Freedom from Fear: Franklin D. Roosevelt and the New Deal

Four major problems Roosevelt has to address upon taking office:

1) a failing banking and financial system
2) unemployment
3) agricultural overproduction
4) prices of goods and wages for workers

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-Steagall 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 transparency – 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.

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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 economy recovery.

Knowing that cash grants to the unemployed would be politically unpopular, he 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, 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 – to as to reassure Americans that such grants would not be routine.

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.

Public works projects stimulate the economy by creating demand for various materials and manufactured goods, employing workers, and even employing those who serve the workers’ needs.

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Roosevelt next turned his attention to the plight of the nation’s farmers, 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 not to grow crops — to leave their fields fallow.

This, Roosevelt believed, would address two problems at once — farmers would produce fewer crops AND their income would rise due to the government subsidies.

Unfortunately, the AAA also 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.

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Roosevelt understood the dilemma the AAA created, 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. 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.

The NRA price codes RAISED prices (much as the AAA raised prices).

However, the NRA also included a measure 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.)

In theory, higher wages would help 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 three workers at $1/hr. Two workers are more productive than the third, so the company raises their hourly rate to $1.25 and fires the third worker. Labor costs in this instance went from $3/hr (3 employees at $1/hr per worker) to $2.50/hr (2 employees at $1.25/hr per worker). The employer expects the two productive employees to work harder now that they make more, so productivity increases 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.

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 intrastate 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 (interstate commerce) but federal regulation of prices within a state was unconstitutional.

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Beyond addressing the emergency conditions that the Depression had created, Roosevelt also hoped to find long term solutions 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 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.

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

All of these programs 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.) In short, Roosevelt’s reform measures sought to provide Americans “freedom from fear.”