

New Deal

Franklin Roosevelt's New Deal created the most dramatic peacetime expansion of government in American economic history.

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

After Roosevelt took office, the federal government, often in conjunction with state and local governments, built a huge number of roads, dams, sanitation facilities, schools, public housing projects, and other public works. The federal government expanded regulation of banking, finance, labour, and a host of other markets, insured and refinanced housing loans, and made extensive loans to numerous private and public entities. In the decades following the 1930s, several waves of historians have provided narratives and interpretations of the New Deal and introductions to their work can be found in collections edited by Dubofsky (1992), Braeman, Bremner and Brody (1975), and Hamby (1969). The recent trends in New Deal studies include a series of studies by economists and economic historians (Fishback et al., 2007; Bordo, Goldin and White, 1998).

Searching for an overarching theme for the programmes is a daunting task. The doubling of annual federal spending between the Hoover (1929–32) and Roosevelt years tempts many to describe the New Deal as Keynesian expansionary policy. But the Roosevelt administration ran relatively small budget deficits, as federal tax collections also more than doubled. In a brief meeting and a letter to the *New York Times* Keynes had encouraged Roosevelt to follow an expansionary policy, but the levels of government spending and the small budget deficits pale in comparison with the fall in output to be counteracted (Barber, 1996; Brown, 1956; Peppers, 1973; Romer, 1992).

One goal appeared to have been to raise prices and wages, as the establishment of the NRA allowed each industry to establish cartel-like codes that stifled price and quality competition, labour policies promoted unionization and high wages, and farm policies offered price guarantees while cutting output. Ultimately, Roosevelt and his advisors were pragmatists faced with terrible economic problems of nearly every kind. They established agencies and programmes meant to try to solve nearly each and every one. At times the programmes operated at cross-purposes. Higher farm and industry prices worsened the plight of the unemployed and other consumers. The pressure to

raise wages exacerbated the unemployment problem, and the NRA codes limited output growth. The administration made constant adjustments in policies, creating a climate of uncertainty about the regulatory environment that left businesses wary of making new investments (Higgs, 1997).

New Deal monetary, banking, and international policy

Building on the seminal work by Friedman and Schwartz (1963), many economists argue that monetary policy contributed significantly to the harsh decline in the economy between 1929 and 1933. The Federal Reserve took seriously its international responsibilities in maintaining the gold standard and thus failed to respond sufficiently to three major waves of bank failures in a timely fashion. Many states had begun declaring 'holidays' that closed state banks to stave off bank runs. Roosevelt took office in the midst of the third wave of failures and declared a Bank Holiday that closed all national banks. Two-thirds of the banks were declared sound and reopened within the week. The troubled banks were reorganized and the Reconstruction Finance Corporation (RFC) subscribed to their new stock issues, reassuring the public about the solvency of the banking system (Smiley, 2002; Mason, 2001).

In 1933 Roosevelt also announced that the United States was leaving the gold standard, prohibited gold exports, and devalued the dollar to \$35 per ounce of gold. In response, the United States received a substantial flow of gold that stimulated the money supply, and economic growth resumed. Japan, Britain, France and several other leading nations experienced similar resumptions of economic growth when they broke free of their 'golden fetters' (Eichengreen, 1992; Temin, 1989; Temin and Wigmore, 1990). Gold inflows continued for the rest of the 1930s as Europe moved towards war. By choosing not to offset the gold inflows, Roosevelt and the Federal Reserve allowed the money supply to expand (Romer, 1992). The Federal Reserve took a misstep, however, when it used its newly awarded control over reserve requirements to double them in three steps between 1935 and 1937. The goal was to prevent a potentially inflationary rise in lending by soaking up the substantial excess reserves that banks were holding at the time. The banks responded by increasing their reserves and keeping the same cushion because they did not trust the Federal Reserve to provide adequate liquidity if a bank run occurred. The money supply fell and contributed to a sharp rise in unemployment and drop in real GDP in 1937–8 (Friedman and Schwartz, 1963; Romer, 1992). There is some disagreement about the impact of the monetary policies. Real business cycle economists argue that monetary and investment changes played much smaller roles than productivity shocks and high-wage labour policies in accounting for the fluctuations during the 1930s (Chari, Kehoe and McGratton, 2005).

The decision to leave the gold standard was accompanied by efforts to expand world trade beginning in 1934 with the Reciprocal Trade Agreement Act (RTA). The Smoot–Hawley Tariff Act of 1930 had helped touch off a series of protectionist responses by other countries that had caused total imports for a group of 75 countries to fall to one-third of their 1929 level. The RTA freed the Roosevelt administration to sign a series of tariff reduction agreements with Canada, several South American countries, Britain and