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WHAT WE COULD HAVE LEARNED FROM THE NEW DEAL IN CONFRONTING THE RECENT GLOBAL RECESSION

JAN KREGEL

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Preface

To the extent that policymakers have learned anything at all from the Great Depression and the policy responses of the 1930s, the lessons appear to have been the wrong ones. In this public policy brief, Director of Research Jan Kregel explains why there is still a great deal we have to learn from the New Deal. He illuminates one of the New Deal's principal objectives—quelling the fear and uncertainty of mass unemployment—and the pragmatic, experimental process through which the tool for achieving this objective—directed government expenditure—came to be embraced.

In the search for a blueprint from the 1930s, Kregel suggests that too much attention has been paid to the measures deployed to shore up the banking system, and that the approaches underlying the emergency financial policy measures of the recent period and those of the 1930s were actually quite similar. The more meaningful divergence between the 1930s and the post-2008 policy response, he argues, can be uncovered by comparing the actions that were taken (or not taken, as the case may be) to address the real sector of the economy following the resolution of the respective financial crises.

In the context of outlining the evolution of the New Deal, Kregel focuses on a critical obstacle that had to be overcome for its eventual success: the fetishism of balanced budgets. He notes that the New Deal's public works policies and direct provision of paid employment, rather than being informed by a formal Keynesian theory of macroeconomic stabilization, were designed to support morale, provide relief from the suffering and uncertainty of unemployment, and serve as a bulwark against more interventionist alternatives. But the attempt to secure these objectives—to address the deep uncertainty in the domain of the real sector of the economy—collided with an orthodox commitment to rein in what were regarded as excessive fiscal deficits; a commitment, Kregel points out, that was just as much a part of the early New Deal. The resolution of this internal conflict, in his view, provides the essential, largely ignored lesson of the 1930s.

The contrast with the more recent crisis period and its aftermath is that no such conflict arose, in the United States or Europe, since the reduction of unemployment and poverty was never adopted as a direct policy target. Instead, Kregel observes, rescuing the financial system seems to have been regarded as necessary and sufficient for recovery of the real economy. In the eurozone, the commitment to austerity and its dire consequences are on full display. But even in the United States, after a brief but inadequate federal fiscal stimulus measure was passed in 2009—roughly cancelled out by austerity at the state and local level—the government settled into a fiscally conservative policy stance, with a degree of fiscal consolidation unprecedented among postwar US economic recoveries.

The Roosevelt administration experienced its own return to fiscal conservatism and balanced budget policies in 1937, and as Kregel recounts, Roosevelt himself was prone to comparing the federal budget to a constrained household budget. But the difference, Kregel emphasizes, is that this turn to austerity was recognized as a mistake and ultimately abandoned. Fiscal conservatism came to be regarded as incompatible with recovery of the real sector of the economy, and New Dealers set about trying to persuade Congress and the public of the need for an expansive role for fiscal policy.

In the aftermath of the 2008 crisis, not only have the forces of fiscal conservatism prevailed, the battle, as Kregel describes it, was never joined. It is a fight we still need to win in order to begin meaningfully addressing outright depression in the eurozone periphery and "secular stagnation" elsewhere. Whether the next major crisis is just over the horizon or further off, the question of how it will be handled should leave us deeply concerned. We can hope that policymakers look to the New Deal, and to the lessons highlighted here, for the way out.

As always, I welcome your comments.

Dimitri B. Papadimitriou, *President*
March 2016

Introduction

It has become common to refer to the policies introduced after the Great Depression of the 1930s as providing a template for what should have been done after the recent financial crisis. After all, the series of regulatory and policy decisions taken at that time in the areas of banking and finance laid the groundwork for a 20-year postwar expansion with stable prices and stable financial markets, while since the recent crisis financial markets have remained highly volatile, with recovery in real activity extremely slow and feeble. However, this view of the lessons of the 1930s focuses excessively on the success of the reform and regulation of the financial system and tends to overlook the most important lesson to be learned from the experience of the New Deal.

Roosevelt faced the same conundrum that is present in current policymaking. He espoused direct action by the government to alleviate the poverty and suffering caused by the Depression, while at the same time accepting fiscal conservatism as economic dogma. The real success of the New Deal was in recognizing that if the former were to be achieved, the latter would have to be abandoned. Today, as millions in Europe are cast into unemployment, poverty, and despair by the strict adherence to fiscal austerity, the experience of the New Deal provides a laboratory example of how to escape from this impasse. The forthcoming will thus differ from multiple previous dissections of the New Deal, as well as from recent attempts to relate it to the current crisis (see, for example, Desai 2011 or Shugart 2011). The aspects of the New Deal that I would like to highlight are the process by which Roosevelt went about getting the public "united in favor of planning the broad objectives of civilization," by which he meant supporting the well-being of the unemployed rather than supporting the financial system (Roosevelt 1932, 12).

As Frances Perkins noted, "when Franklin Roosevelt and his administration began their work in Washington in March 1933, the New Deal was not a plan with form and content. It was a happy phrase. . . . It made people feel better. . . . 'New deal' meant that the forgotten man, the little man, the man nobody knew much about, was going to be dealt better cards to play with" (Perkins 1946, 166). Once the objectives were accepted, the problem was to find the methods to achieve them. Roosevelt understood that, in his words,

> the country needs and, unless I mistake its temper, the country demands bold, persistent experimentation. It is common sense to take a method and try it: If it fails, admit it frankly and try another. But above all, try something. The millions who are in want will not stand by silently forever while the things to satisfy their needs are within easy reach. We need enthusiasm, imagination and the ability to face facts, even unpleasant ones, bravely. We need to correct by drastic means, if necessary, the faults in our economic system from which we now suffer. (Roosevelt 1932, 12)

It was this pragmatic approach that eventually led him to abandon the precepts of conservative fiscal policy, independently of Keynes's *General Theory*, and to the eventual recognition that the government's budget policy could be used to achieve the main New Deal objectives of providing relief and employment. This is the path that was not followed in the recent crisis and its aftermath. Instead, the overriding objective was to save the banks through Federal Reserve and government support, without departures from fiscally conservative policies. From the International Monetary Fund to the European Community to the US Congress, austerity continues to be the policy recommendation, despite the clear evidence that it is not the remedy for the "faults in our economic system from which we now suffer."

Two Crisis Responses

The collapse of the banking and financial systems in both crises and the measures taken to overcome them tend to dominate our attention. But this similarity is deceptive and leads to an undue emphasis on the misbehavior of the financial system as the proximate cause of the collapse of economic activity—and to the belief that by fixing the financial system the rest of the economy would eventually return to normal.

The March 1933 bank holiday that ushered in the newly elected Roosevelt administration came over three years after the September 1929 stock market break and a period of futile policy measures to counter the rising tide of unemployment and bank failures, as national income fell by more than half. Indeed, many note that profits and employment had been dropping—as a result of the tightening of Fed policy—well before the 1929 collapse of asset prices. After the exuberance of the roaring '20s postwar recovery, the stock market break and subsequent failure to stem rising unemployment over the following three years, culminating in the collapse of the financial system, created an aura of increasing helplessness and desperation; a failure of a liberal democratic solution. Citizens marching in support of what were considered to be successful policy responses by fascist and communist countries made the failure of traditional policies to reverse the crisis, and the resulting national closure of banks, more debilitating.

On the other hand, the recent crisis was almost the reverse of the 1930s events. It was the unforeseen and unexpected collapse of the housing and commodity market euphoria and the possibility of the financial failure of long-established institutions such as Citibank, AIG, and Merrill Lynch that inaugurated a disintegration of financial relations and confidence that quickly sent the real economy into a self-reinforcing downward spiral.

Nearly a decade after the collapse of the subprime loan market and the financial system, the real economy is still operating well below productive capacity at reduced growth rates that have become so pervasive as to be called the "new normal," with virtually no improvement in household incomes compared with the precrisis period. But it is the centrality of the banking crisis and the similarity of the policies employed to rescue the respective financial systems that blur our vision of the other causes of the disappointing economic performance—and thus of the lessons to be learned from the diverging policy responses of the two crisis periods.

Indeed, the emergency financial policy responses of the present crisis more or less followed the measures taken in the prior crisis, although with important differences in degree. The existence of New Deal measures such as deposit insurance, the larger size of government, and the associated automatic stabilizers provided by social security measures largely explain the absence of a classic bank run in the 2008 crisis and a decline in activity and employment that was far less steep than in the 1930s. It was the failure of government policy to reverse the recession that started in the late 1920s that acted as prelude to the bank holiday, while in 2008 it was a period of euphoria culminating in the collapse of the financial system that caused the sharp reversals in output and employment. In the 1930s, solving the banking crisis was a prerequisite to the promulgation of policies to deal with the continuing Depression, while in the recent period, solving the banking crisis was regarded as being necessary and sufficient for the rapid recovery of the system. Put simply, the problem to be faced in both periods was not financial, it was how to address the debilitated forces of domestic and global demand. Thus, the lessons that should have been learned, but were clearly ignored and forgotten, are to be found in comparing the policy responses deployed *after* resolving the respective financial crises.

The New Deal Confronts the Age of Uncertainty

Ira Katznelson (2013) provides an insightful interpretation of Roosevelt's objective in proposing a "New Deal" to the American people. Katznelson notes that what "observers and commentators" of the dilemma facing the incoming administration shared was

> an understanding that theirs was a time when uncommon uncertainty at a depth that generates fear had overtaken the degree of common risk that cannot be avoided. . . . When deep uncertainty looms, the ability to choose is transformed. . . . Measurable risk generates worry. Unmeasurable risk about the duration and magnitude of uncertainty spawns fear. . . . Under conditions of fear . . . people develop a heightened mindfulness and self-awareness about the constraints on free action, and take, as a central goal, the desire to restore a higher degree of coherence and certainty; that is, they try to reduce deep uncertainty to ordinary risk. (Katznelson 2013, 33)

New Dealers believed that Hoover's policies were based on the mistaken idea that the system would eventually return to normal, when the real problem was that the breakdown of the capitalist system was reproducing conditions of fundamental uncertainty. Roosevelt's New Deal was to take measures that would eliminate this deep uncertainty, what he called the "fear of fear." What had disappeared by 1933, and what was believed to be the major impediment to recovery, was the disappearance of conditions in which

> choices are made based on past experience. Because the properties of most things remain fairly constant, and because the relationship between cause and effect is mostly predictable, it is possible to assess probabilities intelligently. When firms invest, when parents decide which school to select for their children, when individuals buy a house, or when political leaders bargain, vote, and make laws, most of the time the distribution of likely results from particular actions can be calculated, either intuitively or on the basis of statistical analysis. This is the basis for most strategic calculations and rational estimates based on a reasonable degree of confidence. (Katznelson 2013, 33)

These were the conditions that had to be restored if recovery were to be achieved.[1]

For Rexford Tugwell, the New Deal programs sought to

> reduce paralyzing national fear to more manageable risk. . . . [The programs] shaped by this activist sensibility guided industrial decisions, regulated the economy's commanding heights, organized countervailing powers for working people, and provided security for persons who fell outside labor markets for reasons of age, infirmity, or unemployment. . . . The central goal of these initiatives was "to promote a more stable and more evenly distributed prosperity, and to prevent the inevitable breakdown of an undisciplined, uncoordinated control of the business enterprises upon which our security and freedom depend." (Quoted in Katznelson 2013, 232–33)

The particular measures included "passing new rules for banking and investing, . . . convening new large-scale programs to build infrastructure and advance conservation, . . . providing public employment, and . . . comprehensively enlarging labor rights and creating America's first fully modern program for social insurance" (232). By instituting these measures, the administrators of the New Deal "forcefully rejected what the new president, at his inaugural, had called 'an outworn tradition' of political economy that thought markets to be self-correcting" (232).

The First Step: Removing the Fear of Banks

Bank failures had been increasingly common since the late 1920s, and a national bank holiday had been proposed by the Hoover administration and the Federal Reserve in the context of a growing number of state bank regulators' decisions to close banks in the period between Roosevelt's election and his inauguration (Kennedy 1973, 155n9). Thus, the first step on the road to the elimination of fear was to restore confidence in the financial system. Roosevelt was reputed to have had virtually no training or competence in economics and, as Susan Estabrook Kennedy comments, "had no plan of his own for opening the banks" (Kennedy 1973, 168). But the reform of the financial system had been under discussion in Congress since the stock market crash, in particular due to a series of banking reform bills submitted by Carter Glass, the father of the Federal Reserve System. In addition, measures that had been under consideration by the Hoover Treasury and the Federal Reserve, but had not been implemented, were also available and could be implemented extremely rapidly.[2]

These existing proposals originally worked out by Hoover administration officials won out over more radical options, such as the nationalization of the banks and the issue of scrip to address the problems that would be encountered during the bank holiday closure.[3] Roosevelt himself seems to have proposed an even more radical plan: to make all outstanding government bonds—some $21 billion—immediately convertible into cash (a real bond drop, pace Michael Woodford and Lord Adair Turner). However, as Kennedy notes, Roosevelt's choice of orthodox experts, who had developed the earlier proposals to advise the process of bank reform, in the end precluded more radical proposals. Ultimately, the procedure chosen for the restoration of confidence in the banks after their reopening was in fact the one that had already been worked out by Hoover's outgoing Treasury Secretary Ogden Mills. Indeed, after having refused to engage with any of Hoover's proposals before the inauguration, the cooperation between the officials of the two administrations was strikingly effective. Raymond Moley's firsthand account confirms that "the evidence shows conclusively that practically all the tools used in meeting the emergency were already in existence in the Hoover Administration" (Moley 1966, 169).

The Mills proposal was to group banks into three categories and then reopen those in the major Reserve cities that were Class A certified sound, in order to give the public certainty as to the payments system. The second-tier Class B banks were to be opened next day, with the provision of additional capital to ensure they could be considered safe, and then at a later date the third-tier banks subject to conservatorship were either to be wound up or recapitalized and reopened.

In the recent crisis, there were many who lamented the failure to follow a similar procedure. But this approach to restoring banks to health was not as successful as it has been remembered. According to Jesse Jones, head of the Reconstruction Finance Corporation (RFC), responsible for providing the capital injections needed by weak and insolvent banks,

> It could easily be charged, and properly so, that a fraud was practiced on the public when the President proclaimed during the bank holiday broadcast that only sound banks would be permitted to reopen. It was not until the late spring of 1934, nearly fourteen months

afterwards, that all the banks doing business could be regarded as solvent. (Jones 1951, 29)

The main reason for this, as Jones explained, was that in the days between the March 9 Emergency Banking Act and the March 13 target for the reopening of sound banks,

> it was difficult to decide whether a bank was truly sound. The plunge in values, particularly market values, made one man's guess as good, or bad, as another's in assessing the probable worth of many a bank's portfolio. Mistakes were inevitable. A great many unsound banks were allowed to resume business. Judged by the panic prices then prevailing, four thousand of the banks which were allowed to open after the moratorium were unsound. (Jones 1951, 21)

For non-national banks outside the regulatory remit of the Treasury's Office of the Comptroller of the Currency, it was the responsibility of the Federal Reserve to provide "lists of banks that might be reopened, yet they had no clear information on whether or how those lists might be used. Nor did they have a specific formula for judging banks, since national and state examiners used different standards of evaluation" (Kennedy 1973, 183). It was these state banks that were generally considered to have been the source of the banking problem,[4] and this persisted after the banks were reopened. According to Walter Wyatt, "I believe that New Jersey reopened all nonmember state banks, regardless of their insolvency, and I know that many insolvent state banks were opened by state authorities all over the country, and that they had to be restored to solvency before they could be insured by the FDIC" (quoted in Moley 1966, 176n).

Ralph Robey also noted that

> some of the banks licensed to resume operation without restrictions were known to be insolvent unless new capital had been poured into them during the holiday. It was possible that it had been. It was not probable. . . . On Tuesday, with the opening of banks in some 250 other cities, almost the last basis for hoping that licenses would be granted only to solvent institutions was wrecked. It would have been impossible to raise enough capital within one week to bolster up so many weak institutions. . . . Thousands of banks were open that were unsound. We still did not have a solvent banking system. Even this, bad as it was, did not complete the picture. In addition, we would have hundreds upon hundreds of millions of dollars of deposits frozen in closed [Class C] banks. (Robey 1934, 50–51)

The inherent paradox in the Mills procedure as a means of restoring confidence, according to Robey, was that it would be difficult to convince the public that the banking problem had been solved if all of these Class C banks' deposits remained uncertain. It was these banks, managed by conservators under the Bank Conservation Act, that Jesse Jones referred to in his assessment that all the banks open were not really solvent until January 1934. This flaw in the reopening procedure was a source of continued distrust in the banking system and preserved the public's general perception of the prevailing weakness of banks. Thus, a policy to ensure full elimination of fear had to be met with other, longer-term policies that dealt with the structural weakness of the banking system. One proposal was to have the sound banks absorb the weaker banks, a proposal that was roundly rejected by the bankers[5] (as was the request for banks to rescue Lehman Brothers in September 2008). According to Robey, the panic to find alternative support for the banks created the impetus to resort to reflation of prices to improve the value of bank assets, promoted by Irving Fisher (e.g., Fisher 1934, Allen 1977) and on the advice of George Warren (Warren and Pearson 1933), and thus the decision to devalue and then go off gold in order to raise commodity prices was born.[6]

While the separation of deposit and investment banking is the most visible structural measure of the 1933 Banking Act, its formulation and rapid approval was primarily the result of a battle amongst competing financial groups for control of the financial system (Ferguson 1995, 148–49).

There were two more important confidence-building measures. On March 9, the RFC had been authorized to invest in the preferred stock or capital notes of commercial banks. According to Jones, "This program of putting capital into banks prevented the failure of our whole credit system." However, he also noted that "getting the banks to cooperate in the preferred stock program was unexpectedly difficult. . . . Bankers, in general, remained reluctant to ask the government for help" (Jones 1951, 26).

The second measure was the decision, over the objections of the president, Senator Glass, Professor H. Parker Willis, and others, to accept Congressman Henry Steagall's proposal for a deposit guarantee system in the March Banking Act on a temporary basis, to commence on the first of January 1934. Aside from the confidence generated by the guarantee, the deadline for banks' qualification for insurance provided the impetus to the banks to accept the RFC capital injections. As Jones noted, by mid-December there were some two thousand banks that could not meet the capital requirements for membership in the deposit guarantee scheme, all of whom recognized that after the initiation of the scheme on January 1 they would be at a distinct disadvantage relative to member banks who did qualify. Banks were thus classified as solvent on condition that they accept the capital injection from the RFC in the form of sale of preferred shares, and thus qualify for deposit insurance.

As already noted, Roosevelt had no clear operational ideas about how best to deal with the banking crisis. He opted in the end for a plan that had already been elaborated by members of the previous administration, and subsequently supported measures that had been proposed and promoted by bankers and were widely ventilated in Congress, including deposit insurance (to which he personally objected). Ultimately, the particular measures employed were somewhat ancillary; what mattered was the impact on the confidence of depositors and their ability to rely on the financial system. In the famous fireside chat of March 12, 1933 Roosevelt suggested that the banking problem could be resolved if only the public would have faith in the system; to stop "fearing fear" so that the run could be reversed. Both Raymond Moley and Secretary William H. Woodin "were convinced that the key to reviving the banking system was restoring the public's faith in banking. . . . To reassure depositors, Moley and Woodin wanted Roosevelt to make a direct appeal to the public to put their faith in the banks" (Cohen 2009, 77). As Moley recounted,

> We knew how much of banking depended upon make-believe or, stated more conservatively, the vital part that public confidence had in assuring solvency. . . . It was essential to public confidence and the termination of panic that as many banks as possible be reopened at the end of the holiday. Where there was doubt about solvency, the decision should be weighted on the side of reopening. (Moley 1966, 171–72)

Mark-to-market accounting would not have been compatible with this approach to the crisis!

Next Step: Removing the Fear of Unemployment

According to Perkins (1946, 278), one of the few measures that had been discussed before Roosevelt's inauguration was the creation of some form of unemployment and old-age insurance, which eventually came to encompass disability and family support. But the first order of business was to provide instant relief to the unemployed. As William Bremer notes, the initial approach was again driven by

> concern with the psychological impact of their policies and programs. If general economic recovery and the physical well-being of the unemployed had been their overriding concerns, then New Dealers might have appropriately supported massive deficit expenditures for direct relief to give jobless people money to support the economy and themselves. New Deal administrators and their social work consultants, however, specifically rejected direct relief, because it threatened to undermine morale. (Bremer 1975, 637)

It is in this attempt to fine-tune the "psychological impact" of relief and "support morale" that the most innovative and experimental aspects of the New Deal are to be found. Driven by Harry Hopkins, the hodgepodge of alphabet agencies to provide relief represent a path of innovation that evolved from the Civilian Conservation Corps, to public works under the National Industrial Recovery Act (NIRA), to direct government provision of employment. For the New Deal, "the antidote for joblessness was not charity but work. United by this belief and led by a group of New York reformers, American social workers campaigned for work relief programs at the local, state, and federal levels of government" (Bremer 1975, 637). Hopkins and Roosevelt shared their dislike for alms-type relief in favor of what came to be called the "American Way": government provision of normal jobs paying market wages when they were not available in the private sector. Hopkins hoped to see such a program included in the proposals for Social Security, but it was omitted for political reasons. The evolution of these various work-relief programs and his experience in administering them is recounted by Hopkins (1936).

It is important to note that initially the federal employment programs were not based on any idea of Keynesian macroeconomic stabilization, but rather on moral and ethical grounds that employment was preferable to the dole and would have a better psychological impact on the elimination of fear. Nonetheless, this approach ran into resistance from a different type of fear: that such programs would compete with the private sector and lead to excessive fiscal deficits. And here lies the basic conundrum that had to be solved in crafting the New Deal policies.

An Orthodox Detour to Certainty

After the banking and direct relief measures, the next order of business in the search to build public confidence was the 1933 Economy Act: "A Bill to Maintain the Credit of the United States," drafted by fiscal conservative Budget Director Lewis Douglas to meet the Democratic platform pledge to cut government spending by 25 percent and, according to Roosevelt's top advisers, to restore business confidence. As Adam Cohen observes, "Roosevelt liked to think of abstract policy issues in concrete human terms. He thought of the nation as being like a family, and the federal budget as being like a household budget. . . . An overspending nation, he argued, like an overspending family, was one 'on the road to bankruptcy'" (Cohen 2009, 85).

It is thus important to note that despite common interpretations of Roosevelt's employment and public works policies as being influenced by Keynesian economics, to the contrary, these polices sought to restore faith in the ability of government to provide a safe and stable economic environment by avoiding the introduction of stronger interventionist alternatives:

> Expansive fiscal policies also were ruled out. . . . The New Deal remained committed to fiscal conservatism, the one orthodox economic idea still standing. Most university and think-tank economists who advised the Roosevelt administration worried that large federal deficits would undercut the dollar's value, reduce national savings, and raise consumer prices unduly. . . . Roosevelt was urging Congress to pass the Economy Act to cut federal expenditures by $500 million, and permit him to reduce federal salaries and cut payments to veterans, stating that "too often in recent history liberal governments have been wrecked on the rocks of loose fiscal policy. We must avoid this danger." (Katznelson 2013, 234–35)

Indeed, the only way in which Roosevelt the candidate differed from Hoover was that the latter considered "the urgent question of the day as the prompt balancing of the budget. When that is accomplished I propose to support adequate measures for relief of distress and unemployment," to which Roosevelt countered:

> If starvation and dire need on the part of any of our citizens make necessary the appropriations of additional funds which would keep the budget out of balance, I shall not hesitate to tell the American people the full truth and ask them to authorize the expenditure of that additional amount. (May 1981, 77)

In the end, it was necessary to propose a politically popular bill to legalize 3.2 percent alcohol content beer to overcome the massive opposition to a bill that would cut spending in the face of rising unemployment.

The ambiguity with which he approached budget balancing is also present in the last-minute request to amend the Economy Act to provide $300 million for a program to send young men out to plant trees. His advisers viewed this as asking Congress to approve an internally inconsistent policy, whereas Roosevelt clearly did not: "Roosevelt's impulsive humanitarianism," Dean May writes, "led him eventually to break down the old . . . belief that paupers somehow deserved privation and public calumny. Respectable self-reliant, able-bodied people found themselves poor, through no fault of their own, and with no independent means of altering their situation." His "disregard of the traditional distinction between public works and work relief" led Roosevelt to seek policies to "provide employment that would preserve a maximum of self respect and pay at a living wage" (May 1981, 77).

The commitment to a balanced fiscal position would eventually prove to be the issue that produced a reassessment of objectives in the New Deal—the most important lesson to be learned from the 1930s experience. We return to this critical juncture below.

The Comprehensive Plan for a "New Deal"

These initial programs—the banking, relief, and budget acts were all implemented in March 1933—dealt with specific problems and not with what was considered a systemic problem facing US capitalism: "Facing crumpled market policies, New Deal leaders searched elsewhere for economic designs. They had no wish to build a socialism in which the national state would supplant private firms to become the central economic actor, and they certainly did not want to discard private property" (Katznelson 2013, 234). Refusing full state planning and corporatism, which were the measures taken by other governments that had successfully beaten the scourge of unemployment and depression, required "American versions of these two features of public intervention, [Rexford] Tugwell explained, aimed 'to repair disaster, imminent, pressing,' by providing 'coordinated administration and negotiation' that could create 'a control to conserve and maintain our economic existence' by acting 'to eliminate the anarchy of the competitive system'" (Katznelson 2013, 235).

While the measures intended to initiate an immediate reversal of expectations involved the various agencies dealing with short-term relief measures, the real focus of the New Deal was Title I of the NIRA, titled "Industrial Recovery," which was to create the structural changes in the operations of markets and the degree of government monitoring of capitalism that would make further policies unnecessary. If the market system were not self-adjusting, the government would create mechanisms and institutions that would deliver the adjustment, and convert the uncertainty of free market depression into risk-based decisions that would generate recovery. The National Recovery Administration (NRA) was meant to promote coherent decision making in the corporate sphere, while the National Labor Relations Board would improve working conditions and establish a bargaining framework for labor—what John Kenneth Galbraith (1952) was later to define as the creation of "countervailing power" in the postwar economic system.

Speaking at his 1933 inaugural, Roosevelt chastised

> "the rulers of the exchange of mankind's goods" for "having failed through their own stubbornness, and their own incompetence." None had talked of the "unscrupulous moneychangers [who] stand indicted in the court of public opinion, rejected by the hearts and minds of men," or had identified the "generation of self-seekers" who pursued "the mad chase of evanescent profits." No other had called for "unifying relief activities" that "can be helped by national planning" and for a federal role so assertive that the country's national government would be called on to supervise "all forms of transportation and of communications and other utilities which have a definitely public character." (Quoted in Katznelson 2013, 234)

According to Perkins (1946, 192ff.), the NRA grew out of the response to pending legislation to introduce work sharing, which was counter to the logic of employment creation, and was intended to provide some coordination of hours and conditions of work[7] and an all-encompassing framework for public works employment programs.[8] As already noted, these employment-creating relief and public works expenditure programs were initially considered temporary; once the economic structure had been reformed they would no longer be necessary, as government action through the NIRA was supposed to supply the negotiated self-adjustment mechanisms that the market could not. But the centerpiece of the recovery measures, the NRA, was an administrative nightmare and effective disappointment that did not survive legal challenge. Even contemporary commentators saw difficulties in its implementation (see Beard and Smith 1934, chap. 4, and Robey 1934, chap. 9).

This left the short-term expedients of the job-relief and employment-creation programs, initiated in Title II of the NIRA—titled "Public Works and Construction Projects," providing for the Federal Emergency Administration of Public Works, which became the Public Works Administration (PWA)—as the major policy lever. However, even this measure had little immediate impact, as the disbursement of allocated funds awaited the lengthy process of the selection and planning of public works projects.

As noted by May,

> It was originally expected that the PWA would provide an immediate lift to the spending stream, which the NRA, with its dramatic restructuring of the traditional determinants of production and distribution, would then sustain. Neither expectation was realized, and the summer rally was followed by an autumn slump, leading the President to improvise hastily the Civil Works Administration in November to help the unemployed through the winter of 1933–34. (May 1981, 79)

The increasing need for more immediate, short-term expenditure measures is evidenced by the establishment of the Works Progress Administration (WPA), created and appropriated by Harry Hopkins to provide a more rapid spending of funds and in offering the maximum impact on employment. As May comments, "Roosevelt's choice of Hopkins to head the WPA meant that the Ickes ideal of efficiency—providing the finest possible public monuments at the minimum cost—was being supplanted. The Hopkins ideal of efficiency—providing a maximum of employment and spending in a minimum amount of time—was gaining dominance" (May 1981, 82). Hopkins had been appointed as the original head of the Federal Emergency Relief Administration, which was primarily concerned with providing job relief, that is, the provision of employment income as a substitute for poor relief, and allocated according to what was a means test.

However, it was thought that once the NRA was in place, it would have made job relief redundant. Hopkins, on the other hand, sought a permanent government employment program, virtually identical in philosophy to what Hyman Minsky eventually proposed as an employer of last resort. As experimentation proceeded, without any clear impact on reducing unemployment, it was this more permanent approach that gained dominance over the job-relief and initial public works proposals. It was the WPA that provided the basic part of the stimulus that allowed the recovery from the depths of the Depression.

The Legacy of the Platform and the Economy Act

This emphasis on spending as quickly as possible eventually overcame the reversals of the autumn of 1933 and contributed to a slow improvement in conditions, but was accompanied by sustained increases in government debt that quickly ran into the resistance of those advisers who had backed the Economy Act and the return to budget balance. This raised a dilemma for the administration, and the Treasury staff was given the task of completing "the seemingly contradictory task of explaining that even though past New Deal fiscal policy had been beneficial, future policy, to be equally beneficial, would have to move in the opposite direction" (May 1981, 94).

By the end of 1936, decisions were taken to produce a balanced budget in fiscal 1938 with provisions for debt reduction in 1939. And the impact of these reductions harbored the threat of a downturn that would bring the economy back to the conditions of 1933. As the pressure accumulated, Roosevelt was pushed by his Treasury secretary, Henry Morgenthau, to modify his support for the continued pursuit of budget balance: from a position that considered the New Deal policies as having succeeded so well as to have raised incomes to the level at which the government's fiscal position was in balance, to one that argued that the balancing of the budget was the only remaining positive measure available to combat what soon appeared to be a return to recession, by inducing business confidence and higher private business expenditures. In this respect, the now common arguments of crowding out (as well as Ricardian tax equivalence!) were used to garner support for budget balance measures.

But there were counterarguments from two influential advisers. Harry Hopkins had noted to Roosevelt early on that emergency measures would not solve the unemployment problem. In 1936, Hopkins wrote: "While we have a problem of emergency proportions at the moment . . . we are faced for an indefinite number of years with a situation which will require a permanent plan that cannot be carried on as an emergency matter. We should face this frankly" (quoted in Hopkins 1999, 189). He advised extending unemployment insurance and "supplementing it with a broad program of public works . . . as an established governmental activity" (189). This government guarantee of employment through a formal, permanent program of employment to fight poverty was virtually identical to Minsky's subsequent proposals for a government employment scheme to fight poverty (see the various proposals collected in Minsky 2013).

Marriner Eccles was also key in promoting the evolution from the pursuit of budget balance as an indicator of stability and certainty to the government's use of fiscal expenditures as a means of achieving stability. Eccles coined the term "compensatory fiscal policy" (May 1981, 155) as a response to the impending recession and argued against the return to traditional balanced budget policies in terms that call to mind the derisive invocation of the "confidence fairy" of more modern times: "The Republican Party was wrecked by relying on wishful thinking that business would turn up, while at the same time pursuing policies that intensified the depression. . . . The situation today is too serious for us to rely on wishful thinking" (May 1981, 117).

Eccles (along with his advisers at the Fed, including Lauchlin Currie[9]) had been early to identify the downturn as being induced by the reversal in the government budget. In a memorandum to the president he noted, among other things, that the initiation of the Social Security system had paradoxically resulted in the collection of $2 billion in taxes, while

> no part of this was disbursed in benefits. Moreover, the tax pulled potential buying power out of the pockets of the very people most likely to spend the money if it had not been taxed away from them. . . . To sum up, in the absence of consumer purchasing power upon which the speculative growth of inventories had been based, the

> inventories were dumped on the market in a drastic deflation, and the conventional pattern of a recession was re-enacted. (Eccles 1951, 295)

The combined advice of Eccles and Hopkins led to a revision of New Deal policy that came to be called the "socio-economic policy"—to replace the "social-financial policy"—approach to social problems. According to May,

> It began with an attempt to compute what level of national income would bring the nation near to full employment. Only after the desirable level of national income was decided upon and the amount of government investment needed to achieve that level of income [was] determined could policy makers begin to decide what forms the expenditures should take. . . . Equally significant for long-term policy was the implication that the economy had moved into a period . . . requiring a continuous, or at least recurrent government stimulus to insure full utilization of manpower and other resources. (1981, 142)

> The emerging attitude towards reform was implicit in the economic philosophy Eccles had helped bring to dominance among New Dealers. Morgenthau, representative of an earlier New Deal, asked, when economic crisis threatened, "How can farmers be helped? How can jobs be found for workers? What can we do for railroads?" Eccles, representative of an emerging redefinition of New Deal economic thought, asked "What level of national income will bring full employment?" (158)

The result was that the New Dealers discovered "functional finance," in the form of "compensatory fiscal policy," on their own—well before any intimations of a "Keynesian Revolution."[10] But the important point here is that they recognized it was a policy that had to be sold to the American people and implemented through congressional legislation. While it differed in form and essence from the initial fiscal policy predilections, it met the essential condition that it provided an end to economic uncertainty and restoration of an economy in which the past was a good predictor of the future.[11]

By Way of Conclusion

The responses to the banking crisis of 1933 and the more generalized financial crisis of 2008 followed very similar approaches: providing capital to the banks that the banks did not want and did not recognize as being necessary to their operations. In the end, in both cases the government imposed the recapitalization of banks using government funds. The basic difference was that in the former period it was the RFC that provided the capital on the basis of government-mandated fiscal funding, whereas in the latter period it was provided through manipulation of the Federal Reserve's balance sheet, until the Fed sought congressional approval because it believed it was bailing out financial institutions outside its regulatory jurisdiction. This might have led to the equivalent of the RFC, but instead took the form of the Troubled Asset Relief Program. Nonetheless, the motivation behind these emergency measures was similar, in the sense that it was thought that the recovery of the banks was a necessary precondition for further recovery measures.

This is primarily because the concern in the 1930s was the public's confidence in the financial system, and the challenge was to stem a classic bank run; and in 2008 it was the confidence of the financial system in the financial system—a counterparty run. The fear in 2008 was not that the general public would lose its bank deposits, which was quickly quelled by removing the ceiling on deposit insurance. With the Fed taking over the quasi-governmental role played by the RFC in the 1930s, the confidence measures largely worked, but rather than taking place via recapitalizing the banks, the Fed became the guarantor and residual buyer of the impaired assets of the financial institutions—many of which, pace Lehman Brothers, still survive on the Fed's and other institutions' balance sheets.

Unfortunately, the meager measures to repair household balance sheets failed miserably, and the support for private sector financial institutions did not lead to increased private sector lending. Instead, the majority of the support for the banks went into excess bank reserves. While the New Deal recognized that additional measures beyond stabilization of the banking system to support household incomes were necessary to recovery, in 2008 the belief, based on Ben Bernanke's (2002) lesson from Milton Friedman, was that expanding bank reserves "à outrance" would be sufficient to prevent the subsequent recession. Whether or not Friedman was right for the 1930s, it was clearly wrong for the structure of the financial system in the 2000s, as Bernanke was eventually forced to admit when he left the problem of bailing out banks in the lap of an unwilling Congress. The suggestion that the entire financial crisis could have been avoided if the Treasury had bought out every underwater subprime mortgage is compelling.

But the most important lesson can be found in the New Deal's post-banking-crisis response. Roosevelt's initial diagnosis of the Depression was in terms of the distribution of purchasing power:

> No, our basic trouble was not an insufficiency of capital. It was an insufficient distribution of buying power coupled with an oversufficient speculation in production. While wages rose in many of our industries, they did not as a whole rise proportionately to the reward to capital, and at the same time the purchasing power of other great groups of our population was permitted to shrink. We accumulated such a superabundance of capital that our great bankers were vying with each other, some of them employing questionable methods, in their efforts to lend this capital at home and abroad. I believe that we are at the threshold of a fundamental change in our popular economic thought, that in the future we are going to think less about the producer and more about the consumer. Do what we may have to do to inject life into our ailing economic order, we cannot make it endure for long unless we can bring about a wiser, more equitable distribution of the national income. (Roosevelt 1932, 10)

To remedy this problem, the main area "which seems most important to me in the long run," Roosevelt stated, "is the problem of controlling by adequate planning the creation and distribution of those products which our vast economic machine is capable of yielding. It is true that capital, whether public or private, is needed in the creation of new enterprise and that such capital gives employment" (Roosevelt 1932, 8). However, he continued,

> let us not confuse objectives with methods. Too many so-called leaders of the Nation fail to see the forest because of the trees. Too many of them fail to recognize the vital necessity of planning for definite objectives. True leadership calls for the setting forth of the objectives and the rallying of public opinion in support of these objectives. Do not confuse objectives with methods. When the Nation becomes substantially united in favor of planning the broad objectives of civilization, then true leadership must unite thought behind definite methods. (Roosevelt 1932, 8–9)[12]

In the recession that began in 1937, it became apparent that the idea of an equitable capitalist system organized through voluntary indicative planning by corporations was not providing the income and employment that was promised after the resolution of the banking crisis. Directed government expenditure thus became the instrument that would be relied upon to provide the necessary restructuring and reorganization. But this required the rejection of the one basic premise of orthodox economic theory that had been preserved in the early New Deal: fiscal austerity. This rejection of orthodoxy entailed the need to convince, first the members of the administration of the need for such policies, and then the president, Congress, and the general public of the error of looking at the federal budget in the same way as a single family budget. Roosevelt was eventually convinced, Congress was eventually convinced, and the general public was eventually convinced of the need to embrace government expenditure as a policy tool—rather than as a necessary but undesirable consequence of the short-term anticyclical employment relief measures. The eventual outbreak of the war should have provided confirmation of the validity of this approach—irrespective of Keynes's eventual publication of a theoretical justification—since it represented, in Katznelson's terms, the only possible response to escape full-scale state planning under communism and corporatism under fascism.

It is perhaps necessary to note a number of basic differences between the 1930s and the latest crisis period; differences that supported Roosevelt's ability to succeed. First, support for regulating (by at least some parts of) the financial system was clearly absent in the drafting of the 2010 Dodd-Frank Act. Second, the industrial structure was no longer dominated by highly capital-intensive industries requiring high levels of demand but rather by natural resource barons and Silicon Valley venture capitalists, none of which benefited from increased government environmental or demand management. And finally, the Protestant social gospel traditions[13] that supported the settlement movement and informed Hopkins's approach to poor relief via the provision of employment by the government—equivalent to Minsky's employer-of-last-resort role for the government (cf. Minsky 2013) rather than a demeaning and debilitating poverty relief—has been replaced by a religious movement seemingly isolated from the economic human suffering caused by sustained unemployment.

Thus, if there is a lesson to be learned, it is that the response to the recent crisis was far from experimental, and its policies in support of employment were not sold to the public or to legislators. The forces of selfish individualism in the Tea Party and austerity in both major parties bear no comparison with the environment in which the New Deal was allowed to flourish. The budget balancers recognized that they lost the battle for the soul of FDR, but have vowed to never lose the battle again. This is the lesson and the battle that has to be joined. In the response to the recent financial crisis, it was never joined. Relief of the financial system, rather than relief of the family, was presumed to be sufficient. We are still waiting "for business to turn up" on the basis of traditional policies, and for the massive accumulation of corporate profits to lead to an expansion in investment and growth of the productive potential of the economy.

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Notes

1. In his discussion of these conditions, Katznelson refers to the description of uncertainty and risk presented in the work of Frank Knight (1921), but also provides a footnote reference to Paul Davidson's Keynesian conception of fundamental uncertainty. This use of the contraposition of risk and uncertainty and the framing of the objective of New Deal policy seem to fit more easily into Keynes's approach to uncertainty in explaining the paralyzing force that prevents the system from self-adjusting, or to reflect G. L. S. Shackle's (1961) highlighting of the difference between "serial experiments" and crucial, unique decisions. But the origin of the idea is unimportant; it is Katznelson's view that this was the framing of Roosevelt's interpretation of the causes of the breakdown of the system and thus the policies that would be required to eliminate the "fear of fear itself" that pervaded the decade of the 1930s.

   The reference to uncertainty is not novel. Economists have used uncertainty as the explanation of the collapse in output after the stock market break, due to the impact on investment (Bernanke 1983), consumption (Romer 1990), and interest rates (Ferderer and Zalewski 1994). In this case, however, the concept of uncertainty being used is more socio-systemic in nature, similar to Keynes's observations in the *Economic Consequences of the Peace* (1919) about the breakdown of the implicit bargain upon which the pre-WWI system was based, leaving nothing in its place to anchor behavior.

   One of the objectives of Katznelson's book is to show that the success of New Deal policies was dependent on legislative approval via the liberal democratic process as an alternative to authoritarian options and the crucial support of Southern Democrats seeking to defend slavery to produce congressional majorities and managing of legislation in committee—confirming that racial equality was completely absent from New Deal policies.
2. In this regard, it is important to note that, in addition to the role of Southern Democrats in backing the implementation of New Deal policies, Thomas Ferguson emphasizes the significance of what he calls "money-driven political systems": changes in the industrial structure of the US economy and in the control of the financial system generated industry support for both a more open trading system and measures to promote higher levels of aggregate demand, to meet the high-volume needs of capital-intensive and export industries (Ferguson 1995). Ferguson's essay "From Normalcy to New Deal" (Ferguson 1984) notes the influence of changes in the dominant financial institutions in providing support for the formulation and rapid acceptance of the bank reforms.
3. In the event, an emergency order allowed banks to undertake "usual banking functions to such extent as its situation shall permit and as shall be absolutely necessary to meet the needs of its community" (Emergency Regulation No. 10, issued by Secretary Woodin on March 4; quoted in Kennedy 1973, 165).
4. "Glass put his finger on the basic situation, which had had so much to do with the creation of the crisis. This 'was the multiplicity of state banks and the lack of proper supervision of them by state authority'" (Moley 1966, 186).
5. Jones recounts a visit he made to J. P. Morgan (Jones 1951, 23) to solicit him to organize New York bankers, members of the New York Clearing House, to recapitalize the Harriman National Bank and Trust Company to avoid its being placed in Class C conservatorship (the only New York bank thus classified). He was met with polite refusal.

6. This decision was one of the most controversial, and least effective, actions that is perhaps best explained by Robey's charge of panic. Beard and Smith (1934, 111ff.) pointed out that the Agricultural Adjustment Act already provided extensive powers to the president to influence exchange rates through the Federal Reserve. And Eccles noted the major fallacy in the argument that going off the gold standard would increase purchasing power: namely, the fact that few people held gold—and certainly few of the unemployed (Eccles 1951, 123). However, Moley (1966, 300) links the decision to the response to the Thomas Amendment to the farm bill to remonetize silver or to issue greenbacks to set the price of gold, which Roosevelt eventually accepted.
7. Section 7 of Title I required that "every code of fair competition" gave employees the "right to organize and bargain collectively" and that "employers shall comply with the maximum hours of labor, minimum rates of pay, and other conditions of employment, approved or prescribed by the President" (reproduced in Hosen 1992, 198–99).
8. The original proposals (there were two) were worked out by members of the administration (one by Tugwell and Hugh S. Johnson, the other by Robert F. Wagner and Meyer Jacobstein). See Perkins (1946, 199).
9. May (1981, 146–47) also credits the support for a more active fiscal policy based on Keynesian principles to "An Economic Program for American Democracy," authored by a group of Harvard and Tufts economists, elaborated in 1937 and published in 1939. However, Roger Sandilands notes that at Harvard in January 1932, Currie, along with Paul Theodore Ellsworth and Harry Dexter White, had already elaborated their support for more active policies in a memorandum submitted to Hoover, and most probably was part of the advice he provided to Eccles. See Sandilands and Laidler (2002).
10. Although as Herb Stein (1969, 108–9) notes in his chapter on "The Struggle for the Soul of FDR, 1937–1939," Keynes wrote to FDR on at least two occasions exhorting support for Eccles and Hopkins's position on increased federal spending, but was largely ignored.
11. Again, the point is not about whether the decision to reverse the budget balancing was the cause of the recovery, but about the political process of determining economic policy. Romer (1992) provides support against the dominant mainstream opinion that the New Deal more or less laid the groundwork for the natural recovery of the system. It is ironic that Romer's estimates of the stimulus that would be required to produce recovery after the bailout of the financial system in 2008 were apparently sharply reduced on political grounds.
12. As a corollary of planning, Roosevelt observed, "It is self-evident that we must either restore commodities to a level approximating their dollar value of several years ago or else that we must continue the destructive process of reducing, through defaults or through deliberate writing down, obligations assumed at a higher price level" (Roosevelt 1932, 8).
13. Ironically, the founder of the American Economic Association, Richard T. Ely, was a part of this social gospel movement (Hopkins 1999).

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Kregel studied under Joan Robinson and Nicholas Kaldor at the University of Cambridge, and received his Ph.D. from Rutgers University under the chairmanship of Paul Davidson. He is a life fellow of the Royal Economic Society (UK) and an elected member of the Società Italiana degli Economisti. In 2010, he was awarded the prestigious Veblen-Commons Award by the Association for Evolutionary Economics for his many contributions to the economics field.