History 271
Devine

<u>Freedom from Fear: Franklin D. Roosevelt and the New Deal</u>

Four major problems Roosevelt has to address upon taking office:

1) a failing banking and financial system
2) unemployment
3) agricultural overproduction/prices of goods and wages for workers
4) a social safety net to protect Americans from future Depressions

In 1932, at the worst point of the Great Depression, Americans went to the polls to elect a President.

President Herbert Hoover, when elected four years before in 1928, was considered the most qualified man ever to run for the office. Even Franklin Roosevelt remarked at the time that no one would make a better President than Hoover.

Unfortunately for Hoover, the stock market crashed seven months after he took office and nearly four years of unrelenting hard economic times followed. Though not Hoover's fault, the Depression ruined Hoover's reputation and political career.

In November 1932, he lost in a landslide to Franklin D. Roosevelt.

Between November and inauguration day (March 4, 1933) the economy continued to slump. By March, it appeared the entire banking system was near collapse.

Fearful that banks would go under, many depositors had run on the banks to withdraw all of their money. Since the banks only kept a fraction of deposits on hand, they were unable to give depositors all of their money.

When depositors insisted on withdrawing their money all at once, banks did not have enough cash on hand to meet the demands, and some otherwise healthy banks had to close their doors.

Beyond that, when banks had to pay out their funds to depositors, they could not use this money to lend to people looking to borrow money to expand businesses, meet payrolls, and build new factories. As a result, credit became harder to get and many businesses suffered or even went bankrupt.

Hoover contacted President-elect Roosevelt and urged him to announce his support for Hoover's efforts to save the nation's **banking system.**

Roosevelt refused to commit himself and would say nothing in public. In the days leading up to his inauguration, however, he did allow his staffers to work with Hoover's Treasury Department staff to work out a plan.

When Roosevelt took the oath of office at noon on March 4th, the Hoover and Roosevelt people switched sides of the desk in the Treasury Department and continued working to save the system.

The plan to emerge had THREE PARTS to solve three major problems:

1) To restore public trust in the banks, the government established the Federal Deposit Insurance Corporation (FDIC) that would insure depositors' money up to $100,000.

   Thus reassured – and with some encouragement from Roosevelt himself in the form of a "fireside chat" broadcast on the radio – the people returned their money to the banks and the system stabilized.

   Government's insuring of deposits, however, might have motivated some unscrupulous bankers to make riskier loans or investments with depositors' money (since if they lost the money, the government – and not the bank – would make sure the depositors got their money back.)

2) To address the fact that banks had been using depositors' money to make overly risky investments, Roosevelt asked Congress to pass the Glass-Stegall Banking Act. The act separated savings (or commercial) banks from investment banks.

   Those who preferred to have their money invested conservatively – in government bonds, etc. – but accrue only a low rate of interest would deposit funds in savings banks.

   Those who had more disposable income and who were willing to invest in more risky (but higher yield) investments could put their funds into investment banks.

   The act enabled people to make more informed decisions about where they put their money and how much risk they were willing to take.

   The act also established more government oversight of banks' investment and lending policies thereby enabling people to feel more secure that their money would not be squandered by irresponsible or dishonest bankers.

3) To address unethical behavior on Wall Street, Congress created the Securities and Exchange Commission (SEC). This agency was charged with stopping "insider trading." It insured <u>transparency</u> – all investors would have access to the same information when they made a decision to purchase a stock; no one would have an unfair advantage because they received "inside information."

Those purchasing stocks would be well informed about a company's financial profile, potential earnings, recent history, budgets and expenditures, etc. since the SEC required all of this information be made available to the public.

The SEC also standardized accounting procedures so that potential investors could easily understand every company's financial report.

To head the agency, Roosevelt chose Joseph P. Kennedy one of the leading "insider traders" of the 1920s. He figured, correctly as it turned out, that a person who had so succeeded in "gaming" the system would be the best to oversee the new regulations and to insure that nobody was able to get around them.

****

After addressing the nation's financial security, Roosevelt turned his attention to the problem of **unemployment**, which was nearly 25% when he took office.

Roosevelt, a firm believer in the Protestant "work ethic" and a staunch opponent of "the dole" (cash grants to those who were not working), at first refused to consider giving direct cash grants to the unemployed.

After consulting his economic advisors, however, Roosevelt acknowledged that to revive the economy, consumer purchasing had to increase. The only way to achieve this was to get money into people's hands as quickly as possible so they could spend it and thus start the process of economic recovery. (Once demand for products goes up, factories begin to make more of a product which can lead to the hiring of more workers.)

Knowing that cash grants to the unemployed would be politically unpopular (most Americans, even during the Depression, opposed giving money to people who did not work for it) Roosevelt had to "sell" his plan to the people by using the metaphor of **"priming the pump."**

Most Americans – and particularly those who lived on farms and in small towns – understood that to get a pump working so it could extract water from the ground, one first had to add water to get the process started.

Roosevelt thus equated the initial cash grants with "priming the pump." Once the economy began to revive (when people began to use the money they received from the government to buy things), he would discontinue the "dole."

The agency that oversaw the distribution of cash to those in need was called the Federal Emergency Relief Administration (FERA). Roosevelt emphasized the "E" – *emergency* – so as to reassure Americans that such grants would not be routine and would end once the emergency of the Depression ended.

Next, Roosevelt backed public works programs.

Such programs included the building of infrastructure (roads, bridges, dams); the construction of federal government buildings (especially post offices); and the development and improvement of private and federally owned lands (irrigation projects, hiking trails in national parks, planting rows of trees to keep the top soil from blowing across the country during times of drought).

These projects had a far more significant economic impact that cash grants because they not only employed people who would work for the federal government but also people in the private sector.

Consider, for example, the variety of jobs created when a post office or dam is built. Contractors purchase building materials; they hire laborers and more specialized workers like electricians, plumbers, carpenters, etc.

Public works projects therefore stimulate the economy by creating demand for various materials and manufactured goods, employing workers, and even employing those who serve the workers' needs (the guy who runs a food truck catering to construction workers at lunchtime).

But who would pay for these programs?

Because so many people were unemployed and had no income, they were not paying income taxes. As a result, the government was taking in <u>less</u> revenue. There was not enough money in the treasury to pay for the various public works projects that Roosevelt was proposing. Yet, he believed, such programs would help get the country working again, restore income, and lead to economic expansion.

At this point, Roosevelt accepted the view of the British economist, John M. Keynes. Keynes believed that in times of economic hardship, while individuals cut back on spending and "tightened their belts," government should NOT do so. Rather, government should spend more money, even if meant that the government had to go into debt (that is, spend more than it was taking in).

Roosevelt justified "unbalancing" the budget (going into debt) by pointing out that the economic good produced by public works jobs would, in the long run, outweigh the short term problem of going into debt. He also noted that government borrowing would restore stability to the banking system – banks could make money again by charging interest on loans to the government.

To an extent, public works programs were successful. They not only put a lot of people back to work in the employ of the government, they also stimulated the private sector (particularly construction firms, plumbers, electricians, concrete companies, etc.) by giving them government contracts. The government paid for the materials while the companies paid the workers who did the work to fulfill the contract. Companies that received contracts began to turn a profit and then in turn hired more workers.

Over the course of his first term, Roosevelt saw the rate of unemployment slowly decline.

Still, the government would have to spend an incredible amount of money to bring the economy back to the prosperity of the 1920s. Roosevelt, still in many ways a fiscal conservative, remained worried about spending more money than the government was taking in.

After being re-elected in 1936, he decided to cut back on public work programs, hoping that the private sector could now recover on its own without "help" from the government. Many believe that this decision helped to precipitate another recession, since once again unemployment began to rise. Others claim that Roosevelt's attempts to regulate business too heavily was what caused the recession. Either way, the funding for pubic works was cut and the economic recovery stalled.

Public works, then, were only a partial success. The economy only recovered entirely when production for World War II began at the end of the 1930s. Most historians, though not all, maintain that it was World War II more than any other factor that brought about full economic recovery.

Only with the outbreak of World War II does unemployment decline to pre-Depression levels. Orders for war materials increases demand and creates jobs, thereby pulling the nation out of the Depression.

****

Roosevelt next turned his attention to the <u>**plight of the nation's farmers**</u>, who, as usual, were producing too much and, in doing so, were driving down the prices of their crops.

Initially, Roosevelt's advisors supported "dumping" excess American crops on European markets. Even if they had to sell their crops for a relatively low price, American farmers could still sell them and turn a profit.

This idea was problematic since such a policy would hurt European farmers who might then demand high tariffs be placed on all goods coming from the United States. This would hurt not only US farmers but also US manufacturers.

Instead, employing an innovative strategy, Roosevelt introduced a program, the Agricultural Adjustment Administration (AAA), that would pay farmers <u>**not**</u> to grow crops – to leave their fields fallow.

This, Roosevelt believed, would address two problems at once – farmers would <u>produce fewer crops</u> AND their <u>income would rise</u> due to the government subsidies. More importantly, producing fewer crops would lead to an increase in prices for those crops, enabling farmers to make more money.

Unfortunately, the AAA raised the price of food at the very time when consumers could least afford such an increase. Even if the farmers were doing better, they wouldn't be doing better for long if people could not afford to buy food. Also, farmers themselves grew staple crops and were not self-sufficient (they didn't grow all of their own food). They might get more for their cotton, wheat, or corn but this was offset by having to pay higher prices for food.

Also, when large landowners took advantage of the help offered by the AAA, often poor sharecroppers suffered as a result. When the landowners received subsidies for not growing crops on all of their land, they usually decided to evict the sharecroppers and not grow crops on the land these poor farmers had been cultivating. While the landowners received subsides for not using the land, the sharecroppers were often left with nothing (landowners generally failed to share the subsidies with their sharecroppers, even though they were expected to do so under the terms of the AAA).

Roosevelt understood the dilemma the AAA created because it raised food prices, so he sought to address the problem by creating the National Recovery Administration (NRA).

Under the NRA the government would set prices of nearly every commodity and manufactured good. By establishing a minimum price for all goods, this "managed competition" was intended to help businesses get back on their feet and to avoid cutthroat competition.

If you sold butchered chicken, for example, you could not charge **less** than a certain price per pound or you would be in violation of the law.

But, as a result, the NRA price codes RAISED prices (much as the AAA raised prices).

However, the NRA also included measures that would help to raise wages, which would address the problem of "underconsumption" (that is, workers being unable to afford to buy goods because their wages were too low.)

The government passed the first minimum wage law, which raised wages for those at the bottom of the socio-economic scale.

In theory, higher wages would help these workers. In fact, this was not always the case.

Businesses had for some time pursued a "high wage" policy. Employers preferred to hire skilled, efficient workers and pay them more. In doing so, they could more easily lay off unskilled, inefficient workers and save on labor costs. For example…

A company employs four workers at $1/hr. Two workers are more productive than the other two, so the company raises their hourly rate to $1.50 and fires the third and fourth workers. Labor costs in this instance went from $4 per hour (4 employees at $1 an hour per worker) to $3 per hour (2 employees at $1.50 an hour per worker). The employer expects the two productive employees to work harder now that they make more, so productivity increases (more goods are produced more quickly) as labor costs go down.

By requiring businesses to pay higher wages, the government precipitated an unintended consequence: unskilled, unproductive workers were more likely to be fired and, once unemployed, they found it much harder to find another job since employers, now paying higher wages, preferred to hire more productive workers.

The NRA also empowered labor unions. Employers whose workers unionized were now required to negotiate wages and job conditions with the union, not individual workers. With official recognition (backed by federal law), unions had more leverage in negotiations and could win workers higher wages and better benefits.

Ultimately, neither the AAA nor NRA achieved their intended purposes. In fact, the Supreme Court found the NRA unconstitutional in a 9-0 vote and the agency folded.

The Court held that the federal government in setting prices for goods and commodities overreached by trying to regulate <u>**intra**</u>state commerce (trade that goes on within the borders of a single state.) The federal government could regulate prices of goods that were bought and sold across state borders (<u>**inter**</u>state commerce) but federal regulation of prices within a state was unconstitutional.

FDR was furious at the Court and in his second term tried to expand the size of the Court by adding judges who might be more favorable to his New Deal programs. But this proved such an unpopular proposal with politicians from both parties (and the American people) that Roosevelt had to withdraw it.

In fact, given that the NRA was failing to achieve its stated purpose, it may have been for the best that it was ruled unconstitutional. Even so, the Supreme Court did not find either the minimum wage or the recognition of labor unions to be unconstitutional and so Roosevelt salvaged these two ideas and passed another law that kept them in effect.

****

Beyond addressing the <u>emergency conditions</u> that the Depression had created, Roosevelt also hoped to find <u>long term solutions</u> that would insure Americans some degree of financial security should another depression occur in the future.

Older Americans were most vulnerable to economic hard times. Retired workers relied on meager pensions, private charities, and the generosity of relatives to sustain them. Roosevelt wanted to create a “social safety net” for these people.

Simply giving them money would have been politically unpopular and also conflicted with Roosevelt’s hostility to “the dole.”

Roosevelt also knew that some future Congress might vote to end this program. He needed to implement a program that would have broad support and that could not be dismantled or cancelled.

Accordingly, Roosevelt set up a “social insurance” program – what we know as Social Security.

The government would withhold a certain percentage of each worker's paycheck and "save" it for them until they retired. This set up insured the permanence of the program.

In 1938, when the program began, life expectancy was far lower (65-66 years). As long as people did not live very long after retiring, the system would be financially viable. Current workers paying into the system would fund the social security payments to those who had retired. Today, when life expectancy is 78-79 years and when the baby boom generation is moving into retirement, the system is facing unforeseen challenges. There are more and more retired workers entitled to social security benefits and fewer workers paying into the system. None of this, of course, could have been foreseen in the 1930s.

Beyond social security, the New Deal also introduced unemployment insurance and disability payments for those who could not work.

Much like social security, unemployment insurance was not a "dole" or giveaway. Rather, employees and employers paid into a system from which the workers could draw should they lose their jobs.

At the time, some critics pointed out that social security and unemployment were taking money out of workers' pay checks at the very time when they needed more money. These new programs left workers with less money to spend at the very time the government wanted them to be spending so as to help revive the economy.

This was a valid criticism, but perhaps beside the point. Roosevelt was trying to handle all three "R"s at once – relief, recovery, and reform. The first two demanded short-term fixes – getting money into people's hands (relief) and getting them jobs so as to stimulate the economy (recovery).

The third "R," was more long-term. Knowing there could be another depression in the future, Roosevelt wanted to set up a permanent "safety net" that would prevent Americans from becoming destitute during hard times in the future. Social security and unemployment insurance were intended to achieve this purpose. Even though, in the short term, they might take some money out of workers' hands, in the long term, these workers could be made more secure if and when hard times returned.

In the final analysis, through all of the New Deal programs, Roosevelt sought to bring more stability to Americans' daily lives and to smooth the rough edges of capitalism (without challenging the basic premises or mechanisms of a capitalist economic system.) They were NOT intended to destroy capitalism, but rather to make it work for more people and to construct a "safety net" to save those who were not able to survive otherwise. Most of all, however, his reforms sought to provide Americans with a basic level of security – as he would say, "freedom from fear."