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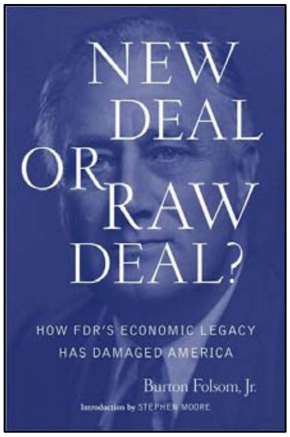

New Deal or Raw Deal?

How FDR's Economic Legacy Has Damaged America

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About The Author:
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General Overview:
In *New Deal or Raw Deal*, Folsom argues that the idyllic legend of Franklin D. Roosevelt is a myth of epic proportions. He asserts that with a vendetta against the business elite, Roosevelt created New Deal programs marked by inconsistent planning, wasteful spending, and opportunity for political gain, which ultimately elevated public opinion of his administration but failed at achieving the economic revitalization that America so desperately needed from the Great Depression.

Folsom takes a critical look at Roosevelt's presidency and his economic policies. He makes the argument that even 60 years after FDR died in office, Americans are still struggling with the damaging repercussions of his legacy.

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Introduction

The notion that Franklin Roosevelt's economic policies lifted America out of the Great Depression is one of the biggest myths of the 20th century. Roosevelt's buoyant personality and optimism were leadership assets, but these qualities were more than offset by defects in FDR's character and his policies. In fact, it was the massive public spending associated with WWII – which led to virtually full employment – that finally pulled the nation out of the Great Depression.

Most historians rank Roosevelt as one America's greatest presidents (in most surveys, Roosevelt is second only to Lincoln). However, most historians tend to be liberals, thus they have a vested interest in burnishing the reputation of progressive policies associated with the New Deal – i.e. price-fixing, farm subsidies, and workfare, for instance. The only problem, however, is that such policies never solved America's economic ills, though they did create new ones.

Roosevelt was an incorrigible liar, a hypocrite, and a philanderer. He campaigned for office as someone who would balance the federal budget, but he busted it instead by greatly expanding the power of the federal government in ways that ran counter to the intentions of America's Founders. He excoriated and targeted the rich for trying to evade the draconian tax rates he imposed, but he used evasive loopholes himself. Further, he abused his power by using the Bureau of Internal Revenue (later the IRS) to investigate, intimidate, and punish political enemies. And his unconstitutional scheme to pack the Supreme Court was rightly seen as an executive power grab that threatened the foundation of America's system of government – i.e., the separation of powers.

The United States is still coping with the unintended consequences of Roosevelt's good intentions. In essence, Roosevelt was convinced that his redistributive policies were essential to creating a socially just society. To this end, he initiated a host of regressive excise taxes, oppressively high income tax rates, and the Social Security tax. Unfortunately, Roosevelt failed to realize the hidden costs that accrue from confiscating private wealth in order to redistribute it to other parties. For instance, taxing "rich" business owners to fund the Work Progress Administration (WPA), inevitably meant less private wealth was available to hire employees, create products, and provide services. There is no doubt that Roosevelt's invasive regulation, price fixing, and redistributive schemes decimated countless small businesses.

Many of the government programs Roosevelt created in his New Deal – farm subsidies that pay farmers not to plant, minimum wage laws that discourage employers from hiring entry level workers, and welfare handouts that discourage work – are still with us in some form. They may have been initiated with the best of intentions, but they are every bit as damaging now as they were then.

"The New Deal has been the greatest political force in America during the last one hundred years, and Franklin Roosevelt has probably been the most influential president during this time." But Roosevelt's lack of integrity, coupled with his economically dubious New Deal policies, has altered America's character for the worse.

The Making of the Myth: FDR and the New Deal

The Great Depression was the most devastating catastrophe in American history. Most historians credit FDR and the New Deal with lifting America out of the Great Depression, but the evidence indicates that Roosevelt's policies actually prolonged it. For example, in 1939 – seven years after Roosevelt won the presidency from Herbert Hoover – the national unemployment rate stood at almost 21%. Indeed, Roosevelt's Treasury Secretary, Henry Morgenthau, confessed to fellow Democrats on the House Ways and Means Committee that "We have never made good on our promises… I say after eight years of this administration we have just as much unemployment as when we started… And an enormous debt to boot!"

Roosevelt subscribed to the theory that the Great Depression was caused by under-consumption. This thesis claims that "The Great Depression was accelerated because workers did not have adequate purchasing power during the 1920s to buy the products of industrial America." In short, Roosevelt blamed America's economic maladies on the misdistribution of wealth.

The under-consumption theory sounds plausible on a superficial level. After all, it seems reasonable to believe that unequal distributions of wealth would mean that at some point too many goods would be churned out with not enough buyers able to afford them. However, the statistical evidence does not support the under-consumption theory. In fact, the evidence indicates that, prior to the Great Depression, demand far exceeded supply as Americans gobbled up radios, vacuum cleaners, telephones, cars, and other consumer goods. Further, there was no great surge in corporate profits prior to the Great Depression. Instead, employee compensation as a percentage of corporate income was on the rise. All this makes the under-consumption theory untenable. Nevertheless, Roosevelt latched onto the thesis and made it the linchpin of his economic program.

The under-consumption theory implicitly blamed the rich for wrecking the economy. The assumption was that businessmen and entrepreneurs could not be trusted to manage the economy. Therefore, academic and other experts would be needed to serve on economic planning boards and see that wealth was more evenly redistributed. The stage was set for a massive government intervention in the economy.

FDR's Rise to Power: Political Skill, Ambition, and Deception

In the popular imagination, Roosevelt remains an American icon. He is widely credited with being an innovator who reversed the economic slide that began with the Hoover administration. Undoubtedly, Herbert Hoover's decision to raise tariffs by signing the Smoot-Hawley Tariff Act proved to be a major cause of the Great Depression. Hoover also got government into the business of farm subsidies and bailing out failing banks and industries, which politicized economic decision. As a result, when Roosevelt faced Hoover in the presidential contest, he was able to campaign as the candidate who would balance the federal budget and restore fiscal prudence. Once elected, however, Roosevelt quickly abandoned his campaign pledges.

Roosevelt, in fact, knew little about economics. He was a mediocre student and a failed businessman, but he had an abundance of personal charisma. There is little doubt, however, that Roosevelt "displayed great perseverance and skill to become president." After all, FDR had to contend with the crippling effects of polio he contracted in his late thirties.

Oliver Wendell Holmes said Roosevelt possessed "a second rate intellect. But a first-rate temperament." Indeed, Roosevelt's incapacity to think rigorously, coupled with his tendency to act impulsively, contributed to his multiple business failures. However, Roosevelt was able to tap his family's fortune in order to further his political ambitions.

Roosevelt was the governor of New York when the Great Depression hit. Most everything President Herbert Hoover tried seemed to make matters worse. As a result, "his presidency was in shambles." Roosevelt saw his chance for the presidency as he knew a great deal about politics. His knowledge about economics, however, was another matter.

What Caused the Great Depression?

The First World War certainly figured prominently in the factors that led to the Great Depression. For instance, The U.S. had lent its allies vast sums of money during the war, but high U.S.-imposed tariffs (the Smoot-Hawley Tariff Act) prevented borrowers from repaying the loans. Further, when the Europeans retaliated with tariffs of their own, American exports suffered. As a result, the tariff war raised the cost of consumer goods for Americans and deprived American industry of vital imports. Many economic experts believe the Smoot-Hawley Act was instrumental in causing the Great Depression.

The performance of the Federal Reserve was very shaky in the run-up to the Great Depression. For instance, the Fed raised interest rates four times between 1928 and 1929. And it did little to stem the run on the banks that took place in the early 1930s. As a result, one-third of the money supply vanished in just three years. The causes of the Great Depression were complex, but war debt, high tariffs, and poor monetary policy were central factors. It is worth mentioning that all three of these primary causes were government blunders, not defects of the free market.

The NIRA: Why Price-fixing Damaged American Business

When Roosevelt became president, he signed the National Industrial Recovery Act (NIRA). It proved to be one of the most far-reaching pieces of legislation Congress ever enacted. Essentially, the NIRA allowed industrial leaders from competing companies to collaborate in setting prices. In short, with the NIRA, "America's traditional free market system, where businesses compete and innovate to sell products of varying price and quality to choosy customers, was overthrown."

Roosevelt and his New Deal compatriots believed that higher wages and fixed prices, even in the absence of higher productivity, would entail higher purchasing power for ordinary Americans. This was the essence of the under-consumption theory. However, even one of the staunchest advocates of government intervention in the economy, the great economist John Maynard Keynes, believed that the NIRA undermined recovery.

There is little doubt that the kind of wage and price fixing mandated by the NIRA stifled innovation, thus hurting the American consumer. After all, when wages and prices are fluid – that is, set by the marketplace – there is a tremendous profit incentive to develop more efficient production methods.

Many small business owners were fined and jailed for refusing to follow the dictates of the NIRA. The NIRA also led to many small business owners being driven out of business. In 1935, however, the Supreme Court ruled that the NIRA was unconstitutional. Roosevelt denounced the decision and attempted to push similar price-fixing schemes through Congress. Roosevelt was not chastened by the Court; indeed, he would soon begin plotting to pack the Supreme Court with justices sympathetic to his New Deal philosophy.

The AAA: How it Hurt Farming

Roosevelt also set out to restructure the farming industry with his Agricultural Adjustment Act (AAA). This program was extremely complicated, but it essentially paid farmers not to produce on their land. The rationale for this strange policy was simple: it was an attempt to protect farmers against falling prices caused by overproduction. Such policies, however, raised a serious question: if government is in the business of protecting farmers, why doesn't it protect everyone else?

Insuring farmers received a set price for their farm products, of course, undermined any incentive to innovate. It also politicized the farming process, since not all farmers (and not all crops) qualified for government subsidies. This meant that the farmers not receiving government subsidies paid taxes to support farmers receiving subsidies. Needless to say, the higher food prices entailed by these schemes were borne by consumers.

A vast bureaucracy sprouted in order to manage the complicated business of determining which crops should be reduced, who should receive payments, and how much they should receive. Enforcement, of course, was another complicated matter. By 1935, this byzantine arrangement resulted in a disastrous level of underproduction. In 1935, the U.S., which had always been a net exporter of food, became a net importer. In short, "when politicians decided to manipulate the prices of food, the farmers gained, the consumers lost."

Relief and the WPA: Did They Really Help the Unemployed?

"The Founders all saw relief as local and voluntary, and the Constitution gave no federal role for the government in providing charity." However, as unemployment soared during the Great Depression, many Americans wondered how the jobless would find the means to provide for themselves. President Hoover, under immense economic and political pressure, inaugurated federal relief efforts. Many states and charities opposed this tendency, but Roosevelt expanded this approach with his Federal Emergency Relief Administration (FERA).

The federal government's assumption of functions traditionally managed by charities and localities would prove to be a far reaching shift that ultimately undermined the American work ethic. Federal handouts had a number of unintended consequences:

1) It discouraged recipients from finding work.
2) States had an incentive to exaggerate needs in order to receive large chunks of federal aid.
3) FERA money was frequently dispensed on the basis of political considerations, rather than on the basis of real needs.

To his credit, Roosevelt recognized some of the pernicious consequences of FERA. As a result, he replaced FERA with the Works Progress Administration (WPA), which replaced direct handouts with a form of workfare. Undoubtedly, this was a move in the right direction. Many WPA projects led to improved public works such as roads, bridges, and schools. However, many observers believe that creating jobs in the WPA meant losing at least as many private sector jobs. After all, government spending depends on higher tax rates, which leaves less money for private job creation. In fact, many WPA programs proved to be boondoggles.

Roosevelt promised he would not use WPA and other government relief programs for political ends, but the evidence indicates this is exactly what he did. Simply put, workers were hired or fired depending on their allegiance to the Democratic Party. Not surprisingly, states that were key to Roosevelt's electoral prospects were showered with relief money. Some elected officials objected to how federal money was being used to buy votes, but politicians that refused to accept political pork soon found themselves out of office.

Safety Net or Quagmire? Minimum Wage, Social Security, and Labor Relations

Roosevelt wanted to permanently reform America's economic system. In particular, he tried to advance labor unions, minimum wage laws, and the Social Security system. His aim was to insure that each and every American had a certain level of income.

Social Security and the minimum wage were pillars of the New Deal. The idea behind the minimum wage was to insure that every worker received a living wage. However, the minimum wage "caused unemployment – unemployment of the very people the law was crafted to protect." And as many observers have noted, it also interfered with the liberty of contract between employer and employee. There were good intentions behind the minimum wage laws, but Roosevelt and others failed to appreciate how minimum wage legislation hurt small businesses and priced low-skill workers out of the labor market.

Social Security owed its origin to a federal pension plan aimed at protecting disabled veterans and their widows. Roosevelt's plan began modestly enough: workers were docked a maximum of $30 a year (a figure matched by employers) until they turned sixty-two, at which time they received monthly checks of almost $23. Congress, of course, has steadily increased both the benefits and the withholding tax since that time.

Roosevelt's Social Security scheme created many difficulties. First, it fostered unemployment, thus hindering recovery from the Great Depression. Second, the payroll tax was highly regressive. An third, the system was fiscally unfair. For instance, it soaked minority workers with low life expectancy rates. Finally, the return funds deposited into the Social Security system averaged a paltry 2% (or less) for most workers, far less than the 8% return many private pension plans have generated over the last 60 years.

President Roosevelt deliberately wanted to strengthen the power of unions. Following the passage of the Wagner Act in 1936, which greatly expanded the bargaining power of unions, the country was plagued with strikes. In fact, workers at a GM plant in Flint, Michigan, essentially took over the company's plant.

Roosevelt's New Deal labor policies proved damaging to property rights. However, tilting the playing field in favor of labor also had the effect of making America's exports less competitive while exacerbating unemployment (since higher wages caused companies to hire fewer workers).

No Free Ride: The Burden of Excise, Income, and Corporate Taxes

Franklin Roosevelt dramatically expanded excise taxes to finance his New Deal policies. An excise tax, of course, is a government fee on goods manufactured within a country. Traditionally, the United States had limited excise taxes to alcohol and tobacco. After all, excise taxes tend to be heavily regressive. However, Roosevelt expanded excise taxes to cover cars, telephone calls, stock transfers, gasoline, and countless other consumer goods.

Roosevelt justified his reliance on heavily regressive excise taxes on the grounds that the rich were not paying their fair share of the income tax. Roosevelt had a conspiratorial mindset when it came to the wealthy; believing a clique of wealthy businessmen were hoarding wealth and purposively hindering new investments. Some advisors suggested Roosevelt should cuts taxes to stimulate growth, but FDR's response was paranoiac; he agreed that cutting taxes would probably help recovery, but he insisted doing so would lead to the election of a fascist president.

Roosevelt's paranoia regarding the wealthy was reflected in the draconian tax rates he aimed at the rich. In 1939, the top federal income tax rate stood at 79%. But if Roosevelt had it his way, anyone earning $100,000 or more would have been hit with a 99.5% tax rate.

The IRS: FDR's Personal Weapon

FDR may have been the originator of the practice of using the IRS as a political weapon. In fact, "Roosevelt marveled at the potential of the IRS for removing political opponents." In addition to targeting political leaders who opposed him, FDR also used the IRS to go after wealthy Americans and media critics of the New Deal. In short, Roosevelt used the IRS to intimidate the wealthy in order to insure they sent more of their money to Washington for the funding of New Deal programs. Ironically, FDR used substantial deductions and loopholes to shield his own income. His tax avoidance schemes were legal, but hypocritical.

Patronage Transformed

Roosevelt was one of the most popular and charismatic leaders in American history. He won a series of overwhelming electoral victories. However, the evidence is clear that FDR's New Deal policies did not work. Indeed, Roosevelt often pushed unpopular and reckless programs that prolonged the Great Depression. How then do we account for FDR's electoral success? Roosevelt, as it turns out, was a master at turning patronage into political gold.

Patronage has always been a feature of American politics, but the gargantuan federal sums Roosevelt raised through taxes and then disbursed took the practice to a new and unprecedentedly self-serving level. Without patronage, Roosevelt might well have been a one-term president.

How FDR's Deception Tarnished the Presidency Forever

Roosevelt was a serial exaggerator and manipulator. He acknowledged his propensity to stretch the truth, but he claimed he did so for a higher purpose. For instance, Roosevelt insisted, "I am perfectly willing to mislead and tell lies if it will help win the war [WWII]." But Roosevelt's tendency to dissemble went well beyond matters of national security.

Roosevelt's casual relationship with the truth lowered the bar for American presidents. George Washington had argued that morality and character were necessary components of leadership. With FDR, however, *intentions* supplanted character. After FDR, fewer and fewer presidents would feel bound to keep their word, follow the Constitution, or maintain the highest standards of conduct in their personal lives.

Conclusion

Roosevelt's New Deal programs did not bring America out of the Great Depression; most historians agree that the mobilization and large-scale spending made necessary by WWII led to the full employment that catalyzed America's recovery. In fact, the evidence indicates that Roosevelt's ad hoc, whimsical, and politically self-serving New Deal policies created the kind of uncertainty that prolonged the Great Depression.

Despite Roosevelt's poor economic track record, the vast majority of historians have lauded FDR. No doubt, many are sympathetic to his New Deal philosophy and wish he had done even more to redistribute wealth and reform society. However, FDR's progressive view of government – that it should intervene to insure equality – is diametrically opposed to the Founders' conception of limited government, which emphasized process not results.

"Roosevelt's new progressive rights, unlike those of the Founders, imposed obligations on society to provide jobs, buy homes, and pay for education." Consequently, FDR's progressive philosophy led to a huge increase in the size of government.

The New Deal continues to cast a giant shadow over American society. It is a myth that FDR's New Deal policies restored American prosperity. Minimum wage laws prevent low-skill workers from gaining a foothold in the workplace, thus exacerbating unemployment. Social Security is financially unsound since the funds paid into the system are no longer sufficient to meet future obligations. And farm subsidies continue to impose indefensible costs on taxpayers and consumers.

The federal government's massive intervention into American society began with FDR. This fact has produced dramatic changes in our economic system, our politics, and our presidents. Unfortunately, these changes have led voters to weigh money and subsidies more heavily than substance and character when picking presidents.