Deal or No Deal?

THE LEGACY OF FDR

Why did the Great Depression last so long? In many ways, Roosevelt was a hero, but some of his policies actually delayed the recovery for years

Seventy-five years ago, Harold Ickes tried to explain to a New York City audience the special bond between the President and the American people. Franklin Roosevelt, the Secretary of the Interior said, was "the leader you have been looking for--for more years than you would like to remember." This was a President, Ickes told the crowd, who would fight for America's forgotten man--the hungry, the senior citizens, the laborers--even as he waged a wider offensive against the Depression.

As it turned out, F.D.R.'s tenacity did not suffice to get the economy back to where it had been before the Great Depression began, in 1929. Today we know that actions Roosevelt took to resolve the crisis may actually have perpetuated it. Especially during the period from 1935 to about 1939, Roosevelt's moves kept recovery at bay.

The first bleak years of the Depression were no fault of his. After the historic market crash of 1929, his predecessor, Herbert Hoover, through a misguided sense of charity, took steps that kept the economy down. By insisting that companies continue to pay high wages at a time when they could ill afford it, Hoover made employers slow to rehire. He signed into law a tariff, Smoot-Hawley, that set off a global trade war. He also joined Congress in pushing the top income tax rate from 25% to a confiscatory 63%.

Meanwhile, events abroad triggered further damage. In 1931, while Roosevelt was still governor of New York, Britain shocked the U.S. by going off the gold standard, meaning that Britons could no longer demand gold in exchange for paper currency at their banks. Foreign governments and individuals then rushed to redeem their dollars for gold. A banking panic ensued. To lure back cash, the Fed pushed up interest rates. Such actions worked to cause a whole new round of bank failures. In 1932, the year Roosevelt was elected to his first term, 24% of U.S. workers were jobless. As soon as he took office, in March 1933, Roosevelt made a number of positive moves. Brushing aside opposition from the financial glitterati, he created federal deposit insurance for banks. Knowing that they could retrieve their money even if the local thrift closed its doors so reassured small depositors that they were willing once again to leave their cash in banks. The following year, F.D.R. established the Securities and Exchange Commission, which, over the long run, bolstered U.S. competitiveness by promising clear rules for investors in American equities.

Roosevelt also reassured seniors by creating Social Security. During his first term, the stock market rallied strongly, affording snapshots of robust growth for short periods. By the fall of 1936, when he was running for re-election, unemployment had dropped to about 10%, from 20%. Perhaps the Depression was history. Voters rewarded the President with a stunning electoral sweep--46 of the 48 states.

But at least five New Deal policies would halt that tentative recovery. The trouble started with Roosevelt's erratic budgetary-spending patterns. During his first term and especially in the lead-up to his 1936 re-election campaign, F.D.R. submitted budgets to Congress that called for unprecedented spending. From 1933 to 1936, the federal budget rose from 6% to 9% of the nation's GDP. Roosevelt's Public Works Administration had such a large budget, $3.3 billion, that even Ickes, who headed it, was astounded. "[If] we had it all in currency and should load it into trucks," Ickes wrote, "we could set out with it from Washington for the Pacific Coast, shovel off one million dollars at every milepost and still have enough left to build a fleet of battleships."

Once safely past the '36 election, the President permitted himself the luxury of second thoughts about outlays. Soon after, he, the Federal Reserve and the Treasury tightened money. Those moves helped cause the infamous Depression Within the Depression, a sharp downturn in 1937 and 1938. As much as the measures themselves, Washington's inconsistencies did damage.

Next came taxes. Instead of reversing Hoover's tax-hike error, Roosevelt compounded it by raising taxes again and again. His Treasury also cobbled together new business taxes. The same caution that had led banks to accumulate reserves during the worst of the downturn had moved corporations to put aside extra cash instead of using it to expand. Roosevelt, angered that firms were not spending to stimulate the economy, retaliated with an undistributed-profits tax on top of ordinary corporate taxes. Taken aback, observers accused him of "breaking the nest egg."

Beyond tax rates, a broader New Deal tax philosophy took its toll. Tax authorities had once drawn a clear line between tax avoidance--the use of legal deductions--and criminal tax evasion. Roosevelt blithely blotted out that line, conflating evasion with avoidance. Anyone who seemed to pay too little became a target of F.D.R.'s prosecutors. One of those targets was Andrew Mellon, Treasury Secretary under Warren Harding and Hoover. Roosevelt's Treasury Secretary, Henry Morgenthau, told prosecutor Robert Jackson, a future Roosevelt appointee to the Supreme Court, that when it came to Mellon, "you can't be too tough."

New Deal labor policy also prolonged the Depression. The centerpiece of the New Deal, the National Recovery Administration, supported minimum wages that employers often could not pay. The 1935 Wagner Act gave John Lewis and what would become his Congress of Industrial Organizations the power to insist that wages stay high or rise while the economy was still fragile. In the late '30s, joblessness rose yet again, and it became clear that double-digit unemployment would be the rule for the decade. People began to realize that the government-jobs programs that Roosevelt had created did not amount to true recovery because those jobs disappeared when the government stopped funding them.

Most intimidating of all was not a fact but a prospect: What more might this President do as he aggregated authority? In his 1937 Inaugural Address, F.D.R. told the nation outright that government was now fashioning itself into an "instrument of unimagined power." This shocked many who recalled the days of smaller government. That same year, when he sought to pack the Supreme Court, it became clear that F.D.R. meant what he said. The bill to allow court-packing was defeated, but voters still wondered where Roosevelt would turn next.

During the Depression Within the Depression, industrial production collapsed and families hungered again. Businesses went on "capital strike," choosing not to invest in the future. Even British economist John Maynard Keynes, who believed in deficit spending, chastised the U.S. President. "It is a mistake to think businessmen are more immoral than politicians."

In those later years of the 1930s, the Dow gave up its previous gains, closing off hope that it would soon return to its 1929 benchmark level. (The market would not regain those heights until the mid-1950s.) Per capita GDP reached pre-Crash levels only at the very end of the 1930s. But worst of all was the abiding unemployment, which gave the Depression its adjective--Great--in American memory.

Astonished by the difficulty of attaining true recovery, Americans talked about how the term forgotten man could have several meanings--it could also describe the citizens who paid for the New Deal. "Who is the forgotten man in Muncie?" asked an editorialist from the Indiana town's paper. "I know him as intimately as I know my own undershirt. He is the fellow that is trying to get along without public relief . . . In the meantime the taxpayers go on supporting many that would not work if they had jobs."

When the recovery came, as the decade closed, what were the causes? For one thing, as scholars like Christina Romer, chairwoman of President Obama's Council of Economic Advisers, have noted, gold flowing in from troubled Europe gave U.S. banks the kind of reserves that enabled them to lend more. And as F.D.R. turned his attentions to crises in Asia and Europe, he tired of his war on business at home. Instead of getting pounded, big companies found themselves working hand in glove with the government to arm the U.S. or supply matériel for lend-lease.

The real question about the Great Depression is not how or whether World War II ended it, but rather why the Depression lasted until the war. That episode of American life reminds us that even the best-intentioned government intervention can make things worse. And that when a politician remembers one forgotten man, he often creates another.

By Amity Shlaes

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