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BOOM TO BUST: STORIES OF GOVERNMENT INTERVENTIONS IN THE AMERICAN ECONOMY

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The Civil War and the Industrial Revolution

When eleven slave states seceded in 1860-61, they left the federal government in the hands of the new Republican party. The Republicans were dedicated above all to ending slavery and preserving the Union, but many of them also advocated a revival of the Federalist and Whig system of national mercantilism, which sought to have the federal government shape economic development. While James Buchanan was still president, Congress (controlled by Republicans as southern Democratic states had seceded) enacted the protective Morrill tariff, a tax on imported goods that gave American products an advantage. Tariff rates became increasingly high as the Republicans controlled all of the government until 1875. Large-scale American industry grew up under this protection from foreign competition, and many small firms were able to survive because large ones felt less pressure to become more efficient. The vast Union war effort also fed industrial development.

Some small manufacturers, farmers, and consumers, especially in the South and West, would complain that the tariff exploited them for the sake of northeastern monopolists.

Congress also created a new banking system during the war, by the National Currency Act of 1863. This did not establish a fully central bank, but it did wipe out state bank notes and for the first time established a uniform national currency. The Union government also borrowed some $2 billion to finance the war, creating a huge capital market in bonds and a new class of financiers. In order to pay for war needs, Congress authorized $500 million in paper money not redeemable in gold or silver. These “greenbacks” were legal tender for all debts and contributed to a wartime inflation that raised prices by 80 percent. The Supreme Court in 1870 held that Congress could not make them legal tender, but then reversed itself in its next session. Farmers and debtors clamored for more inflationary paper-money currency issues, but Congress did not respond. By 1879 the greenbacks could be exchanged for gold at face value, and the late nineteenth century saw deflation as the value of money increased.

Congress also provided land grants and loans to several companies to build railroad lines to the Pacific, the Union Pacific and Central Pacific railroads linking up in 1869. Even more than the tariff and banking, railroads were accused of corrupting government by robbing the public for the enrichment of their politically connected promoters. Several state courts held that railroads were not genuinely “public” enterprises for which states could levy taxes and tried to repudiate bonds issued for their promotion. But the Supreme Court upheld that constitutionality of both state and federal railroad promotion. By the 1870s, public reaction to the excesses of internal-improvement schemes ended government railroad promotion. States then attempted to rein in the railroads, especially to protect local shippers from what they regarded as exploitative rates of foreign monopolies.

The Supreme Court struck down these acts as interfering with interstate commerce. This gave rise to the first federal regulatory agency, the Interstate Commerce Commission.

The Interstate Commerce Act (1887) was a futile attempt to promote competition in what was essentially a public utility. The act sought to provide lower rates where railroads had no competitors but forbade the railroads to limit competition where they did compete. It was also a constitutional anomaly, appearing to combine legislative, executive, and judicial powers. The federal courts thus kept it from setting rates, and it had little impact in the nineteenth century.

Congress also used the vast western public lands to promote homeownership in the Homestead Act of 1862.

Congress also used the vast western public lands to promote homeownership in the Homestead Act of 1862. Any loyal adult could receive 160 acres of public land if he settled on it for five years and improved it. A million and a half people acquired homes by this Act. The Morrill Land-Grant College Act gave federal land to the states to establish colleges, especially for agricultural and mechanic arts. In 1887 Congress began to provide cash grants rather than land, and in 1890 the Second Morrill Act began to attach conditions to the grants.

The Civil War also gave rise to the U.S. Department of Agriculture, the first client-oriented federal agency, though it was slow to expand its functions beyond data gathering and dissemination of information.

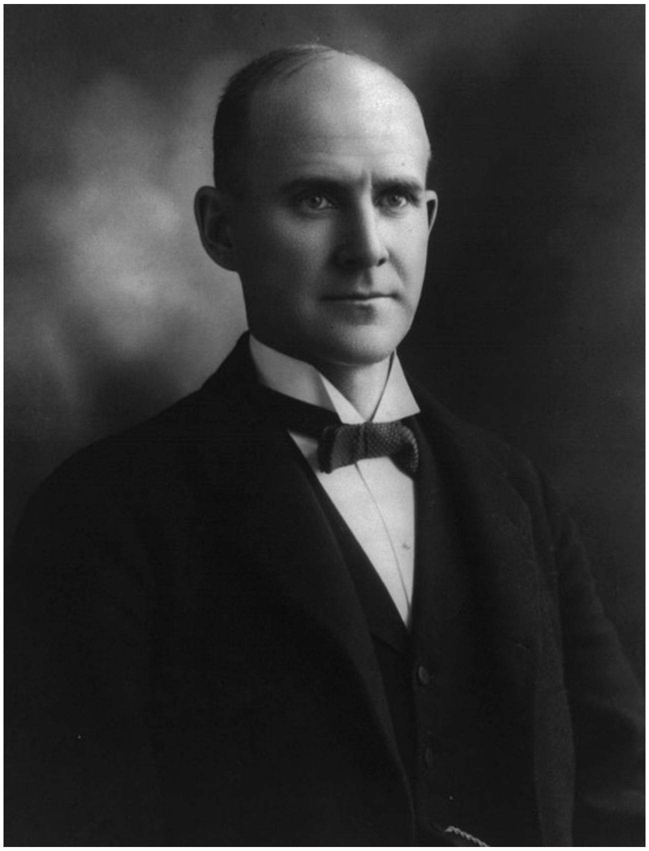
By 1890 the U.S. had become the world's leading industrial power, its industrial output now exceeding Great Britain. Fears that American industry had become too large and powerful dominated by "robber barons" led Congress to enact the Sherman Antitrust Act in 1890. Heretofore the state had power to control and limit the corporations that they had created, and some did break up industrial cartels (conspiracies among competitors not to compete). But they increasingly welcomed big business for the benefits that they provided in tax revenue, employment, and consumer welfare. Congress then made it illegal to engage in any "combination in restraint of interstate commerce."

The Supreme Court in 1895 insisted that corporate activity must be genuinely interstate and genuinely commerce—the activities of manufacturers within the states were not held subject to national regulation.

This effectively killed the antitrust act, and the U.S. economy experienced a great concentration of industry around the turn of the century, exemplified by the 1901 formation of U.S. Steel, the first billion-dollar corporation.

Labor unions were another popular response to the rise of big business. Labor organizations tried to form organizations of workers who would counter the great market power of employers—to agree to reduce output (hours) and raise prices (wages). Workers were too numerous to establish successful cartels and so resorted to strikes, which had the effect of eliminating competition from workers not in the union. State and federal courts countered the use of strikes by issuing injunctions—court orders to strikers to stop interfering with an employer carrying on his business. The most famous injunction was used against Eugene Debs in the Pullman strike of 1894 and upheld by the Supreme Court the following year. Unions also found themselves liable under the Sherman Antitrust Act.

As they entered the twentieth century unions would take action politically to escape these restrictions.



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Southern and western complaints about the post-Civil War political economy coalesced in the Populist party in southern and western states in the 1890s. A national "People's Party" was organized in 1891. The party demanded free trade, inflation by the coinage of silver, public ownership of railroads and telegraphs, and a progressive income tax. They denounced court injunctions against the power of labor organizations and the federal judiciary's protection of property rights—especially when the Court held the 1894 income tax unconstitutional. Nearly all of what would come about in twentieth century progressivism and modern liberalism can be found in the Populist demands. In 1896 the Democrats repudiated their incumbent President Grover Cleveland, who had defended the gold standard and broken the Pullman strike, and fused with the Populists. Their nominee, William Jennings Bryan, campaigned on the "free silver" issue, insisting that the federal government inflate the money supply by adopting an unlimited coinage of silver at a 16:1

ratio to gold. But William McKinley and the Republicans prevailed, and the U.S. adopted a purely gold standard in 1900.

The Constitution's protection of property rights facilitated the great industrialization and urbanization of the United States. For all of human history, labor-intensive agriculture meant that no more than about 5 percent of the population could make a living other than by farming. Industrial production reversed this; now less than 2 percent of the population can feed the other 98 percent. The great social effects of these revolutions particularly the rapid change from rural to urban life and the increasing economic inequality between farm and city and within cities, produced calls for government redress. Though the Populists were defeated by the Republican party at the end of the century, their concerns for marginal farmers and the urban poor would continue to shape calls for reform of the political economy in the twentieth century.

Andrew Carnegie and the Creation of U.S. Steel

Written by: John Steele Gordon, Independent Historian

Early in 1901, J. P. Morgan, the country's most powerful banker, merged Andrew Carnegie's Carnegie Steel Corporation with nine other steel companies to form the world's largest corporation. The United States Steel Corporation, usually known as U.S. Steel or simply Big Steel, was capitalized at $1.4 billion. To get a sense of how big a sum that was at the turn of the twentieth century, consider that the federal government that year spent only $517 million. The creation of U.S. Steel was the culmination of an era of American industrial consolidation that made many fear such corporations were becoming too powerful, financially and politically, and thereby threatened American democracy.

Morgan and Carnegie could hardly have come from more different backgrounds. Morgan had been born rich in Hartford, Connecticut, in 1837, the son of international banker J. S. Morgan and the grandson of the founder of Aetna Insurance Company. He was well educated, having attended the English High School in Boston and then University of Göttingen in Germany. He was fluent in French and German. By the 1870s, Morgan was a partner in the Wall Street firm of Drexel, Morgan and Company and acted as the New York agent for his father's bank, which was headquartered in London. On his father's death, he formed J. P. Morgan and Company.

Andrew Carnegie (Figure 9.28) had been born in 1835 in a one-room house in Dunfermline, Scotland, the son of a handloom weaver. But when the weaving of cloth was mechanized in the 1840s, the Carnegies became impoverished. Under the leadership of Carnegie's strong-willed mother, the family emigrated to Allegheny, Pennsylvania, in 1848, when Andrew was 13 years old. With his formal education, such as it was, at an end, he found work as a bobbin boy in a cotton mill, earning $1.20 for laboring 12 hours a day, six days a week.

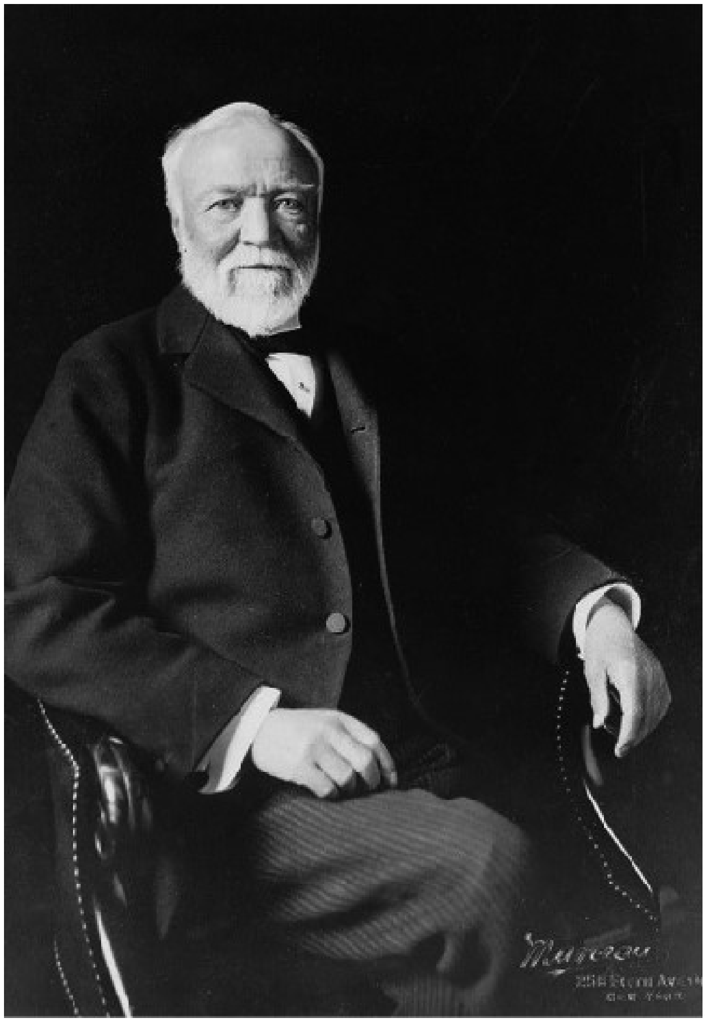


Figure 9.28Andrew Carnegie, pictured here in his later years, lived a true rags-to-riches story by transforming himself from a poor Scottish immigrant into one of the country's wealthiest men.

In 1849, Carnegie went to work at the Ohio Telegraph Company, earning $2.00 a week as a messenger boy. He soon mastered telegraphy, learning to "read" messages by ear, and was promoted to operator. There he met Colonel James Anderson, who let working boys borrow books from his personal library, a privilege Carnegie used to the full. He resolved that if he ever became rich, he would give other working boys the same opportunity.

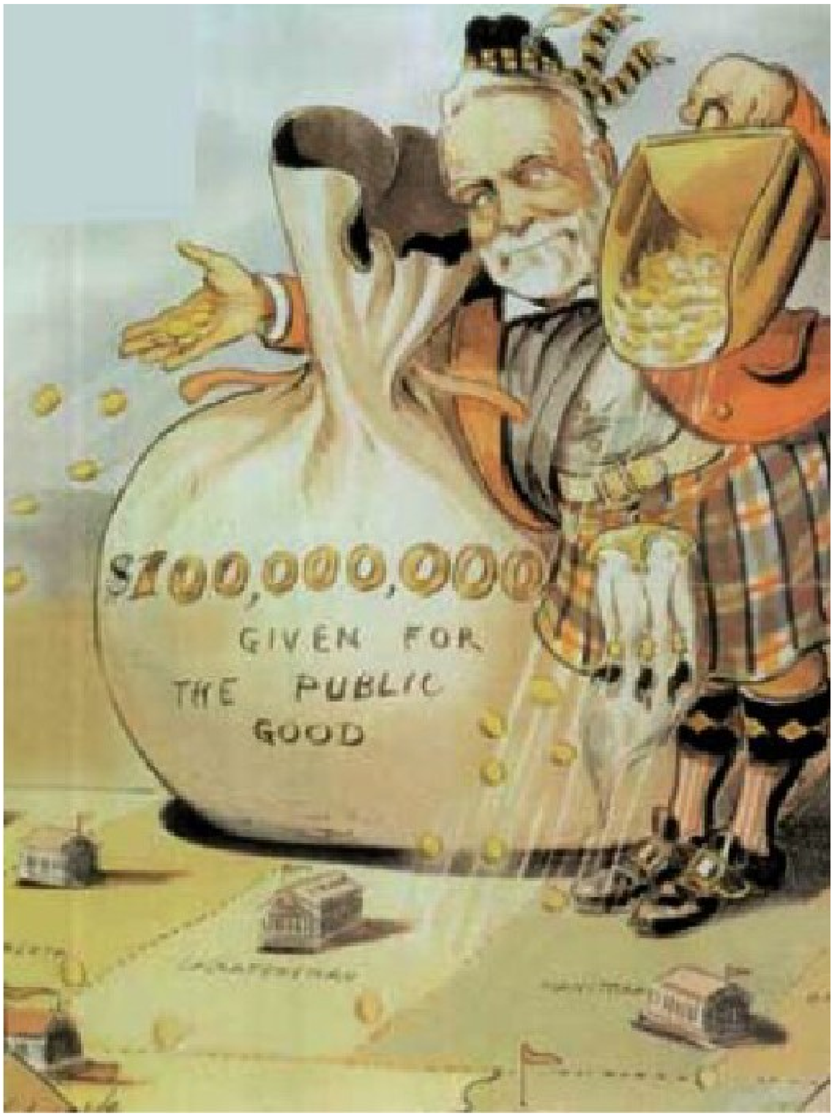
A tireless worker, Carnegie came to the attention of Thomas A. Scott of the Pennsylvania Railroad, who hired him as his personal telegrapher at $4.00 a week. By 1859, when he was 24 years old, Carnegie was put in charge of the Western Division of the railroad and was earning $1,500 a year, a middle-class income. Mentored by Scott, who helped him start investing, often in insider deals, Carnegie was a rich man by the end of the Civil War. He invested in iron works and saw potential in the future of steel.

Carnegie was right. Before the 1850s, steel could be made only in small batches and was so expensive that it was limited to specialized applications like sword blades and precision tools, despite being much more versatile and stronger than wrought iron. Then in 1857, the English engineer Henry Bessemer developed a way to make steel in large quantities at a fraction of the old price. Steel quickly began to replace wrought iron in such things as railroad rails and structural beams.

In 1860, the United States had produced only 13,000 tons of steel. In 1880, it produced 1,467,000 tons. Twenty years later, it produced 11,227,000 tons, more than England and Germany combined. By that time, steel was the measure of a country's industrial might, and Carnegie was primarily responsible for American strength in steel production. He left the employ of the Pennsylvania Railroad to devote himself full time to overseeing the production of iron and steel. But he was careful to maintain close relationships with Thomas Scott and J. Edgar Thomson, the railroad's president, and the railroad was soon his best customer. When Carnegie built his first steel mill, he named it after Thomson.

Carnegie's business philosophy was simple. He retained a large part of the profits earned in good times to tide him over and give him flexibility in bad times. He used those earnings to expand during depressions, when construction costs were low and competitors were forced to the wall and had to sell cheaply. Most importantly, he was open to constant technological and business innovation to reduce operating costs even by a little, because they had much more impact on profits than construction costs. The strategy was a great success. In addition, Carnegie Steel bought up its sources of raw materials and shipping (in a strategy called vertical integration) and bought out and absorbed its competitors (horizontal integration) to dominate the steel industry. By the 1890s, it was the largest and most profitable steel company in the world.

But Carnegie felt a keen sense of social responsibility, as recounted in an article he wrote called "The Gospel of Wealth." In it he argued that "the man who dies rich dies disgraced." As he approached his sixties, he wanted to spend less time making money and more time giving it away by dedicating himself to philanthropy (Figure 9.29).



Figur e9.29 Andrew Carnegie, depicted in this 1903 cartoon, believed that he and his fellow wealthy industrialists should use their surplus wealth to better society, rather than bequeathing it to their heirs.

The president of Carnegie Steel was Charles Schwab. In late 1900, a dinner in his honor was given in New York City and attended by many of the country's industrial and financial elite, including Morgan, who sat next to Schwab. A gifted public speaker, Schwab stood up after the dinner and extolled the strength and efficiency of the American steel industry. But, he argued, it could grow even larger and more powerful compared with its European rivals. A single company with the most efficient mills in the country could control the industry through economies of scale, advanced technology, and specialization. The resulting conglomerate, Schwab declared, would dominate the world's steel market.

Morgan had paid close attention to what Schwab said, and after the dinner, he took him aside to talk privately. Characteristically, Morgan decided to immediately pursue Schwab's vision. Both he and Schwab knew Carnegie's agreement was key to the deal.

Schwab went to see Carnegie at a cottage Carnegie maintained at St. Andrews Golf Course north of New York City, and over a game of golf, Carnegie agreed to sell U.S. Steel to Morgan for $492,000,000. When Carnegie shook hands with Morgan later, the latter said, "Congratulations on becoming the richest man in the world." Carnegie had come a long way from his first job as a bobbin boy making $1.20 a week.

Carnegie spent the last two decades of his life giving away 90 percent of his fortune. Beginning in 1880, he built more than 2,500 libraries in the United States, Canada, Britain, and elsewhere (Figure 9.30). The first, not surprisingly, was in his hometown of Dunfermline, Scotland. By the time of his death in 1919, about half the public libraries in the United States had been built by Andrew Carnegie.

Figure9.30Carnegie libraries, like this one in Littleton, New Hampshire, were built to fulfill Andrew Carnegie's sense of social responsibility and provide access to education for generations to come.

Carnegie also established the Carnegie Institute in Pittsburgh, which operates four museums in that city; the Carnegie Technical Schools, now part of Carnegie Mellon University in Pittsburgh; and Carnegie Hall for classical music performances in New York. His most generous gift, of $120 million, was given to establish the Carnegie Corporation of New York, one of the earliest and still one of the biggest philanthropic foundations in the United States.

Commerce and the Progressive Era

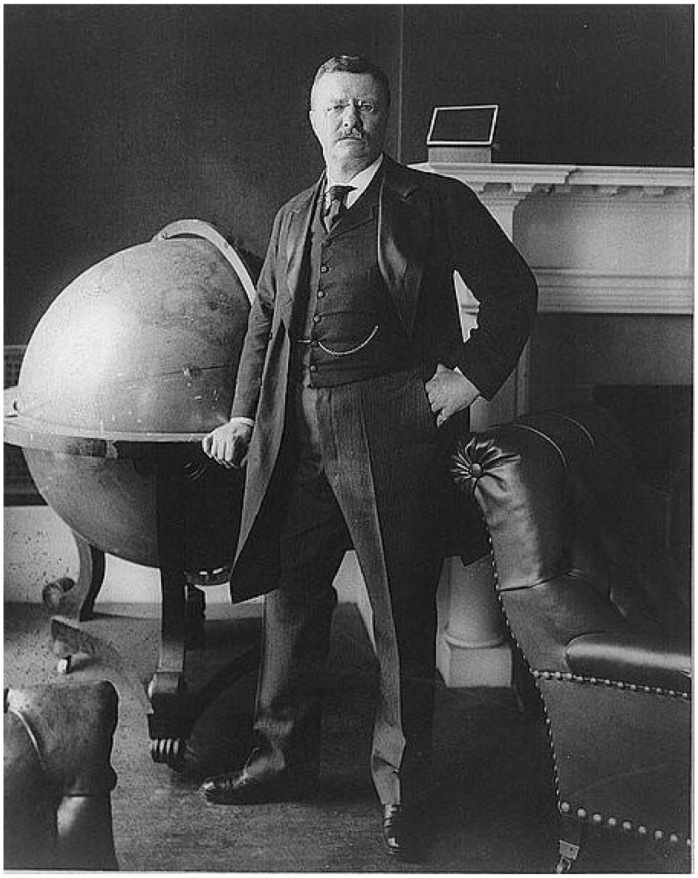
The twentieth century saw the rise of a widespread but not very clearly defined group of reformers known as the progressives. (In 1912 and 1924 some progressives organized national Progressive parties.) The basic belief that united them was that the industrialized, urbanized United States of the nineteenth century had outgrown its eighteenth-century Constitution. That Constitution did not give the government, especially the federal government, enough power to deal with unprecedented problems. Progressive political theorists argued that government must be regarded as a living organism; that it must evolve along with its environment or die. The progressives targeted big business, whose economic power allowed it to dominate politics, enabling it to gain special privileges (such as franchises, monopolies, tariffs) and to avoid regulation for the public good (such as health and safety regulations). They held that it was necessary to regulate the national economy to counter the influence of big business.

The first steps toward regulation came from Congress in the 1890s, which began to use its constitutional power to tax, spend, and regulate interstate commerce for purposes that lay beyond the Constitution.

In the aftermath of the 1894 Pullman strike, Congress tried to promote labor unions as a way to balance the economic power of the railroads. (The Supreme Court struck down the labor-relations provisions of this act in 1908.) Congress began to use the taxing power not to raise revenue but for regulatory purposes. At the behest of dairy farmers who wanted to drive a competing product, margarine, from the market, it laid a heavy tax on margarine. It then used the taxing power to stop the manufacture of dangerous phosphorous matches, and to control narcotics. It also acted to prohibit the interstate shipment of things that nearly everyone condemned—lottery tickets, diseased meat, other impure foods and drugs, and obscene literature (including information about abortion and contraceptives). In 1910 Congress made it a crime to transport women across state lines "for any immoral purpose." This law, the Mann "white slave act," was aimed primarily at commercial (and coercive) prostitution but was applied more often to consensual and non-commercial sexual immorality.

All of these acts amounted to what was called a "federal police power," regulating matters of public health,

safety, welfare and morals that had been traditionally left to the states.



Roosevelt was a moderately progressive president from 1901 to 1909 and would run as the head of an independent Progressive party in 1912.

Progressive political theorists placed greater hope in presidential than congressional action, and Theodore Roosevelt set the tone for the modern presidency. Roosevelt was a moderately progressive president from 1901 to 1909 and would run as the head of an independent Progressive party in 1912. In his view, the president could do anything that the Constitution did not expressly forbid. This alarmed the more conservative leadership of the Republican party, which had, like their Whig forebears, regarded the legislature as the predominant branch in a republican government. He thus intervened in a national coal strike in 1902, launched loud rhetorical attacks on big business, and was actively involved in shaping legislation. Above all, Roosevelt promoted the progressive idea that policy should be made by expert administrators, scientifically trained civil servants who would be above politics. This idea led to the creation of a Department of Labor and a Bureau of Corporations.

The federal judiciary lagged behind the other branches in embracing progressivism. Though it accepted most progressive legislation at both the federal and state levels, it continued to believe that the Constitution limited Congress to the exercise of enumerated powers, that most regulatory power (the "police power") belonged to the states, and the due process clause of the Fifth and Fourteenth Amendments protected fundamental rights from infringement. But it accepted as legitimate doubtful opinions that legislators offered—that margarine was a dangerous product, or that segregating the races was necessary to prevent race riots. A new generation of judges, educated in new law schools, brought a different jurisprudence into the twentieth century. Oliver Wendell Holmes, Roscoe Pound, and Louis D. Brandeis all embraced the idea of a "living Constitution," of law and a Constitution that would evolve in response to social and economic changes. The socialists among them saw law as simply a tool of the capitalist class and sought to turn it into a tool of the proletariat or working class.

Before the presidential election of 1912, Theodore Roosevelt formed an independent Progressive party because he considered his successor as president, William Howard Taft, as insufficiently progressive (though Taft considered himself a "progressive conservative"). This schism in the Republican party paved the way for the election of Woodrow Wilson, who had had a long career as a progressive political scientist and was also critical of the Constitution. Wilson's legislative agenda, known as the "New Freedom," included several pieces of economic regulation. He gave the U.S. the equivalent of a central bank in the Federal Reserve Act of 1913. This was a significant delegation of Congress' monetary powers and made the ensuing century one of marked inflation (the century prior to 1913 had been marked by deflation). Congress also established the Federal Trade Commission as a means of "regulating competition" to protect small businesses. Shortly after the Sixteenth Amendment authorizing the income tax was ratified, Congress enacted a "progressive" (higher rates on higher incomes) income tax. Wilson went further when he sought re-election in 1916, embracing measures that he had previously said were unconstitutional, such as loans to farmers and a prohibition of the interstate shipment of goods produced by child labor. He also got Congress to impose an eight-hour day for railroad workers at the behest of their unions, who then threatened a strike on the eve of American intervention in World War I.

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World War I brought about the greatest concentration of federal power and economic regulation in American history, far greater than that of the Civil War.

The top income tax rate rose from 7 to over 70 percent, and many more Americans paid income taxes. The Federal Reserve dutifully served the Treasury by keeping its borrowing costs low. The federal government took over the railroads and established a virtual command economy over industry and labor. It prescribed the eight-hour day, promoted collective bargaining, and controlled prices.

After the war came a popular reaction, a desire to return to what the new Republican President Warren G. Harding called "normalcy." Though usually depicted as a return to isolationism and laissez-faire, the supposedly pro-business 1920s did not repeal the preceding progressive era. The Republicans curtailed but maintained many progressive innovations, like the income tax and the Federal Reserve bank. They continued most of the prewar "grants-in-aid" programs, by which Congress got the states to pursue policies that were held to be beyond the federal government's power, such as building roads and schools and promoting maternal and child health, by proving matching funds for them. While the railroads were returned to private ownership, they were now a federally regulated public utility, and the government provided for the promotion of unions in the Railway Labor Act.

Prohibition (secured by the ratification of the Eighteenth Amendment in 1919) abolished in law one of the largest industries in the country and set the federal and state governments on course to the most ambitious effort by the federal government to police morals in American history.

Herbert Hoover was the most important progressive of the 1920s. He had been a supporter of Roosevelt's Progressive party in 1912. He initiated many campaigns to regulate the economy as Secretary of Commerce under Presidents Harding and Coolidge. Hoover endeavored to use the federal government to promote voluntary cooperation among American businesses, to eliminate wasteful, "cutthroat" competition, to establish industry standards, to promote fledgling industries like radio, and to save declining industries like coal. Hoover called this the "New Individualism," which would help America avoid laissez-faire capitalism and socialism or fascism. When the Great Depression began, shortly after his inauguration as president, Hoover took unprecedented steps to alleviate the crisis. The most significant of his measures against the depression was the Reconstruction Finance Corporation, which provided assistance to prevent the failure of banks and utilities—what would later be called "bailouts"—rather than letting the market liquidate failed enterprises. But Hoover was unwilling to use the power of government to impose direct controls on business, or to provide direct relief to the many unemployed.

In the years between the great depressions of 1893 and 1929, the federal government took its first steps to regulate the industrial economy that had grown up in the nineteenth century. These steps were guided by the ascending progressive political philosophy that saw the Founders' Constitution as outdated. Under Presidents Roosevelt and Wilson especially, Congress's power to tax, regulate commerce, and spend money was expanded in order to shape the American economy rather than allow it to shape itself. The period also saw the expansion of new "administrative" agencies, as they were called, neither executive nor congressional, and so insulated from popular electoral control, such as the Interstate Commerce Commission, the Federal Reserve Board, and the Federal Trade Commission. Most Americans remained reluctant to make fundamental changes in their political and economic systems and did so only under the duress of crises like the First World War. It would take the Great Depression of 1929 to make Americans accept a fuller variety of progressive reforms.

Point-Counterpoint: Did the New Deal End the Great Depression?

Issue on the Table

Did New Deal spending and programs succeed in restoring American capitalism during the Great Depression and should the government have spent more money to help the New Deal succeed, or did the New Deal spend unprecedented amounts of money on relief and recovery efforts but ultimately fail to stimulate a full economic recovery?

Claim A

Yes, the New Deal ended the Great Depression

By: Glenda Gilmore

When President Franklin Delano Roosevelt gave his inaugural address on March 4, 1933, America was in the midst of financial collapse. Banking holidays closed banks in twenty-eight states, and investors traded their dollars for gold to have tangible wealth. The president reassured Americans, "This great Nation will endure as it has endured and will revive and will prosper." He listed three goals to shore up capitalism through his New Deal: banking regulation, laws to curb speculation, and the establishment of a sound currency basis. From a wealthy New York family, Roosevelt shored up the financial sector through regulation to restore the public trust that mismanaged banks and financial speculators had destroyed. His New Deal gave the federal government regulatory responsibility to smooth economic downturns. Over the next eight years, the New Deal's economic practices and spending helped create recovery and restore capitalism.

By the time Roosevelt was inaugurated in the spring of 1933, almost 5,500 banks had failed, and, in many cases, their customers had lost their deposits and life savings. Therefore, Roosevelt's first task was to restore confidence in the banking system, and so, on March 6, he declared a four-day national bank holiday. While banks were closed, Congress quickly approved the Emergency Banking Relief Act to audit the financial viability of banks and provide emergency currency. When banks reopened, the federal government guaranteed that banks were safe, and deposits outnumbered withdrawals. The next month, FDR banned the use of gold for foreign exchange and increased its price in order to increase the U.S. gold supply and thereby cause inflation in a depressed economy suffering deflation. By June 1933, legislation required full disclosure for stock sales, and the Glass-Steagall Act separated consumer and investment banking to prevent bank speculation with consumer deposits. Congress created the Securities and Exchange Commission to regulate the stock market. These measures restored Americans' faith in the financial system.

However, Roosevelt had another goal: to put the nation back to work. When FDR took office, churches and city governments had run out of charity relief funds, and Congress had appropriated only $500 million in the Emergency Relief Act. Unemployment was 25 percent nationwide and even higher in most industrial cities. In 1933, Congress created the Federal Emergency Relief Administration, which spent $3.1 billion dollars putting 20 million people to work over the next two years. Congress also created the Civilian Conservation Corps, which, by 1935, employed 500,000 young men on public forestry projects and allotted their families $25 a month to stimulate the economy. Since 82 percent of Americans supported the program, it could have been expanded with even higher appropriations. Also in 1933, Congress passed the Public Works Administration as part of the National Industrial Recovery Act and spent $3.3 billion on public works infrastructure projects such as schools and hospitals. Federal funds spent on direct relief stipends and work programs increased personal spending to boost the economy.

By 1935, the financial system functioned more smoothly, but the economic situation remained dire. Production lagged. Unemployment had dropped from a high of 25 percent in 1933 to 22 percent. Personal income remained 20 percent below 1929 figures. So, in 1935, the Emergency Relief Appropriation Act created the Works Progress Administration (WPA). FDR wanted to end direct relief to able-bodied workers, and the WPA employed them at a cost of $4.88 billion. Ultimately, the federal government under the WPA employed 8.5 million, or one out of every three unemployed people, doing everything from building dams to writing tourist guides to planting trees. These programs seemed to work, and the depression lifted by early 1937. In the first quarter of that year, unemployment dipped to 14 percent, production was up 40 percent over 1934, and gross personal income grew by 30 percent.

Buoyed by these figures, Roosevelt honored his 1936 reelection promise to balance the budget and cut $2 billion from public employment programs. Simultaneously, the Federal Reserve required banks to increase gold investments to 50 percent of their currency reserves. The result was a tight money supply and cuts in government-funded employment that curbed consumer demand. Industrial activity dropped to 1934 levels, unemployment figures shot up to 20 percent, and the stock market lost one-third of its value. Critics called it the "Roosevelt Recession." Although Roosevelt and Congress responded by increasing federal spending in 1938 and secured $5 billion for public works and relief, unemployment remained high at 20 percent. He had made a strategic error.

Had New Deal spending continued through 1937 to fund economic growth, perhaps the nation would have been better equipped to mobilize against fascism in 1939. Battered by a decade of depression and the 1937 industrial downturn, the nation's military hardware was antiquated and scarce. In November 1938, Roosevelt demanded the building of "airplanes and lots of them," and in 1940, he secured $1.8 billion in new military spending. The military spending build-up helped defend Britain from German assaults and built the fighting force that enabled the United States to enter World War II. The wartime spending in the 1940s also finally ended the Great Depression.

Claim B

No, the New deal did not end the Great Depression

By: Michael E. Parrish

In the spring of 1934, encouraged by Harvard law professor Felix Frankfurter, President Roosevelt sat down in the White House for a chat with British economist John Maynard Keynes. Keynes had initially risen to celebrity after World War I with a devastating critique of the Versailles Treaty. In 1936 he would publish his General Theory of Employment, Interest and Money, the most influential work of economic analysis since Adam Smith's *An Inquiry into the Wealth of Nations* (1776). In the General Theory, with wit, bravado, and mind-numbing equations, Keynes sought to demolish the core assumptions of classical economics, which maintained a belief in a rational free market where supply and demand remained always self-correcting.

Since the stock market crash and the onset of the depression, Keynes and other British economists such as Roy Harrod had urged western governments to stop tinkering with monetary solutions and adopt an aggressive program of government spending, especially in the areas of public works and housing, to stimulate the economy during the depression. Keynes stressed these ideas in his session with FDR, who soon complained to labor secretary Frances Perkins: "He [Keynes] left a whole rigamarole of figures. He must be a mathematician rather than a political economist." Roosevelt's comments about Keynes open a window on one basic reason why the president's New Deal, despite unprecedented levels of federal spending, never achieved full economic recovery between 1933 and 1940. Although surrounded with key advisers such as Federal Reserve chairman Marriner Eccles, who understood Keynes and his central message about the importance of government spending, FDR did not grasp these ideas intellectually. He remained at heart a fiscal conservative, little different from Herbert Hoover. Roosevelt condoned government spending when necessary to "prime the pump" for recovery, combat hunger and destitution, but not as a deliberate tool of economic recovery.

Until the end of the decade, he remained an economic moralist who abhorred government deficits, not a convert to countercyclical Keynesian theory to spend more or cut taxes to stimulate the economy during a depression. Echoing Hoover, FDR had pledged during the campaign of 1932 to reduce government spending and the Economy Act of 1933 did just that. It trimmed salaries, merged departments, and cut non-disability payments to veterans. When Congress authorized $3.3 billion for public works projects in the National Industrial Recovery Act, the President wanted that sum eliminated and soon appointed the parsimonious interior secretary Harold Ickes to dole out the dollars. “Honest Harold” spent only $2.8 billion of the original appropriation. Soon displaying his fiscal conservatism again, Roosevelt wielded the veto pen when Congress insisted that veterans receive their World War I cash bonus.

On April 8, 1935, FDR signed the single largest expenditure in American history to that date, $4.8 billion in the Emergency Relief Appropriation Act, of which $1.4 billion would go directly to the new federal relief agency, the Works Progress Administration. Until its demise during the war, WPA spent over $11 billion and employed over 8 million Americans who built roads, hospitals, schools, and airports or performed plays, composed music and wrote oral histories. But the potential economic stimulus of this measure was offset by the Revenue Act of 1935, which raised the maximum personal income tax levy to 75 percent, and the Social Security Act, which soon imposed payroll taxes on working Americans and their employers. Tax reform, the regressive payroll tax, and a cut in work relief that Roosevelt endorsed finally sucked the air out of the economy and it tumbled back into a frightening recession in 1938. The stock market fell sharply, national income went down 13 percent, and federal relief rolls grew by 500 percent.

Faced with a Hoover-like crisis, FDR asked Congress for another $3 billion in spending for the WPA, PWA, and other programs in 1938, but this whipsaw from belt tightening to fiscal expansion only fomented greater uncertainty and confusion, especially among businessmen who remained reluctant to invest in new plants or equipment. By the end of 1939, unemployment remained around ten million persons. As one business leader stated: “Are we to have inflation or deflation, more government spending or less? Are new restrictions to be placed on capital, new limits on profits? It is impossible to even guess at the answers.”

Roosevelt’s fiscal caution and incoherence provides explanation for the New Deal’s failure to achieve recovery. To that can be added the president’s growing commitments to political and economic reforms, including taxation, labor relations, banking, and stock market regulations, which often left the business and financial leaders dazed, angry, and confused.

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Further Suggested Reading:

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