harsh decline in the economy between 1929 and 1933. The Federal Reserve took seriously its international responsibilities in maintaining the gold standard and thus failed to respond sufficiently to three major waves of bank failures in a timely fashion. Many states had begun declaring 'holidays' that closed state banks to stave off bank runs. Roosevelt took office in the midst of the third wave of failures and declared a Bank Holiday that closed all national banks. Two-thirds of the banks were declared sound and reopened within the week. The troubled banks were reorganized and the Reconstruction Finance Corporation (RFC) subscribed to their new stock issues, reassuring the public about the solvency of the banking system (Smiley 2002, Mason 2001).

In 1933 Roosevelt also announced that the U.S. was leaving the gold standard, prohibited gold exports, and devalued the dollar to \$35 per ounce of gold. In response, the U.S. received a substantial flow of gold that stimulated the money supply and economic growth resumed. Japan, Britain, France, and several other leading nations experienced similar resummptions of economic growth when they broke free of their 'golden fetters' (Eichengreen, 1992; Temin, 1989; Temin and Wigmore, 1990). Gold inflows continued for the rest of the 1930s as Europe moved toward war. By choosing not to offset the gold in-flows, Roosevelt and the Federal Reserve allowed the money supply to expand (Romer, 1992). The Federal Reserve took a misstep, however, when it used its newly awarded control over reserve requirements to double them in three steps between 1935 and 1937. The goal was to prevent a potentially inflationary rise in lending by soaking up the substantial excess reserves that banks were holding at the time. The

banks responded by increasing their reserves and keeping the same cushion because they did not trust the Federal Reserve to provide adequate liquidity if a bank run occurred. The money supply fell and contributed to a sharp rise in unemployment and drop in real GDP in 1937-1938 ((Friedman and Schwartz, 1963; Romer 1992). There is some disagreement about the impact of the monetary policies. Real business cycle economists argue that monetary and investment changes played much smaller roles than productivity shocks and high-wage labor policies in accounting for the fluctuations during the 1930s (Chari, Kehoe, and McGratton, 2005).

The decision to leave the gold standard was accompanied by efforts to expand world trade beginning in 1934 with the Reciprocal Trade Agreement Act (RTA). The Smoot-Hawley Tariff Act of 1930 had helped touch off a series of protectionist responses by other countries that had caused total imports for a group of 75 countries to fall to one-third of their 1929 level. The RTA freed the Roosevelt administration to sign a series of tariff reduction agreements with Canada, several South American countries, Britain and key European trading partners. Consequently, American imports rose from a 20-year low in 1932-1933 to an all-time high by 1940 (Irwin, 1968; Kindleberger, 1986).

Meanwhile, the Banking (Glass-Steagall) Act of June 1933 enacted an additional set of banking policies. Despite the checkered history experienced by state deposit insurance programs (Calomiris and White, 2000), the act created the Federal Deposit Insurance Corporation (FDIC) to insure commercial bank deposits of up to \$10,000. Insurance for savings and loans followed within the year. The Banking Act also established regulations, eliminated in the late 1970s, that prevented commercial banks from investing more than 10 percent of their assets in stocks and paying interest on

deposits (Regulation Q). To increase the capital available for housing loans, the Home Owners' Loan Corporation (HOLC) provided funds to refinance troubled mortgages between 1933 and 1936, and the Federal Housing Administration (FHA) began offering insurance of mortgages and home improvement loans. Both agencies aided in the spread of the modern long-term, amortized mortgage loan that replaced short-term loans in which repayment of only interest over the course of the loan was followed by a balloon payment of the principal when it came due.

### **The Reconstruction Finance Corporation (RFC): New Deal Lender**

Established by Herbert Hoover, the RFC was an off-budget government corporation that maintained control of the funds repaid on its earlier loans. The RFC offered the Roosevelt administration flexibility because they could start funding programs without constantly seeking new appropriations from Congress. In consequence, the RFC became the lender during the starting phase of nearly every major New Deal grant and lending program. In addition, the RFC provided loans to large numbers of financial institutions of all types, railroads, farmers, and local governments (Olson, 1998). The RFC loans to private business met with mixed success. The liquidity loans to failing banks in 1932 had not prevented many bankruptcies because the RFC loans were given first priority over depositors and other lenders in case of failure; therefore, banks were prevented from selling their most liquid assets to meet depositor demands for cash. The RFC's purchases of preferred stock in banks reorganized after the Bank Holiday of 1933 exposed the RFC funds to more risk but led to more success at preventing failures (Mason, 2001). RFC lending to railroads succeeded in preventing

several railroad bankruptcies. However, the spared railroads continued to under-invest in maintenance and capital improvements. In contrast, railroads forced into bankruptcy had to make such investments to attract enough capital to reopen for business (Mason and Schiffman, 2004).

### **Emergency Relief and Public Works Programs**

Unprecedented unemployment rates ranging from 10 to 25 percent through the 1930s were the New Deal's greatest challenge. Prior to the New Deal, aid to the poor and labor policies had been the purview of state and local governments. Claiming unemployment to be a national emergency, Roosevelt and Congress raised the federal share of relief spending as high as 79 percent while nearly quadrupling relief spending even as unemployment rates fell by the mid-1930s. The Federal Emergency Relief Administration (FERA, 1933-35), the Civil Works Administration (CWA, winter of 1933-34), and the Works Progress Administration (WPA, 1935-1942) offered work relief jobs to households whose incomes fell below a target budget for necessities. The Civilian Conservation Corps (CCC) offered conservation jobs in the nation's hinterlands to youths whose earnings were shared with their parents. The FERA also handed out direct relief until 1935, when the responsibility for 'unemployables' was returned to state and local governments and the federal government began offering matching grants for public assistance for children, the blind, and the elderly.

Harry Hopkins, who headed the FERA, CWA, and the WPA, preferred work relief because it 'provided a man with something to do, put money in his pocket, and kept his self-respect.' (Adams, 1977, p. 53). To give people incentive to leave work relief for

private jobs, WPA monthly earnings averaged 40 to 50 percent of full-time private earnings, and the WPA assured people that they would be reaccepted should the private job end. 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 (Margo, 1993).

Roughly one-fourth of New Deal grant spending went to the Public Works Administration (PWA), Public Buildings Administration (PBA), the Public Roads Administration (PRA), and the Tennessee Valley Authority (TVA). The planning stages on these large-scale projects were longer, the wages were higher, and there was more freedom to hire already employed workers. The relief and public works programs grants were both designed to provide employment, build public projects, and stimulate the economy.

At one level the relief and public works programs were very successful. Millions of Americans obtained work relief jobs to tide them over and most of the original public works, many renovated since, are still in place today. To understand the true impact of the New Deal, areas with different amounts of spending need to be compared to get a sense of how their economies would have performed without the New Deal. In the past decade economists have been using the substantial variation in spending across local areas to make such comparisons while working to control for the feedbacks caused by administrators using New Deal programs to respond to economic problems. At the local level the benefits of the projects were likely to be stronger when the general share of goods produced for local consumption were higher, the projects hired the unemployed without crowding out private or state and local government employment, and when expansions did not raise incomes enough to generate federal income tax payments.

Although cross-sectional studies show little effect of relief jobs on private employment, analysis of panel data can control for unmeasured factors using the information across time for a cross-section of areas. The panel studies suggest that an additional relief job reduced private employment by up to half a job (Wallis and Benjamin, 1981 and 1989; Fleck 1999a; Neumann, Fishback, and Kantor 2006). A new relief job also raised ‘measured’ unemployment by one person because many discouraged workers, who had been out of the labor force and thus not counted as unemployed, were defined as re-entering the labor force as unemployed workers when they accepted relief jobs (Darby, 1976; Fleck 1999a).

The impact of public works and relief programs had more clearly beneficial effects on other measures of socio-economic welfare. Cross-sectional studies of U.S. counties suggest that an added dollar of public works and relief spending per person raised per capita income by roughly 85 cents and stimulated in-migration (Fishback, Horrace, and Kantor, 2005, 2006). Panel studies of more than 100 major cities between 1929 and 1940 show that increased relief spending stimulated birth rates, reduced property crime, and reduced infant deaths and deaths from suicide and several diseases. The relief costs per death prevented in today’s dollars are within the range of modern market values of life, and the costs are lower than the costs per death prevented of many modern safety programs (Fishback, Haines and Kantor, 2007; Johnson, Fishback, and Kantor, 2006).

## **Farm Programs**

To raise the incomes of farmers, who had struggled through over a decade of hard times, the New Deal established the structure of modern U.S. farm programs. The Agricultural Adjustment Administration (AAA) paid farmers to take land out of production. In 1935 in *United States v. Butler* the Supreme Court struck down the output processing tax that had originally funded the payments. The AAA payments were quickly reinstated (minus the processing tax) under the Soil Conservation and Domestic Allotment Act (1935). The Commodity Credit Corporation (CCC) insured that farmers were paid higher prices by making loans that could be repaid with the crop itself if market prices fell below a target price. The Farm Credit Administration (FCA) reorganized and expanded farm lending, ultimately becoming involved in more than half of all farm mortgages and a large share of production loans. Meanwhile, the Rural Electrification Administration (REA) provided subsidized loans to give farmers access to electricity, while the Farm Security Administration (FSA) developed programs to aid low-income farmers.

Efforts to determine the AAA's impact on limiting farm output have been confounded because a series of major climatic disasters in the 1930s served to cut output anyway. There is evidence that farmers stopped planting their least productive land and raised the inputs used on the remaining land. The AAA clearly aided large farmers but possibly at the expense of farm workers and tenants (Alston and Ferrie, 1999; Whatley, 1983). Cross-county studies show that increases in AAA payments in counties led to no increases in retail sales, were associated with higher infant mortality in the South, and stimulated net out-migration (Fishback, Horrace, and Kantor, 2005, 2006; Fishback, Haines, and Kantor, 2001; Alston and Ferrie, 1999; Whatley, 1983). On the positive

side, the AAA soil conservation programs encouraged a move to larger farms and practices that cut soil erosion, so that the Great Plains avoided a recurrence of the Dust Bowl when the same drought and wind conditions arose later (Hansen and Libecap, 2004).

### **The Political Economic Geography of New Deal Spending**

New Deal grant spending across states and counties varied enormously, as some western states received several times more per head than some southern states. Roosevelt in a radio 'Fireside Chat' vowed that the New Deal would promote 'Relief, Recovery, and Reform.' Critics argued that Roosevelt used the monies primarily to aid his re-election efforts. The distribution process for many programs was opaque, so New Deal scholars have turned to econometric analysis that simultaneously tests the importance of the stated motives and presidential politicking. Politicking was clearly part of the process in the distribution of total funds and at the program level. Nearly every study finds that more grants went to swing states and areas with higher political turnout, while some find rewards for loyal Democratic areas as well as districts represented by powerful Congressmen. The Roosevelt administration was innovative in targeting radio owners in their push to win elections (Wright, 1974; Wallis, 1998; Fleck, 1999b; Stromberg 2004; Couch and Shughart, 1998).

Winning elections required more than just manipulation of spending to hit specific political targets. The Roosevelt administration also enhanced its future re-election prospects by also following their stated aims. Many studies find evidence that the Roosevelt administration promoted recovery and relief by spending more in areas with

higher unemployment and larger declines in income from 1929 to 1933. Few find signs that the total spending was reform-oriented, but specific relief programs did target areas with long-term poverty. State governments influenced the distribution by the intensity of their lobbying and their spending in matching grant programs, while the presence of federal land in a state also drew substantial public works grants. Specific programs typically followed stated goals. There were so many programs that nearly everybody could find one that benefited them, ranging from relief for the unemployed and poor to loans and AAA grants for large farmers. The HOLC and FHA housing programs benefited carefully vetted home owners who were perceived as having lower risk of default (Fishback, Wallis, and Kantor 2003). There were constant charges of corruption, but the WPA actively battled corruption at the state and local level by establishing an internal investigative agency. When the federal government increased its control of the distribution of funds within states in the switch from the FERA to the WPA, the distribution of funds within states more closely mirrored the relief, recovery, and reform goals (Wallis, Fishback, and Kantor, 2006).

### **Industrial and Labor Policies**

To combat 'destructive competition,' low prices, and low wages, the National Recovery Administration (NRA) was created to allow industries to establish their own codes for minimum prices, quality standards, trade practices, and labor relations (Bellush, 1975). The NRA appeared to be sponsoring a series of industry cartels, as large firms tended to dominate the code-writing process in most industries. Wholesale prices jumped 23 percent in 2 years although consumer prices were much slower to rise. Simulations of

the economy with and without the NRA imply that it served to slow economic recovery (Cole and Ohanian, 2004). The internal problems of cartels were also present, as industries with diverse firms had trouble coming to agreement and a number of firms routinely violated the codes (Alexander and Libecap 2000). The NRA ended in 1935 when the Supreme Court declared it unconstitutional in the Schechter Poultry case, and few mourned its passing.

The National Labor Relations (Wagner) Act of 1935 expanded the right of workers to collective bargaining through their own representatives beyond the protections originally offered in the 1933 act that created the NRA. Employers were required to bargain with unions when a majority of workers voted for union representation, and employer-sponsored unions were banned. The National Labor Relations Board (NLRB) was established to oversee union elections and the collective bargaining process. As a result, unionization expanded rapidly through a mixture of strikes and elections. In the long run the NLRB policies regularized the union recognition and bargaining process and the incidence of violent strikes has diminished sharply since (Freeman, 1998).

The emphasis on raising wages continued when the Fair Labor Standards Act (FLSA) of 1938 set a national minimum wage, overtime requirements, and child labor restrictions. Workers in agriculture or not employed in interstate commerce were exempted. Congressional support for the act was centered in states outside the South with high wage industries, more unionization, and more advocates for teenage workers. As a result, the first minimum wage was binding only for low-wage industries in the South, where employers in some southern industries responded by reducing employment

and others switched to labor saving technologies or limited their business to intra-state commerce to avoid federal regulation (Seltzer 1995, 1997; Fleck 2004).

### **The Social Security Act of 1935**

The legislative centerpiece of the Second New Deal was the Social Security Act (SSA) of 1935, which established the modern structure of public assistance and social insurance programs. The public assistance grants set some federal guidelines and offered matching grants that gave the states latitude in setting benefits. The new Aid to Dependent Children (ADC), Aid to the Blind (AB), and Old-Age Assistance (OAA) programs replaced similar state programs in more than half of the states and provided coverage for the first time in the remaining states.

State unemployment insurance programs funded by employer contributions with administrative costs paid by the federal government were established as a long-term alternative to providing emergency work relief. The states retained control over benefits offered. Each designed their own experience-rating system that required employers who laid off more workers to pay higher premiums, a feature not commonly found in other country's unemployment insurance systems. The experience rating helped reduce seasonal unemployment fluctuations (Baicker, Goldin and Katz, 1998).

Social Security is most associated with the federal old-age retirement system. In the debates over social security, Roosevelt pressed for an actuarially sound system where the individual's retirement benefits were based purely on his and his employer's own contributions. He was not convinced the old-age pensions were necessary and sought to insure that future generations would not be saddled with the costs. Others pressed for a subsidized system that provided adequate payments to all who contributed. The plan

adopted in 1935 was a hybrid, but the inadequacies of the hybrid system had become apparent by 1939, and the current pay-as-you-go structure was created. A worker and his employer pay taxes into an administrative trust fund that pays benefits to current retirees and serves as a commitment by the federal government to collect enough taxes to pay the worker his own social security pension when he reaches retirement age. The initial taxes were one percent each for workers and employers and the initial benefits paid in 1940 were roughly 25 percent of the average earnings of workers contributing to the system. Average pension payments are now roughly 40 percent of the contributing workers' average earnings, and the increase in average life spans has caused rapid increases in the ratio of retirees to workers. In consequence, the tax rates have risen to over 5.3 percent each for worker and employer in 2000 with expectations that relative benefits will have to be cut or taxes raised in the future to sustain the system (Scheiber and Shoven, 1999).

## **Conclusion**

The New Deal was a response to the Great Depression, a major peace-time crisis sandwiched between two World Wars. All three crises contributed to short-run rapid expansions of the federal government. When each ended, the government's role retracted somewhat but never to the level that would likely have occurred without the crisis (Higgs, 1987). In the span of six years the Roosevelt administration built an incredible array of public works and established a series of regulations, government insurance, and public assistance programs that are still in place today. The New Deal arguably did more to expand the role of government in the United States than the more evolutionary changes that have occurred since the end of World War II.

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