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The New Deal and the New New Deal : a Comparative Study

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To my parents, husband, and my two little angels

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Abstract

Eager to understand and to overcome the 2007 crisis, economists worldwide are struggling to provide better understanding of past panics. Researches revealed that the recent crisis and the Great Depression, the most severe ever witnessed by the United States, share some similarities. Most of the financial calamities started in the United States and spread internationally since they occurred in a world of interconnected trade. In narrative histories of US financial panics, little is found about similarities and differences of the panics. “All is forgotten until another storm comes”. Contemporary commentators and economic scholars do not seem to have the same identification of the events leading up to banking panics. The result lies in the number of panics they give when referring to US economic history. The most recent definition of banking panic is provided by Calomiris and Gorton. A banking panic may occur when depositors ask for immediate redemption for cash. My paper studies most panics, be them major or minor, from 1819 to 2007; with attributing more importance to the Great Depression of 1929 and the Great Recession of 2007 being focal points in the economic history of the country. My work is a combination of historiography, clinical survey, and analysis. It comprehends history of the panics, analysis the causes behind failures of companies and banks using a cause and effect pattern, and the statement of similarities and differences.

Key words: Bank failure, Bank panic, Economic crisis, Great Depression, Great Recession, New Deal, President F.D. Roosevelt, President Obama, Stimulus Package

الملخص

يسعى علماء الاقتصاد في جميع أنحاء العالم جاهدين لتحقيق فهم أفضل للرعب الذي حدث في الماضي، وهم حريصون كل الحرص لفهم أزمة 2007 قصد تجاوزها. إذ كشفت الأبحاث أن الأزمة الأخيرة

والكساد العظيم ، وهو أشد ما شهدته الولايات المتحدة على الإطلاق، يشتركان في بعض أوجه التشابه. حيث أن معظم الكوارث المالية بدأت في الولايات المتحدة، وبمجرد وقوعها انتشرت على المستوى الدولي في عالم مترابط تجاريا. ولم تذكر الدراسات التاريخية في الرعب المالي الأمريكي إلا القليل حول أوجه التشابه والاختلاف بين هذين الحدثين. "*كل شيء ينسى الى أن تأتي عاصفة أخرى*". ولا يظهر للعيان أن المحللين المعاصرين والباحثين الاقتصاديين لديهم نفس التعريف للأحداث التي سببت الرعب المصرفي. كلما أشاروا إلى التاريخ الاقتصادي الأمريكي، حل الرعب. ويعتبر كالوميريس وجورتون آخر من قدم تعريفا للرعب المصرفي والذي قد يحدث عندما يطلب المودعون استرداد الأموال بصفة فورية. وعليه، فهذه الدراسة تتمحور حول بحث معظم حالات الرعب، سواء كانت كبيرة أو صغيرة ، من 1819 إلى 2007، مع تسليط الضوء على الكساد العظيم الذي حدث في عام 1929 والركود الكبير لعام 2007 باعتبارهما نقطتين محوريتين في تاريخ أمريكا الاقتصادي. يعد هذا العمل مزيجا من التأريخ والمسح السريري والتحليل، محاولا فهم تاريخ الرعب المالي، محللا الأسباب الكامنة وراء فشل الشركات والبنوك باستخدام نمط السبب والأثر ، وبيان أوجه التشابه والاختلاف.

الكلمات الدالة: الفشل المصرفي، الرعب المصرفي، الازمة الاقتصادية، الكساد العظيم، الركود الكبير، الاتفاق الجديد، الرئيس روزفلت، الرئيس اوباما، اجراءات تحفيزية

Résumé

Soucieux de comprendre et de surmonter la crise de 2007, les économistes du monde entier s'efforcent de mieux comprendre les paniques du passé. Les recherches ont révélé que la récente crise et la Grande Dépression, l’évènement le plus grave vécu aux États-Unis, présentent certaines similitudes. La plupart des calamités financières ont commencé aux États-Unis et se sont propagées au niveau international, dans la mesure où

elles se sont produites dans un monde caractérisé par un commerce interconnecté. Dans les écrits historiques de paniques financiers aux États-Unis, on trouve peu de choses sur les similitudes et les différences entre les paniques. "Tout est oublié jusqu'à ce qu'une autre tempête arrive". Il n'est pas clair que les analystes et les chercheurs en économie contemporains aient la même définition des événements qui ont provoqué la panique bancaire. Le résultat réside dans le nombre de paniques qu'ils donnent en se référant à l'histoire économique des États-Unis. La définition la plus récente de la panique bancaire est fournie par Calomiris et Gorton. Une panique bancaire peut survenir lorsque les déposants demandent un remboursement immédiat en espèces. Alors, cette thèse étudie les paniques, qu'elles soient majeures ou mineures, de 1819 à 2007; en attribuant plus d'importance à la Grande Dépression de 1929 et à la Grande Récession de 2007, qui sont des points importants de l'histoire économique du pays. Ce travail est une combinaison d'historiographie, de sondage clinique et d'analyse. Il comprend l'historique des paniques, en analysant les causes des faillites des entreprises et des banques à l'aide d'un schéma de cause à effet, ainsi que la déclaration des similitudes et des différences.

Mots clés: Échec de banque, panique bancaire, crise économique, Grande Dépression, Grande Récession, New Deal, Président F.D. Roosevelt, président Obama, plan de relance

List of Abbreviations

AAA :	Agricultural Adjustment Act
AAPA :	Association Against Prohibitive Act
ADC :	Aid to Dependent Children
AFL :	American Federation of Labor
CCAP :	Cooperation Campaign Analysis Project
CCC :	Civil Conservation Corps
CIO :	Congress of Industrial Organisations
CWA :	Civil Works Administration
EISB :	Emigrants Industrial Savings Banking
EO :	Executive Order
EPB :	Economic Policy Board
ERTA :	Economic Recovery Tax Act
FBI :	Federal Bureau of Investigations
FDIC :	Federal Deposit Insurance Corporation
Fed, FED :	Federal Reserve
FEPC :	Fair Employment Practices Commission
FNMA :	Federal National Mortgage Association
GDP :	Gross Domestic Product
GNP :	Gross National Product
HHFA :	Housing and Home Financing Agency
NAACP :	National Association for the Advancements of Colored People
NBS :	National Banking System
NIRA :	National Industrial Recovery Act
NRA :	National Recovery Administration
NYA :	National Youth Administration
OAPEC :	Organization of Arab Petroleum Exporting Countries
OLITC :	Ohio Life Insurance and Trust Company
OPEC :	Organization of Petroleum Exporting Countries
TARP :	Troubled Assets Relief Program
TVA :	Tennessee Valley Authority
US :	United States
USB :	United States Bank
WPA :	Work Progress Administration
WWI :	World War I
WWII :	World War II

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General Introduction

Eager to overcome the 2007 crisis and avoid future economic downturn, economists worldwide are struggling to provide better understanding of past panics and examine the causes of the recent financial crisis in the United States. The history of the country reveals that the country has passed through different economic crises.

The American business cycle is characterized by banking panics. It has been proved that not all the bank panics could trigger recessions, yet they could force a contraction of credit and contribute to economic slowdowns. The term "bank panics" has been used to identify an economic event when banks fail. Banking panics are either driven by real shocks, and concerns about insolvency, or by illiquidity and beliefs of depositors. During the era of a National Bank between 1865 and 1913, the United States witnessed five major financial panics. The most severe crises of the era witnessed failures of both financial and non-financial institutions because of disruptions and inabilities to find funds. To eliminate such crises, the Federal Reserve System (Fed) was created.

Economists could not attribute a clear definition to bank panics. The result is substantial differences in the number of panics that the United States experienced. Economic researchers, like Edwin Kemmerer, identified the panics of 1890, 1893, 1899, 1901, 1903, and 1907 as major panics. Modern researches differed on what really was a major or a minor panic. More recently, Charles Calomiris and Gary Gorton identified 12 banking panics over the "long" nineteenth century.

Although there have been many different empirical reveals, all economists agreed upon the unique severity of the Great Depression. During the twentieth century, the would-

to-be world's hyper-power encountered rather severe crises notably that of the year 1929 deemed the most important in the century.

My thesis provides a survey of minor and major financial panics in the United States from 1819 to 2007. Researches revealed that the recent crisis and the Great Depression, the most severe ever witnessed by the United States, share some similarities. Most of the financial calamities started in the United States and spread internationally since they occurred in a world of interconnected trade. In narrative histories of US financial panics, little is found about similarities and differences of the panics. "All is forgotten until another storm comes". Hugh Rockoff (2013) noted that the panic of 2007-09 is but a replication of earlier panics.

My work is a combination of historiography, clinical survey, and analysis. It comprehends history of the panics, analysis of causes basically failures of companies and banks, and statements and analysis of similarities and differences. It is intended to provide a historical accounting of the causes that brought the financial system to a precipice and a better understanding of such a calamity. I tried to explain how the financial system in the United States worked and how the crisis occurred. To do so, I indulged in economic arcane subjects and policies of different Congresses and Administrations.

Contemporary commentators and economic scholars do not seem to have the same identification of the events leading up to banking panics. The result of their researches lies in the number of panics they give when referring to US economic history. The most recent definition of banking panic is provided by Calomiris and Gorton. A banking panic may occur when depositors ask for immediate redemption for cash. My thesis studies most panics, be they major or minor, from 1819 to 2008; with attributing more importance to

those of 1839, 1857, 1929, and 2007, being focal points in the economic history of the country.

The economic history of the United States reveals that the country suffered serious financial instability. Prior to the Civil War, the country witnessed the most serious recessions in 1837 and 1839. During the Civil War, the country was hit by a more severe stock crash in 1857. By the end of the nineteenth century and the beginning of the twentieth century, the United States' history was characterized by two major episodes of banking panics in 1892 and 1907.

Finally, during the twenty-first century, the United States was touched by the Global Recession. This economic turmoil lasted for one year and a half (2007-2009), and led to severe social disimprovements. Even after its end, economy, communities, and families in the United States continued to experiences its aftershocks.

I tried to determine what happened in 2007-09 and how it happened so that I could present why it happened and how it differed from previous economic panics. There is but little resemblance between the post-modern financial system and that of past decades. Today's financial markets are more globalized and overwhelmed by the use of technology in transactions. Many Wall Street firms changed to publically traded corporations taking more risks.

Whatever might be the causes of the crises studied in this thesis, the Presidents, who were in office during the times of the economic declines, adopted remedies that were to make ends to the panics. To start with, monetary expansions, reductions of bank credits, and proposals for public work programs were governmental actions the end of which was to remedy depression and/or recessions.

President Andrew Jackson (1829-1837) adopted rather a runway remedy when he chose to get indebted to the Bank of England. Congressional laws to provide a forfeit of a bank charter and to withdraw the usage of some bank notes were remedies suggested by President James Buchannan (1857-1861) to overcome the economic panic of 1857. As far as the Great Depression is concerned, different political and economic measures were adopted.

President Franklin Delano Roosevelt (1933-1945) came into office in a period of economic turmoil. He was the first to introduce the New Deal to remedy the depression. The measure was a group of presidential proposals which were passed by Congress, the aims of which were to better the conditions of the poor and the unemployed, to recover the nation's economy, and to prevent any further malaise. To reach such ends, Roosevelt sponsored the Works Progress Administration (WPA) that made the Federal Government the sole employer nationwide. Moreover, there was the Federal Emergency Relief Administration (FERA) that backed the recovery actions adopted by states and cities.

President Roosevelt financed projects that were supposed to create jobs. The measures adopted later on were to promote labor unions, and aid farmers and migrants. The President's far-reaching legislation ever enacted and approved by the American Congress inspired President Barack Hussein Obama to bring the United States out of the twenty-first century's recession.

What is common between presidents Roosevelt and Obama is that both of them inherited great depressions from their predecessors. On a platform of hope and change, Roosevelt brought new hopes to the American people via the New Deal. Obama adjusted the New Deal to the current needs and exigencies of the post-modern society. He cut taxes from most American workers to finance his "stimulus package". He, just like Roosevelt,

introduced improvements to health care, education, and infrastructure. This was inspired from the Keynesian ideology: collecting public money to sponsor private projects and welfare.

There is an overwhelming tendency to compare and contrast presidents. During the first days of Obama as president of the United States, we were persuaded that the country would be having another F.D. Roosevelt. Many commentators likened Obama's prospects to save capitalism and make it less savage to Roosevelt's measures to overcome the Great Depression.

Both presidents blamed their precedent administrations of igniting the downturns of 1929 and 2007. Therefore, both presidents believed that the crises the nation confronted offered them great opportunity to become heroic leaders of change. Still, differences between them two are inevitable.

My thesis tries to shed light on the social, societal, economic, and political circumstances that were mere consequences of the two economic downturns. The ways and the means whereby the aforementioned presidents managed to shape the nation's economic policy, aiming at helping the American people to overcome the bad conditions, are put under a comparative study. Furthermore, the present thesis states legislative and judicial reactions to the *two new deals*.

The aim of the intended critical analysis of both *Deals* adopted during the eras of Roosevelt and Obama respectively is to sustain the following research interrogations with relative answers.

1. How did President Roosevelt deal with the Great Depression?
2. How did President Obama overcome the Great Recession?
3. To what extent are the Deals similar, and in which ways are they different?

4. Did the two deals meet the same congressional supports and the same oppositions?
5. What are the deficits of the two reforms?
6. Were they mere political measures to gain a second presidential mandate?

Actually, commentators are divided into two groups. While some of them state that the two deals share some similarities, others believe that they are thoroughly different. The first important difference is the severity of the crises. The Great Recession was not as calamitous as the Great Depression. While unemployment reached 8.1٪, it reached 25٪ in 1933. GDP was 30% below normal during the Great Depression; while in 2007, GDP was 5-10% during the Great Recession. Between 1930 and 1933, 50% of all American banks failed, while in the period between December 2007 and May 2009, only 0.6 %of the country's banks failed. The last difference is the decline of the Dow Industrial; in July 1932, the Dow declined 89.2%, yet during the Great Recession it had fallen 53.8%.

Statistics do not narrate the whole story. Both crises carried grave implications about future growth, despair, and hopelessness. However, Roosevelt's fiscal and monetary policies offered stronger economic foundations for Obama. In addition, the Great Depression offered Roosevelt political advantages. He could easily monitor a political transformation in the role of government. Roosevelt's capacity to deal with the crisis was deeper. Although his Court Packing Plan failed, Roosevelt promoted a catalyst to change the judicial institutions' conceptions and interpretations of legislative acts and actions.

Although Obama's measures were not nullified in the Supreme Court, he did not enjoy as much congressional support as Roosevelt's New Deal. Roosevelt confronted the Great Depression with huge Democratic majorities in Congress. The latter pushed him to take actions even at times when he was unlikely to offer remedies. His "hodgepodge" measures proved somehow unsatisfactory, in some cases, to break the Great Depression.

Government furnished substitutive actions that seemed to be working much better. He could instill confidence that conditions were improving.

The Great Depression ended when the United States engaged in its “last good war”. Thanks to his wartime leadership, Roosevelt made of the country stronger with a healthier economic system. However, Obama has been long criticized of being so leaderless during wartime. Still, Obama could borrow themes and tropes of Roosevelt’s times and presidency.

My thesis suggests that the global crisis is but an immediate result of the different social and economic conditions that characterized the country during the two preceding centuries. Policies and strategies to manage crisis just like the establishment of the National Bank, the Federal Reserve, the New Deal, and the Bretton Woods global financial architecture that were developed after the Great Wars; and new technological paradigm, the rise of social movements, and new form of globalization promoted a new form of capitalism.

Therefore my work presents a clinical survey of most, if not of all, economic slowdowns and crises that the United States has experienced. It is divided into four main chapters. The first chapter provides a broad chronology and analysis of the economic panics that occurred from 1819 to 1907. The second chapter studies in a detailed descriptive and analytical approach the Great Depression: the main causes behind it, the New Deal, the oppositions it met from the Supreme Court, and the way the Depression was brought to an end. The third chapter sheds light on the period between the Great Depression and the Great Recession. The last chapter presents a comprehensive study of the causes of the Great Recessions, similarities and differences between the Great Depression and the Great Recession, the Stimulus package” that Obama developed to manage the crisis, and recommendations to avoid future crises.

1.1 Introduction

In narrative histories of US financial panics, scholars proved unable to bring about a common list of the economic crises that disturbed economic stability of the United States. The country was beset by different minor and major panics in the period between 1819 and 1907.

1.2 The First Panic Recorded in the History of the United States

The economy of the present time United States during the colonial era was merely based on farming. The country exported agricultural products, and processed raw for local consumption, though the benefits were in favor of Britain.

1.2.1 The Panic of 1819

The newly independent country faced its first major financial crisis in 1819 which was partially due to international events.

1.2.2 Causes behind the Panic

Soon after the Napoleonic Wars[1], European agriculture recovered. Hence their demand for American agricultural products decreased. Additionally, exportation of precious metals from Mexico to Europe declined because of wars and revolutions at that period of time. Consequently, European governments accumulated all the specie. American bankers started issuing false banknotes to compensate for the absence of international money supply.

Other explanations of the panic have been offered by different scholars. The panic was an outcome of the failure of the nationwide economic system because of the War of

[1] These were a series of armed conflicts of the French Empire, led by Napoleon, against an array of European powers that took place from 1803 to 1815.

1812[2]. The government borrowed and spent big amounts of money to finance the War. Banks' reserve of specie had been strained, a fact that led to the suspension of payments violating the rights of depositors. This culminated in banks failures and bankruptcies.

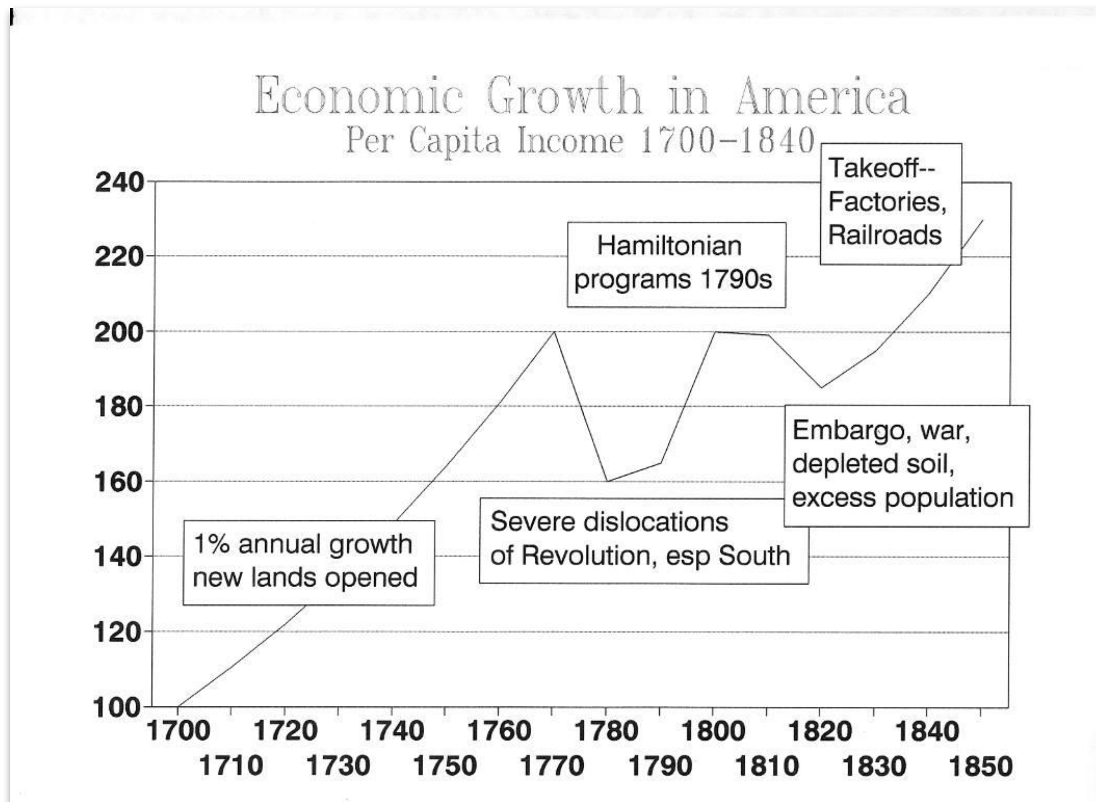

Figure 1.1: Trends in Economic Growth, 1700–1850

Other economists pointed out that the panic reflected the failure of the market economy in the country. Market institutions moved from boom to bust cycle. Banks gave credits in return of low interest rates. Many businesses and investments were promoted leading to a growth in economy. Foreign goods importation decreased because of the blocking of foreign trade; and prices of domestic products rose due to the rapid expansion. This led to overinvestment and excess in production. Subsequently, investors lost their money, and employers lost their jobs leading the country to a crisis.

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[2] It was a conflict between Great Britain and the United States due to the British attempts to restrict American trade. Nevertheless, the War ended after the ratification of Treaty of Ghent on February 17th, 1815. The war is considered by Americans as the "Second war of independence"

Rockoff (2013) contended that the panic was due to real estate speculation. Many private banks in different states and branches of the US Second Bank were bestowed with the power to control land mortgages. Similarly, some other branches could redeem notes issued by any other branch without any restriction.

Western branches made large loans in currencies which were to be redeemed by other branches. As a matter of fact, the U S Second Bank ran out of specie. It then reduced its loans portfolio. Immediately, the western chartered banks of Cincinnati and Kentucky suspended specie payments.

Whatever might be the explanation provided, the panic caused unemployment and distress for money. Benjamin Brand, a merchant, described the situation as follows: *we have gloomy times here, many failures have taken place, and many more soon expected. At this time, there is very little credit business done. Confidence in each other's ability to pay is very slight…* (Qtd Haulman 20)

President Monroe (1758-1831), the fifth President of the United States, as a measure to overcome the panic, limited governmental action to ensure fiscal stability. Public policy, bank debt and debt relief, internal improvements, and tariff protection were all reviewed. Appropriations for internal improvements, for instance, would not be approved without a constitutional law. The panic wrought great changes in different domains. Two important Acts were enacted.

1.2.3 Measures Developed to End the Panic

To start with, there was the Land Act of 1820. Some farmers brought public lands from Government on credit. Thanks to the Act, the number of acres, which farmers were to purchase, was reduced to eighty instead of 160. The cost also was reduced from $2 /acre to $1.25/acre. Those purchasers were required to pay only one fourth of the total price. What remained was to be paid in three annual installments; otherwise, the land might

be forfeited. Nonetheless, most of the purchasers proved unable to complete their payments. Congress, therefore, delayed the lands' forfeiture leaving them with a heavy burden of debts. With the panic, however, these debts became a severe federal dilemma.

As a remedy to this serious problem of land debts, President Monroe presented the issue in front of Congress. Soon after, resolutions were introduced in Congress. Senator Richard M. Johnson of Kentucky (1780-1850) suggested that purchasers unable to pay would give over the possession of the land and be entitled the ownership of only a part of it, that is the part they were able to pay. Similarly, Senator John W. Walker of Alabama (1783-1823) presented another resolution calling for the complete cancellation of any bank interest on payment installments. Although the measure relief met opposition from some southern states, it gained support of all sections of the country and was referred to as the Relief Act of 1821.

Free trade was seriously blamed for the panic. Hence, protective tariff for the American industry was increasingly supported. Duties on cotton and woollen goods were supposed to fall during the crisis period. Thus, for the end of protecting domestic manufactures, the Convention of Friends of National Industry[3] asked for an increase of duties on imported products. According to the members of the Convention, the cause of the panic was the excessive importation of 'worthless fabrics' from China and East India.

Free trade, according to Mathew Carey[4], might cause unemployment, factories' bankruptcies, and bank runs. Protective trade, on the other hand, would promote a prosperous domestic industry and a secure national market, and employment. Therefore, imposing high duties on foreign products was highly recommended. As a subsequent consequence, a bill of protective tariff was introduced during the congressional session in

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[3] The Convention of Friends of National Industry was founded in 1819 by protectionist leaders from nine states the main proposal of which was to call for more tax imposition on imported goods.

[4] Mathew Carey, a Philadelphia printer, is the organizer and the secretary of the Convention and the writer of its proposal.

1820, usually referred to as the Baldwin Bill.[5] It, nevertheless, gained only one vote in the Senate; thus, it was withdrawn. Nonetheless, manufacturers and farmers signed petitions to Congress for tariff protection for industry.

Slowly and gradually many states, associations, and communities joined the Protectionist movement. Ohio, Missouri, Delaware, Maryland, and New York had their leading protectionists. All of them worked tirelessly for protection and gave preference to domestic products like iron, salt, cotton, and woollen industries. While some states exempted manufacturers from any imposed taxes and debt-paying process, some others doubled taxes on foreign goods sellers. Such resolutions and states actions re-stressed the bottle over the Baldwin Bill, which was at last voted for in Congress despite oppositions it encountered.

"Thanks" to the panic, many federal as well as states actions were set forth and enhanced for the sake of improving the young nation's monetary system. Being the primary source for depression, bank credits were restricted. Although the panic ended in 1823, it influenced economy in later years in the United States of America. Issues of banking system, tariff protection, and debt collection existed before the panic and well after it was over.

In the spring of 1837, US economy was gripped by another financial crisis.

1.3 The 1837 Panic

By 1836, the Suffolk Bank of Boston, New England, became the clearer of all banknotes; it was acting as a national bank. However, most of US banks witnessed widespread suspensions of specie payments. The first bank to suspend payment was Natchez, Mississippi, followed by Alabama, New York, Philadelphia, Baltimore, and New

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[5] Henry Baldwin was a representative in Congress from Pittsburgh, and a manufacturer of iron.

Orleans. By the end of May 1837, all the banks had suspended payments. The causes of this bank panic are various and manifold.

Historians and economists, trying to disentangle the real cause of the panic, blamed the seventh president of the United States, Andrew Jackson, for his refusal to pass the bill of rechartering the Second Bank of the United States.

For them, such refusal deprived the B.U.S of its powers and provided state banks with the public money. S. Trask (2002) pointed out that the President's opposition to the renewal of the Bank promoted the banking expansion that followed. From 1833 to 1837, the number of banks mushroomed with a rate of 56%. Local legislatures urged the need to charter new banks for the sake of making profits from public deposits. Such an expansion would inflate the money supply significantly, concluded Trask.

Some economists related the panic to the failures of Hermann, Briggs and Co., and J.L. and S. Josephs and Co. The cotton factor in New Orleans was a client of bill broker in New York. The latter blamed its failure on the former's failure as they were closely tied. While the former failed on March 3rd, 1837, the latter failed a couple of weeks after; citing that the New Orleanians' suspension was the direct cause of their embarrassment. In any case, the failure of these two companies does not at all discard attributing significance to the relationship between the banking system and the panic.

The Treasury of the Jackson Administration issued the Deposit Act in June 23rd, 1836, also referred to as Distribution Act; ordering interbank transfers to distribute $28 million of federal surplus. The latter was to be returned to the states in proportion of their populations, causing inflation. Consequently, the number of deposit banks increased extensively. (Rousseau 458)

According to others, banks were put under more vulnerability to runs by an executive order, issued in 1836, referred to as Specie Circular. The latter provided that

payment for public land purchase would only be in specie. These two measures made banks run out of specie leading to the panic, in motion.

Still other historians claimed that the panic was but due to falling cotton prices, a culmination of the enactment of Specie Circular, leading to a decrease of farm incomes and an increase of mortgage defaults.

Whatever might be the cause or the causes of the panic, the ‘severe depression’ led to the decline of both imports and exports. Additionally, thousands of workers connected with building trade lost their jobs. This slowdown, the watershed event in the history of US economy, lasted for almost five years.

Actually, the Unites States witnessed a short recovery in 1839. In 1838, after the Specie Circular was repealed, northern states increased their construction of new canals and railroads. Likewise, southern and western states propelled their banks’ capital with $20 million. Even states in the far west invested persistently in railroad and canal constructions.

Soon after this recovery, the United Sates did sink into a four-year deflation. The economic literature provides but little explanation about the crisis, the longest banking panic hitherto.

1.4 America’s First Great Depression: The Panic of 1839

Unlike the 1837 panic, the 1839 crisis was a culmination of domestic policies rather than of international forces. Wallis (2001 and 2002) stressed the conclusion that the events leading up to the two panics followed different paths. He believed state excessive borrowing and the collapse of internal improvement investments were catalysts that stimulated the crisis.

1.4.1 Factors and the Extent of the Panic

America’s first Great Depression, the panic of 1839, is usually associated with the failure of the Bank of Pennsylvania. The latter invested its funds in cotton expecting its

prices to rise. However, the Bank failed due to its losses of state government holdings. Additionally, the Bank was engaged in state bonds market. It forwarded bonds to be invested in Great Britain. Soon after, however, bonds prices fell due to the decrease of land values. It also was subject to pressure from creditors in the United States. Thus, the bank declined.

Similar to U.S.B. of Pennsylvania, the Banking Company and the Morris Canal of New Jersey were ignited by financial failures. For internal improvement purposes and to increase its capital, the bank credited in advance $3.000.000 million from the state of Indiana. Then, it was to furnish a fund of $100.000 monthly. Thus, in August 1839, the Bank defaulted. Henceforth, projects in Indiana halted leading up to a decrease of land boom which, by its turn, led to the fall of land prices devastatingly. Furthermore, the failure of the Morris Bank deprived Indiana from any available funds to make its semi-annual interest payment.

The Morris Bank was chartered to build the Morris Canal across northern New Jersey that connected it to New York, as it invested in Western state bonds. It expected making profits of bonds issued by states for internal canal and railroad industries. Prices of bonds, however, depended on hopeful real estate. Similarly, so many other northern states, the focal point of 1839 downturn, borrowed to embark in infrastructure investment in railroads and canals. Southern states, however, borrowed to invest in or create banks.

Stockholders could borrow from those banks to buy new lands. And so, between the year 1837 and 1838, borrowing plummeted. Actually, much of the borrowing was from foreign investors who expected to make future revenues. States, borrowers, applied new tax policies whereby they could levy taxes for debt services. This debt payment policy, among many other policies adopted for the same end, proved unsatisfactory for states to pay back their debts.

Economic scholars related state finances intricacy, shaped in its borrowing measures, with the crisis of 1839. It spread mainly in southern and western banks since states were closely tied to their banks. The latter lost its deposits and specie continuously from 1839 to 1841. During the period between January 1st, 1839 and January 1st, 1840, holdings in banks fell from $43 million to $34 million. As a subsequent consequence, the supply of money fell by 22 percent, leading to deflation.

Wallis (2001) came to the conclusion that the tighter was the state close to their banks the deeper was the economic contraction. In the defaulted states, both holdings and deposits declined by 35 and 54 percent respectively. In the states which were not closely associated with their banks, the decline was less serious. Holdings lowered at 14 percent, and deposits at only 18 percent.

Wallis (2001) believed that during 1839, there was but a brief domestic crisis. The domestic exchange rate reached 6 percent, money supply decreased, and prices fell devastatingly. There was, however, no international payment crisis, as the exchange rate remained steady. State defaults impeded the entire financial system.

1.4.2 Governmental Actions to Cure Economy

At the Federal legislative level, this state default promoted debates among leaders as to what shape they would adopt to determine governmental economic policies. To cure such weaknesses, many constitutional reforms were enacted to determine the relationship between state and economy. State investments were restricted; the way debts were issued by local government was altered, and debt amount was limited; and taxation policy was changed.

Although some states adopted new constitutions to avoid repetition of the mistakes that led to the crisis, economic peacetime in the United States was cut every once and while, with some regularity, by bank runs, panics, and closures. For example, the panic of

1837 took place during the period of the existence of the US Second Bank, unlike the panic of 1857 which occurred during the era of an absence of National Bank (free banking era from 1837-1863); as there was rather a local panic during 1854 in New York. While the former was triggered by a shock about the failure of the nation-wide financial sector, the latter sparked after the insolvency of one local bank.

Generally speaking, prior to panics, bad news about bank assets, price declines, and commercial failures would spread to make people aware that an important shock would occur. This negative information that depositors would learn about banks might lead them to remove their deposits from banks hastily. Kauffman (1994) concluded, however, that bank runs are ignited when depositors force their banks to pay back the value of their deposits. Thus, bank runs spread.

Such 'non-informational contagion' led to a panic during 1854 that started when news about insolvency of one local bank spread over the state of New York.

1.5 The Banking Panic of 1854

For Calomiris and Gorton (1994), the bank run that occurred in New York in 1854, is not classified as a banking panic so long as it was at the local level. White and O Grada (2003) studied it, however, as a banking panic since it meets the definition of the banking panic presented by Calomiris and Gorton.

The Emigrants Industrial Savings Bank was the eighth mutual savings bank to be charted in 1850 to manage Irish immigrants' money. On September 30th, 1850, it started receiving deposits. By 1856, the EISB became one of the largest savings banks in New

York, as it had 4.291 accounts with $1 million as deposits.[6] Deposits of EISB's clients were higher than $500 for which the bank paid an interest rate of 5 percent for each.

For accounts under than $500, the bank paid 6 percent of interest for each. The bank was chartered to invest in purchasing state and municipal bonds, call loans, and mortgages; as it could make call loans to brokers. To be able to make all those investments, the EISB held but little cash of its assets. For its liquidity, it relied more on deposits.

The failure of Knickerbockers Savings Bank prompted runs in other savings banks in New York. The investments of EI Savings Bank decreased by 14 percent while the bank's real estate investment did not witness changes. Such decline would threaten the Emigrant. Henceforth, excited by rumors, depositors would run to withdraw their deposits, reasonably. Only a few of them closed their accounts as they did not know that such closure would deprive them of the payments of dividends.

White and O Grada (2003) concluded that the less experienced and the less informed depositors were the first to close their accounts. Closure of an account might cause an outflow of $ 112.[7] The run gradually died out thanks to the bank's steady payments to its depositors. The local panic of 1854 was sparked by contagion and dramatic response to news events among depositors. The nationwide panic of 1857, however, was led by business leaders.

1.6 A Nationwide Panic (1857)

The early 1850s were characterized by new investments in roads, the most capital-intensive industry of that time. This changed the securities markets in the United States. Securities traded by investors consisted mainly of railroad bonds and stocks. Competition

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[6]Eugene N. White; Cormac O Grada, **The Panics of 1854 and 1857: a View From the Emigrants Industrial Savings Bank**, the Journal of Economic History 213-240, Cambridge University Press, 2003, pp 216.

[7] Ibid., pp 227

between old roads in the West and the newly built lines led to the former's earnings falling. The new lines, however, provided investors with important speculative opportunities; as they sought expansion. Subsequently, many private companies were forced into default.

In the midst of this 'railroad fever', speculative railroad securities fell hand in hand with the fall of the western land values leading to a banking panic; and many industries such as steel and coal witnessed a slowdown.

1.6.1 Factors behind the Panic of 1857

The year 1857 witnessed a general commercial distress. Subsequently, many bank depositors converted their debt into specie promptly. Bonds values were depressed as banks were compelled to sell them to meet the depositors' urgent demand. The discount rate that banks could charge in return of the conversion of notes into specie was restricted. Additionally, brokers were forced to sell their holdings at very low prices as city banks refused to roll over their debts. All in all, railroads failures, land values decline, the prompt drain of specie from banks are arguably the destabilizing elements that led to the panic of 1857.

Actually, the drain witnessed by New York bank affected many other banks especially those which were related directly to it. Furthermore, more banks were under the threat of runs because of the suspension of specie in the New York, Philadelphia, and Baltimore banks, respectively. Suspensions of some banks were defensive. Other banks remained open and confronted the storm. The failure to suspend led them to more serious consequences than suspension.

Other scholars blamed the Ohio Life Insurance and Trust Company (OLITC) for the panic. It foreshadowed the weakness of the economic system at that time. The company's assets were mainly land securities and loans to railroads. Out of its $4.8 million in assets, the company invested $ 3 million, over half its capital, in railroads. Ohio Life's

connection to a faltering railroad company can easily explain why it was the first to go bankrupt, reflecting the failure of railroads especially in the West and land securities.

This could be related to political uncertainty as to whether or not Kansas and Nebraska were slave states. The failure of the company was officially announced on August 24th, 1857.

A week after, railroads share prices decreased. Actually, the OLITC was not only a trust company but also a large shadow bank. It provided local banks with funds on deposits with attractive interest rates. Its default caused a drop in the stock market. Additionally, note holders and depositors run to convert their bank notes into specie.

Consequently, banks' deposits and notes fell from $8.7 million to $7.8 million and from $64.2 million to $56.9 million, respectively.[8] Hence, the panic did spark due to a cluster of failures; banks suspended depositors' payment and bankruptcies mushroomed.

New York bank's deposits as well as specie fell. By October 14th of the same year, almost all banks over the country suspended payments. On the same day, railroad companies such as Michigan Central and Illinois Central proved unable to pay back their obligations. All this coincided with a decline in agriculture, basically in the Northwest.

As early as 1856, wheat prices decreased precipitously due to the decline of export. Farmers liquidated their assets as they were heavily indebted because of the decline of land values. Equally important, the panic was aggravated by the Civil War (1861-1865).

Calomiris and Schweikart (1991) contended that the panic was triggered by the Dred Scott case.[9] The Dred Scott Decision affirmed slave property, opened the western frontier to slavery, and lowered the interest in western railroad investments. Subsequently,

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[8] Ibid., p 223

[9] In ruling over the case of *Dred Scott V. Sanford*, the Supreme Court's Chief Justice Roger B. Taney deprived Scott, his wife, and two daughters of their freedom, being properties of the Sanfords, on the light of the Fifth Amendment which stated that "*No person shall be deprived of life, liberty, or property.*"

the price of Western land dropped[10], and the value of railroad securities plummeted. Prominent railroad companies closed. Likewise, the price of commodities fell drastically. Farmers, ironmasters, and manufacturers suffered bitterly from price decline.

The first three panics occurred during economic booms. The expansion of money supply through credits issuance promoted inflation. President James Buchanan (1791-1868) in describing the panic of 1857 stated in his first annual message that *it is apparent that our existing misfortunes have proceeded solely from our extravagant and vicious system of paper money and bank credits…..These revulsions must continue to occur at regular intervals.*

1.6.2 A Fast Recovery

The panic, in any case, did not last long. The fast recovery can be explained by the absence of a national bank at that time. Monetary inflation was at a lower scale and liquidations were rapid so long as there was not any national bank to issue more money. Coordination between and among banks proved satisfactory for states to cope with the panic. Capital-asset ratios of banks increased from 0.33 to 0.40 by February 1860. (Calomiris 824)

Likewise, interbank net deposits increased. Resumption was hastened thanks to the coordination of Clearing House. Banks reserves increased as $ 7 million of interior bank currency was to be redeemed at 20 percent per month. (Calomiris 825)

Although the antebellum South lacked Clearing House, states achieved coordination through establishing branch banking.

Data about Southern states banks revealed a rise in ratios of deposits and loans; reflecting the branch banking system's success in overcoming the panic. Indeed, banks'

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[10] In Iowa, for instance, the land price per acre reached $ 0.40 after the Dred Scott decision. Source: Smith and Cole (1935) qtd in Jenny B. Wahl, 2009, "Dred, Panic, War: How a Slave Case Triggered Financial Crisis and Civil Union", US: Carleton College, pp27

cooperative behaviors and the establishment of small banks facilitated the limitation of suspension and failures.

The election of the sixteenth president of the United States Abraham Lincoln (1809-1865) sparked political unrest which by its turn led to financial instability. Specie was drained from the North to the South since the latter repudiated its debts. Subsequently, banks in the South suspended specie payments.

1.7 Economy and the Civil War

By 1861, banks reserves decreased because of heavy withdrawal of coin. In the course of time, banks throughout the nation suspended payments. In the midst of the Civil War, the United Sates reformed its economic structure for the end of resolving the financial crisis. The monetary system was established by National Banking Acts of 1863[11] and 1864 passed by Radical Republicans. Additionally, they raised taxes to enable government to finance the infrastructure expansion.

To finance the War, northern states created the National Banking System, and raised the money supply via funnelling states with cheap greenback currency, as people were unable to convert their notes or bills into specie. The fiat currency, or the greenback, was the printed paper money with future repayment.[12] Greenback value was depreciated as it reached 40 cents by June 1864.[13]

The NBS compelled banks to have licenses to produce currency receivable as taxes. In any case, all banks were free to use greenbacks. This led to the explosion of American money supply.[14] The monetary increase promoted an increase of 110% in wholesale prices

[11] The Act is also referred to as National Currency Act signed by President Abraham Lincoln.
[12] The greenback had first been seen in American economy during colonial period. It has not been seen again till the Republican Congress introduced it during the Civil War to finance northern warfare.
[13] The NBS integrated greenback currency into its assets, a fact that is related to the crash of 1873.
[14] In 1875, Congress passed the resumption Act to enable government to start redeeming greenbacks by 1879.

during the war. Similarly, the US debt rose to 30.79%. The country passed through a short recession.

The Civil War, like any other war, had negative impacts on the economy of the United States, as the latter required factories to construct war equipments, rather a short-lived production. Economic downturn, after the war, would be inevitable as factories had to re-adjust their long term productions.

In fact, economy in the United States has always suffered from events of depressions and deflation long before the Great Depression of 1929, basically during the National Banking Era. Companies were indebted, wages fell, and the rate of unemployment, homelessness, and malnutrition increased.

1.8 Post-Civil War Period Panics

The country passed through a series of depressions from 1873 to 1896.

1.8.1 The 1873 Panic

1.8.1.1 Factors that Ignited the Panic

To start with, the United States followed a tight monetary policy to return to the gold standard after the Civil War. The policy was a process whereby the monetary authority controlled the supply of money for the sake of promoting economic growth, stability, and railroad investment expansion. The country was taking money out of circulation and therefore there was less cash available to facilitate trade. Because of the monetary policy the price of silver started to fall causing substantial losses of asset values

and wealth which led to the collapse of 1873[15], the first negative consequence of Industrial revolution, which lasted over six years.

Among other contributing factors to the collapse was the overinvestment in railways. More than forty thousand miles were catered across the United States during the seven years between 1866 and 1873. From 1865 to 1870, 20.000 miles of railways was constructed, and from 1870 to 1873, other 22.000 miles of rails was added. About $2.7 billion was invested in this industry. $725 million of it came from American investors and $250 million was borrowed from abroad.

During 1873, about forty miles was under construction. Federal Government guaranteed railroads bonds, and provided the land to build the railroads. It delegated about 137.281.600 acres of land to railroad companies in the period between 1850 and 1881. Most of all these constructions were financed by bond issuance. Railroad stock prices index took a significant dive down to 85 in October 1873, and then it reached 100 in 1879.

This industry was an important factor in the development of the United States as it promoted the industrial revolution and Western expansion. However, the years between 1874 and 1878 witnessed rather a slowdown in building new railroads. Tables 2 and 3 give a clear image of the growth of railroads' construction from 1865 to 1882.

[15] The collapse of 1873 is also known as the Long Depression, the most severe in Europe and the United States during the decade following the American Civil War, and the worst until the Great Depression.

Period	**Average yearly increase in miles**
1865-1872	9.11%
1873-1878	3.08%
1879-1882	8.85%

Table 1.1: Rate of growth of railroad miles by period[16]

YEAR STATES	1850	1860	1870	1880	1890
New England	2.507	3.660	4.494	5.982	6.831
Middle States	3.202	6.705	10.964	15.872	21.536
Southern States	2.036	8.838	11.192	14.778	29.209
Western States and Territori	1.276	11.400	24.587	52.589	62.394

[16] Christopher Cotter, **Railroad Defaults, Land Grants, and the Panic of 1873**, Vanderbilt University, July 2015, pp 4

es				
Pacific States and Territories	23	1.677	4.080	9.804

Table 1.2: Railroad Mileage Increase by Groups of States (Chauncey M. Depew 111)

It is assumed that this was due to investors' poor governance.[17] Shockingly, this industry was too costly. Faherty (2013) recorded that the average cost of a mile of track was $49.492 the profit of which was only $2.882. Tariffs reached 32%, let alone the bonds interest which varied from six to ten percent.

Companies might be able to pay back only the costs of the constructions in a period of twenty years, estimated Faherty. To illustrate, Faherty considered the Northern Pacific railroad company, financed by Jay Cooke and Co. Bank.[18] The company invested $15.8 million to build 519 square miles of track which were not making money. By 1837, the company run out of money. To redeem for bonds, it resorted to new bondholders. Immediately, old bondholders panicked, and the company bonds rates lowered. Companies which had railroads under construction lacked resources to carry on building them. By 1837, as news spread over the country, many railroad companies defaulted, bank deposits declined, and New York Clearing House suspended payments.

[17] E.BENMELECH; M. BORDO, The Financial Crisis of 1873 and 19th American Corporate Governance, Harvard University Press, USA, p8.

[18] The failure of this bank was preceded by failure of other minor firms like New York Warehouse and Security Company which failed on September 8th, followed by Kenyon Cox and Company which failed on September 13th.

For the first time in its history, the New York Stock Exchange closed for ten days. The closing of the Stock Market was when brokers used certified checks to clear stocks, an action that involved large overdrafts from banks. Bank loans fell by 6.4% and deposits by 9%. Yet, none of the banks closed in the period following this panic.

Defaulted railroad companies had great impact in worsening economic conditions. Jobs disappeared, lines service was interrupted, and future expansions were halted. Nonetheless, in addition to investments in railroads, the United States invested most of its capital in iron, steel, and coal industries, sponsored by states. Government erected tariffs on these industries.

Table 1.3 illustrates how many American industries increased from 1860 to 1920

1860		**1880**		**1900**		**1920**	
Industry	**Value added**	**Industry**	**Value added**	**Industry**	**Value added**	**Industry**	**Value added**
Cotton goods	59	Machinery	111	Machinery	432	Machinery	576
Lumber	54	Iron and	105	Iron and stee	339	Iron and stee	493

		steel		l		l	
Boots and shoes	53	Cotton goods	97	Printing and publishing	313	Lumber	393
Flour and meal	43	Lumber	87	Lumber	300	Cotton goods	364
Men's clothing	39	Boots and shoes	82	Clothing	262	Shipbuilding	349
Machinery	31	Men's clothing	78	Liquor	224	Automotive	347
Woolen goods	27	Flour and meal	64	Cotton goods	196	General shop construction	328

Leather goods	24	Woolen goods	60	Masonry and brick	140	Printing and publishing	268
Cast iron	23	Printing	58	General shop construction	131	Electrical machinery	246
Printing	20	Liquor	44	Meatpacking	124	Clothing	239

Table 1.3: Ten leading U.S. industries by value added (millions of 1914 $'s)
Source: Joel Mokyr

Another factor to the crash of 1873 was the demonetization of silver by European and U.S governments in the early 1870s. The western U.S states namely Nevada, Colorado, and Idaho were outraged because they were huge silver producers with productive mines, and for a few years mining paused. Though silver had been the standard from 1792 to 1834, it could no longer be used as money. Henceforth, little silver was coined. The Coinage Act of 1873 ended bimetallism in the United States as it provided in section 15 that: "*Silver coins of the United States shall be a trade-dollar*" which " *shall be a legal tender at their nominal value for any amount not exceeding five dollars in any one payment*."

The price level under the gold standard went down is by no means the most important consequence of the demonetization of silver. Subsequently, the public held larger cash in return of their balances, a fact that led to velocity of the decline.

Nonetheless, the resumption of the U.S government to buying silver was enacted in 1890 with the controversial Sherman Silver Purchase Act.[19] Yet the panics culminated in a series of economic shocks.

1.8.1.2 Government Response to the Panic

In response to the crisis, many bills were introduced in both chambers of Congress, all of which hoped to increase the amount of greenbacks. The Democratic Party and the "hard money" advocators defeated the bills believing that such bills might help the economy in the short run only. Only the Legal Tender Act could pass the House, and survive in the Senate.

The Act, popularly known as Inflation Bill, provided printing $44 million of greenbacks. President Grant (1822-1885), after great deliberations, rejected the bill as he thought such bill might destroy credit-worthiness of economy. In 1875, he pushed for and passed the Resumption Act. The Act reads,

> The Secretary of Treasury is hereby authorized and required, as rapid as practicable, to cause to be coined at the mints of the United States, silver coins of the denominations of ten, twenty five, and fifty cents, of standard value, and to issue them in redemption of an equal number and amount of fractional currency of similar denominations.....

Section three of the Act provides that

> It shall be the duty of the Secretary of Treasury to redeem the legal-tender the United States notes in excess only of three hundred million of dollars, to the amount of eighty per centum of the sum of national bank notes so issued to any such banking association...

[19] It is assumed that the Act was partially a cause of the 1893 panic.

Through the Act, Government planned to redeem all greenbacks in circulation by 1879 by restoring convertibility and re-establishing the gold standard. The Treasury was bestowed with the power to have gold reserves either via any federal surplus or via issuing government bonds.

To redeem some bonds the government paid about $13 million in currency. In such a way, the amount of greenbacks in circulation fell by $82 million immediately after the passage of the Act. President Grant succeeded to reduce debts by paying the amount of $435 million in 1878. These two presidential measures promoted an economic growth after the panic.

Again, the financial history of the United States reveals that the nation, during the Gilded Age, was beset by banking crises, repeatedly, disrupting its national banking system.

1.9 Minor Panics between 1884 and 1890

The panic of 1884 was confined to New York and other nearby cities, unlike the panic of 1873 which spread throughout the country. The banking disturbance of 1884 culminated from the failure of some firms. On May 5th, the failure of Grant and Ward led to the closure of the Second National Bank. Few days later, the failure of another firm hastened the panic. The Metropolitan Bank held reserves from many banks. Rumors about its failure in speculation led to its suspension of payments.

Other failures followed. The Penn Bank of Pittsburgh failed due to a sharp decrease in oil prices. Conditions did, nevertheless, subsequently stabilize thanks to the New York Clearing House which acted as a lender of last resort. The Clearing House issued loan

certificates to banks for the end of enabling them to have cash to pay depositors and allocate and preserve liquidity. In such a way, banks would be able to deal with panics.

New York City witnessed another banking disturbance in November 1890. Some English investors sold their stock to invest in South America. Henceforth, prices in New York Stock Exchange started falling. Few days after the failure of the brokerage firm of Decker, Howell and Co. was announced, which led to a decrease in the advances of the Bank of North America. The New York Clearing House prompted the issuance of loan certificates. The Bank, hence, overcame its shortfall.

Failures of other firms succeeded, but the crisis was past a week after. It is worthy to mention that New York City was designated as a central reserve city. It had the largest amounts of cash reserves and was able to allocate liquidity to the U S financial market. It provided loans to brokerage firms. That it is why the city witnessed recurrent banking disturbances, banking panics, and even crises.

1.10 The Major Panic of 1893

The year 1893 witnessed another financial crisis, rather a serious one. Again the failure of the railroad industry and its shaky financing led to an unprecedented collapse of many banks and businesses. February 26th of that year saw the first sign of the trouble when Philadelphia and Reading Railroad over-extended itself and went bankrupt. The company rushed to withdraw its money from banks causing their runs. In the course of time, banks proved unable to pay their depositors.

The stock market declined throughout March and April. Clearing houses in different cities had enough reserves to issue clearinghouse certificates. By the middle of July, the situation seemed to be calm. However, few days after, another railroad company failed. Suddenly, banks throughout the nation suspended payments.

Economic scholars stated that, beside the collapse of the railway industry, there was a shock in silver industry that affected economy at the time of the crisis. The Cleveland Administration repealed the Silver Purchase Law enacted in 1890, which provided that government had to purchase a given quantity of silver each year. Henceforth, the price of silver collapsed leading up to the closure of many mines in the West. Additionally, as trade in Europe decreased, European investors exchanged their American stocks for gold funds. Silver notes were then redeemed for gold. As a result, American notes could no longer be redeemed for gold.

European investors removed their funds from the United States; a fact that fostered the panic. Banks as well as important railroad companies failed. Ultimately, about 15.000 companies went bankrupt. Consequently, the unemployment rate increased to reach 3 million by the end of the year, about 17% to 19% of the workforce.

Equally important, some scholars pointed out that prior to the crisis, the Treasury reserves of gold were near the legal limit, a fact that might lead to a run on the currency. It did not persist for long since the importation of gold from overseas was estimated by $ 23 million. In spite of the 'heavy arrivals of gold', which reached $24.46 million in four weeks, the stock market was still in decline. The US economic depression did not improve very much.

1.10.1 Macroeconomic and Microeconomic Explanations of the Panic

Explanations of the real causes of the panic are twofold. The first explanation is that interior banks could not gain access to their assets since banks in New York suspended partial payments. As news spread, individual depositors might question their abilities to

access cash. The interrelation in the banking system allowed initial suspensions to spread over. Thus, the panic spread through the interconnectedness of the banking system.

The second explanation is that due to the shock of the collapse of silver industry, depositors pulled their deposits from the would-to-be insolvent banks randomly; a fact that hastened the panic. Carlson (2005) believed that the panic spread because of these two causes beside others. He stated that this panic, unlike many others, had two phases. The first wave of failures started in the interior and spread to New York. The second phase of the panic started in New York and spread to the interior, like most crises, due to the financial linkage.

The causes are manifold and so are the effects. Prices for export crops fell causing a great farm distress. Waves of strikes took place in 1894, most of which were violent like that of Pennsylvania and Ohio. Unemployed labourers and coal miners asked for a relief in employment program. Yet, the Government had no remedies to the recession.[20]

In addition, because of the Sherman Silver Purchase Act of 1890, the Cleveland Administration was compelled to borrow $65 million from a private banker to support the gold standard. Finally, issues electoral campaign turned around the economic situation. As Democrats were heavily blamed for the panic, Republicans had a great victory in the congressional elections of 1894. Likewise, pro-gold and high tariffs Republican, William McKinley, had a decisive victory in the presidential elections of 1896. The dramatic economic situation persisted till 1896.

1.11 The Panic of 1896

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[20] President Cleveland and Democrats were heavily blamed for the panic that was the reason why the Republicans had a large gain in 1894 Congressional election.

Little has been written about the 1896 panic. The data about the panic revealed that the National Bank of Illinois did lend a sum of $2.400.000, a high amount of money that surpassed its capital and transcended its profits to a company and another sum of $500.000 to one of the bank officers.[21] The bank did not have any cash for banking purposes. As a matter of fact, the bank was forced to close in December 1896 as it could not gain assistance. The Chicago Clearing House refused to assist the Bank because of its bad banking methods.

The latter closure led to runs in other institutions and closings in other banks. Interest rates increased and stock market prices fell, like during many other panics. However, bank payments were not suspended. As the short-lived panic precipitated, prices recovered. Economy recovered in 1897 during the McKinley administration (1897-1901) thanks to Klondike Gold Rush which re-established economic growth.

The Table below reveals the most important failures, of different private as well as national banks beside investment companies, which culminated in the nation's economic crises.

Year of Panic	Institution	Type of Institution	Excessive Investment in...
1819	Cincinnati branch of the Second Bank of the U S	Federal Charter	Real estate
	Bank of Kentucky	State Banks	
	Banks in Western		

[21] Andrew Jalil, A New History of Banking Panics in the United States, 1825-1929: Construction and Implications, Online Appendix, pp A19.

	Pennsylvania		
	Banks in Cincinnati	State and Private Banks	
1837	J. L. And S. Josephs, Co. New York	Bill Broker	Real estate+ cotton
	Hermann, Briggs and Co. New Orleans	Cotton Factor	
1839	Bank of the United States of Pennsylvania	Investment Bank	State government bonds
	Morris Canal and Banking Company New Jersey		
1854	Ellis and Sturges, Goodman Co., Smead and Co., Cincinnati	Private Bank	Railroads
	Ohio Saving Bank, Cincinnati	Saving Bank	
	Kentucky Trust Company	Trust Company	
1857	Ohio Life Insurance and Trust Company, Ohio and New York	Trust Company	Railroads
1873	Jay Cooke and Company	Investment Bank	Railroads

	First National Bank of Washington	National Bank	
	First National Bank of Commonwealth of New York		
1884	Metropolitan National, New York	National Bank	Railroad Stocks
	Marine National, New York		Loans to Grant and Ward
	Grant and Ward, New York	Broker	Railroads and other stocks
1890	Baring Brothers, London	Investment Bank	Foreign bonds
	Charles M. Whitney, Boston	Broker	Railroads
	Decker Howell and Company, New York		
1893	Wisconsin Marine and Fire Insurance Company Bank	Private Bank	Mining
	Herman Schaffner and Company, Chicago		Real estate
	United States Loans	Trust	

	and Trust Company, Chicago	Company	
	Columbia National Bank, Chicago	National Bank	
	Capital National Bank, Indianapolis		
	Chemical National Bank, Chicago		
1907	Knickerbocker Trust Company, New York		Mining
	Mercantile National Bank, New York	National Bank	
1930	Bank of the United States, New York	State Bank	Real estate
	Caldwell and Company, Nashville	Investment Bank	Real estate bands, industrial bonds, and common stock
2008	Lehman Brothers, New York	Investment Bank	Real estate
	Bear Stearns, New York		
	Fannie Mae and	Government	

Freddie Mac, Washington DC		sponsored mortgage insurers
Countrywide Financial		Mortgage Bank

Table 1.4: A Survey of America's Most Important Financial Crises[22]

1.12 The Twentieth Century Panics

The beginning of the twentieth century witnessed suspensions of many banks such as the Seventh National Bank at New York City and Niagara Bank of Buffalo. The Buffalo Clearing House assisted the banks, a fact that culminated in the panic of 1901. American railroads witnessed their golden age by the beginning of the twentieth century. Companies like The Northern Pacific, the Great Northern, and the Southern Pacific, to name only these; and businessmen like James Hill, E.H. Harriman, and J. P. Morgan- the controllers of the nation's railroads- gained great and prominent admiration by the American people.

In his attempt to attain control on the Northern Pacific Railway, Harriman competed with Hill and Morgan to purchase the company's controlling stock. He wanted to buy all of the Northern Pacific stocks. Consequently, prices of other stocks started falling. Overwhelmed by the market drown, investors sold their stocks. Prices of other companies started to fall; a fact that caused the first stock market crash. As a result, the whole market crashed. However, the Northern Pacific could successfully avoid the decline.

1.12.1 Factors behind the Panic of 1907

[22] Hugh Rockoff, The Failures that Ignited America's Financial Panics: A Clinical Survey, Rutgers University, 2013, pp 40-42.

No sooner had the crash ended, than the nation passed through a banking panic in 1907, displaying some similarity with the sequence of events that led to the panic of 1893.

Under the Sherman Silver Purchase Act, the federal government purchased millions of ounces of silver with issues of paper currency; moreover the government was now required to purchase an additional 4.5 million ounces of silver bullion every month. The law required the Treasury to buy the silver with a special issue of Treasury Notes that could be redeemed for either silver or gold. That plan backfired, as people turned in the new coin notes for gold dollars, thus depleting the government's gold reserves and leading to the panic of 1907, better known as the Bankers' Panic.

It was another financial panic that occurred when the New York Stock Exchange fell at almost 50%. Panic amplified with numerous bank runs and runs on trust companies[23] where many state and local banks and businesses went bankrupt[24]. Nearly all industrial sectors have been affected by the 1907 market crash. The main cause of the bank panic was the absence of a regulator and Federal Reserve Bank that could intervene to pump in money when banks run short on liquidity.

Actually, the panic began when a group of banks associated with businessmen suffered large losses. The eight banks at stake were controlled by inexperienced men who used the banks for speculation in copper mining stocks. The failure to corner the Copper Company resulted in great losses to the company's speculators and the banks that financed them. A fall in the stock prices threatened depositors who ran to withdraw their deposits from the banks.

[23] Economists believed that trust companies as financial institutions lightly regulated at that period of time were among other factors which led to the panic.

[24] About twenty five banks and seventeen trust companies failed.

The banks sought assistance from the New York Clearing House. One of the businessmen owned a trust company, the Knickerbockers Trust, which lost public confidence. As a matter of fact, the Clearing House did not assist it. The firm, without external assistance, could not withstand recurrent withdrawals.

As the trust company run on, the bank was forced to close its doors. One after another, two other famous trust companies suspended their businesses. Driven by their fear, banks rushed to withdraw big amounts of money from New York banks, hastening the panic, along with the unreasoning fear among depositors.

Much of the responsibility was placed on the Clearing House. It was the first time that supporters of the laissez-faire policy claimed the need of a regulator.[25] To explain the situation more clearly, we have to go back to the time when U.S President Andrew Jackson allowed the charter of the Second Bank of the United States to expire in 1836. The United States was without any sort of Central Bank, and the money supply in New York City fluctuated with the country's annual agricultural cycle.

Additionally, the complexity of the financial system is to be blamed too. About 16.000 small banks having no branches composed the financial system in 1907. The linkage of all those financial institutions to each other was behind spinning the panic wildly out of control. It made the financial structure of the United States more prone to panics.

Bruner and Carr (2007) stated that after any episode of economic growth, financial panics are likely to occur. The financial system may meet liquidity strains as the demand for money increases due to a rapid economic growth. As a matter of fact, in 1907, there

[25] After the crisis, legislation was passed to revive a central bank.

was a massive demand for external finance. About $100 million was imported from Europe denominated in foreign currencies.

Financial crises are also associated with borrowings denominated in foreign currencies, concluded Bruner and Carr.

The linkage of financial institutions and huge borrowings denominated in foreign currencies all along with the process of credit expansion and the emergence of trust companies were behind the spread of the panic of 1907. As the boom cycle progressed, banks issued more and more credits to less and less creditworthy clients to make more profits.

When external shocks happened, banks reduced affording new loans. This triggered a liquidity crisis. Besides, the unequal regulation of banks and trust companies furnished another key source sparking the panic. Trust companies took advantages of opportunities that banks did not.

Trust companies enjoyed more powers as they were not subject to the National Banking Act's regulations. They could finance corporate investments and acquisitions. In addition, state laws did not impose reserve requirement on trusts. Unlike national banks, those companies did hold very low cash reserve. During the panic, the firms underwent a contraction in loans by 37 percent.

They faced important contraction in lending of $247.6 million.[26] The closure of trust companies led to the suspension of convertibility which culminated in making transactions more and more difficult. Non-financial firms were also hit by the failure of trust companies. Holders sold their shares of the non-financial companies having collateral

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[26] Carola Frydman; Eric Hilt; Lily Y. Zhou, Economic Effects of Runs on Early 'Shadow Banks: Trust Companies and the Impact of the Panic of 1907, pp 15

affiliation with the affected trust companies. The failure of fractional financial institutions was transmitted to the real economy.

Beside these economic sparks, there were the mistakes of political leaders which made country more vulnerable to shocks. Bruner and Carr blamed President Theodore Roosevelt (1858-1919), the Republican moralist, for the panic.

The president resorted to the power of justice to excoriate the 'malefactors of great wealth'. Via court suits and decisions, railroad rates were limited; and fine on Standard Oil to fix rates was imposed. Changes in governmental policies regarding rate regulation, taxation, and antitrust enforcement led to changes in markets and affected the atmosphere of business confidence.

1.12.2 J. P. Morgan Saving Economy

Conditions of economic instability would have been amplified without the interference of Morgan and other influential financiers. J.P. Morgan, the nation's *de facto* central banker, and his associates injected liquidity via the creation of 'money pool' out of their personal funds.[27] The latter helped many financial institutions to stay open by providing them with aid. Although firms suffered for a long time after the panic, the crisis was relatively short-lived.

The lesson learned from this economic storm is worth mentioning. Collective action proved satisfactory in braking the severity of the panic. The private efforts to rescue the failed institutions prevented the panic from spreading. In any case, the panic of 1907, as those of 1873 and of 1893, resulted in significant economic disruption as production fell by 16 percent and the unemployment rate doubled. Soon after, the world entered into World War I.

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[27] The money pool acted as a central bank.

1.12.3 The Panic and the First World War

Although the United States was isolationist by the beginning of the War, its economy was affected. Merchants from the United States and Europe alike were at risk as their ships were attacked in seas.[28] However, American trade continued as the demand and the production of weapons and war materials increased. Hence, much of the European wealth was transferred to the United States. (Hsu 18) During the Roaring Twenties, the country enjoyed a decade of prosperity.

At the international level, by 1914, the rate exchange of gold to currency was fixed in most European countries. To finance the War, they printed money to go off the gold standard. Large quantities of gold were transferred to US banks where gold maintained its value. When the War was over, other floating exchange rates were adopted. Some countries proved unable to return to the pre-war exchange rate. As a result, The United States, holding 40% percent of the world's monetary gold, established the gold exchange rate.

1.12.4 President Harding Dealing with the Panic

Republican President Warren G. Harding (1865-1923) succeeded, undoubtedly, to bring the economy after the WWI to recovery. He cut taxes leading up to an increase in revenues and a decrease in unemployment. The President created the General Accounting Office (1921) which regulated federal budget expenditures.

During his first year as a director of the Office, Charlie Dawes reduced government expenditure by $1.5 billion. Government budget was minimized to half in the course of

[28] President Wilson did his best to keep the country out of the War, but in vein.

two years bestowing the institution with more business. The government then could pay back one third of its national debt.

Among other achievements of President Harding was the passage of the Fordney-McCumber Tariff Act in 1922. The Act raised tariffs on incomes, previously mentioned in the Underwood-Simmons Tariff Act of 1913,[29] to their highest level. To understand how the Fordney-McCumber Tariff Act affected American economy in its long term unfavorably requires going back in history. During WWI, Americans supplied Europeans with agricultural products.

After the War, Europe recovered sufficiently. As a result, American agriculture suffered great surplus. Henceforth, farm income fell to $10.5 billion in 1921 that is about 40% as compared to its income in 1919 which reached $17.7 billion. To avoid similar income loss, the Republicans in Congress rallied to petition for trade protection.

The result was the passage of the Fordney-McCumber Tariff Act[30]. Opponents to the Act pointed out that the cost of living increased highly one year after its passage. In addition, it was harshly criticized as it led European traders to raise their tariffs. Tariffs on American goods such as automobiles and wheat were raised by 40% to 100% in France, Spain, Germany, and Italy. Likewise, instead of being secured under the mercy of the Act, the farmers' loss reached $300 million each year.

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[29] The Act was signed into law on October 3rd, 1913 by President Wilson. It established one percent tax on individual and corporate income. Additionally, there was a surtax imposed on higher incomes. The top rate of 6 percent was imposed on incomes equal to or more than $500.000. Then, in 1914, the President sought an increase in income tax. He signed the law that provided imposing taxes on beer, tobacco, gasoline, bankers, brokers, and a stamp on bonds, mortgages and all types of documents. As the WWI had broken out, Wilson urged the need to have a broad array of tax increases. More taxes were imposed on sugar, gasoline, automobiles, iron, and steel. As the cost of the War reached $50 billion, taxation was highly recommended. In the midst of WWI more revenues were needed. Thus, more laws raising tax rates on different incomes and commodities were signed. When the War was over, taxes were cut.

[30] The Act incorporated high duties on agricultural products. High tariffs led to high prices at home. The Act raised tariffs on chemical industry, too.

In spite of the ongoing unrest caused by the tariff acts enactment, people were eager to invest. A speculative bubble was set forth. American investors invested heavily in the stock market. Small investors borrowed what equaled two-thirds of the face value of the stocks they bought from brokers. Loans were higher than the money circulating in the country at that period of time. The more share prices raised the more people invested in. In the midst of this fever, the market turned down.

Soon after, the world entered into the Great Depression.[31] Economists and historians could not reach the conclusion about which among the panics studied above was the most severe. Yet, the severity of the Great Depression is undeniable. Likewise, *what* actually happened, *why* it happened, *where* it originated from, and *how* it spread divided economists.

1.13 Conclusion

The United States had been plagued in the aforementioned financial panics and bank runs, among many others, during both the ninetieth and the twentieth centuries though they were not with the same severity, neither were they sparked by the same causes. It is easy to deduce that failures were due to excessive investments in the current-time industry. Equally important, it is worth mentioning that each of the financial meltdowns was a culmination of the behaviors of the interlocking markets and sectors.

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[31] Historians believed that the Great Depression furnished an arsenal for World War II.

2.1. Introduction

During Woodrow Wilson's presidency (1913-1921), the American people got sick and tired not only of the president's will to govern the world but also of the government interference in economy and in their lives. The election of 1920 promoted Americans' desire to have a government with its traditional role that is a government with less interference in economy. Technological changes and the adoption of electricity in different industries made the American society more productive. While working hours were decreased, wages increased.

Actually, the American income per capita reached $681 by 1929, the highest wage recorded in the history of the world (Allison 175). They became healthier, and life expectancy changed. Fifty percent of the eligible Americans could attend high schools, and news and culture were transmitted to a wider audience thanks to radio and motion pictures. All those changes with more opportunities for economic advance happened without the interference of Harding or Coolidge Administrations.

The 31st President of the United States Herbert Hoover (1874-1964) took office during a period of unprecedented economic and social prosperity. He was a firm believer in the long-term benefit of new inventions and technologies. Under his leadership, many airports were built and radio stations were licensed. He held that "*this country has reached the zenith of its power, the height of its development due to the scientific research, the opening of new inventions, and new flashes of light from the intelligence of our people*." (Qtd. in Rozell & Pederson 112). As for his social and economic beliefs, Hoover squirreled away the *laissez-faire* policy and promoted bringing into alliance government, business, and consumers to achieve and produce prosperity.

Thanks to the electric power, Americans could produce more, henceforth, they could earn more money. Even the working conditions were enhanced. An eight-hour workday and a five-day workweek were provided. There was no room for labor unions and strikes. ‘Prosperity for all’ and banishment of poverty were on the doorstep of the United States. It seemed to reach its ‘permanent plateau of prosperity’. Yet, that was but a ‘bold promise’. This decade of uncommonly economic growth was proceeded by a decade marked by an unprecedented economic, financial, and industrial decline.

2.2 Great Depression 1929-1941

Few months after Hoover’s nomination, the country swept devastatingly through the deepest depression of its history, bringing to an end his triumph of promoting the New Era. The British economist John Maynard Keynes believed the crisis was brought by abundance. Overspeculation, overinvestment, the boom times of the *Roaring Twenties*, and global as well as other domestic events all contributed in the *making* of the crisis.

Prior to the onset of the Great Depression, in April 1929, the citrus crop in Florida was hit by a fruit fly. The government, to prevent its spread, destroyed infested groves. By June, Congress proved unable to compensate farmers’ losses. Consequently, uncertainty about the banks’ health spread urging depositors to withdraw their funds leading up banks to runs in liquidity. Many financial institutions suffered insolvency, thereafter. By July of that year, the run subsided as banks provided enough cash to depositors.[32] Few months after, however, the country swept into the Great Depression.

2.2.1 Extent of the Great Depression

[32] Economic historians deduced that uncertainty and inability of payoffs of a given bank can affect other banks. Similarly, when central banks provide liquidity, they can easily halt runs and their spread.

The largest European economies such as Germany, France, and Great Britain experienced recessions in the mid 1920s[33]. American contraction hit smaller economies. The Great Depression, in the U.S, began in the summer of 1929. The downturn became markedly worse in late 1929 and continued until early 1933 putting end to a many dream of wealth.[34] Real output and prices fell abruptly. Between the peak and the trough of the downturn, industrial production in the United States declined by 47% and real GDP fell by 30%, wholesale price index[35] declined by 33%. In less than two months, the stock market lost about $30 billion in value. Such declines in the price level are referred to as deflation.

Moreover one fourth of the American workforce was out of work as the unemployment rate exceeded 25%. Employment in the South did not fall so abruptly. In the South Atlantic region, for instance, employment declined only 14 percent. By 1933, it recovered quickly. This can be accounted for the type of industry in the South. However, industrialized states, like Arizona, witnessed a drastic decline of the employment rate during the depression.

Some economists related the decline of the unemployment rate to factors like age and occupational group. Middle-aged workers were less likely to be unemployed compared to young and old workers. Similarly, professionals were less likely to be unemployed as compared to blue-collar workers. The unemployment rate among professionals and managerial workers never exceeded 12%. However, it reached 73% among construction workers by 1933, Robert Margo reported in his article *Employment and Unemployment in 1930s*. published in (1993)

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[33] The years 1920's were years of recovery. Yet, some economists believed that the depression of 1929 emerged from the recovery achieved.

[34] The American novelist F. Scott Fitzgerald at the conclusion of his novel the Great Gatsby 1925 described "the old land" which once "flowered for Dutch sailors" as a land which "pandered in whispers to the last and greatest of all human dreams"

[35] The Wholesale Price Index: a program incepted in 1902 to control and measure the price of a representative basket of wholesale goods.

The Great Depression was the most severe depression ever experienced by the industrialized Western world since it was preceded by the collapse of stock market, waves of bank failures, and contractions in the money stock.

Its social and cultural effects, however, were no less staggering, especially in the United States, where the Great Depression ranks second only to the Civil War as the gravest crisis in American history since it was longer in duration. Economic recovery was not achieved in the following few years of the economic decline like in the previous crises. The government proved ineffectual and the liberal market economy lost credibility.

During the interregnum, Congress, waiting for the elected president to assume office, was unable to pass any legislation. Henceforth, more and more people were driven to despair and extremes. The American Dream began to lose its luster. Americans emigrated in the opposite direction as unemployment rose critically and prices collapsed. Farmers ruined and could not provide their crops with harvest.

2.2.2 Causes of the Great Depression

So many factors ignited the Great Depression. Historians, economists, and political scientists stated that the interaction of a set of political, economical, and social factors were behind the cataclysmic economic collapse. The First World War, the collapse of the Gold Standard, the US stock market crash of 1929, to name only these, are the most obvious causes of the Depression.

2.2.2.1 Post World War I Governmental Policies

To start with, the War caused great loss of lives, money, industry, transportation, and infrastructure. For countries like Australia, Brazil, Argentina, Canada, and the United States, it caused an economic boom, however; as their economies invested heavily in the manufacturing sector. There was an explosion of productivity. To finance the War, each

side spent its gold reserves and printed money. Printing money in excess led to inflation, an increase in prices, and a decrease in the purchasing power, respectively.

Powers like France, Belgium, and Britain borrowed from the United States. By 1929, Germany proved unable to pay heavy reparations to France and England. Therefore, they could not repay their creditor, the United States. None of the three countries could buy American products. As a matter of fact, the United States collapsed. In addition, the War disrupted international trade. In the post war period, European governments engineered deflation to stabilize prices. Yet, this delayed the foundation of the international monetary system. The worst legacy of the war was the vulnerability of the world financial system to a collapse.

Another bad legacy of the War was the dissolution of old European supremacies and the creation of smaller states, each of which highly required the establishment of new treasuries, the issuance of new currencies, building new economies and new economic relationships. The impact on the old Empires was even worse as the new countries imposed barriers on trade between each other. Also, gold was suspended in international trade. Yet, going back to the gold standard was not that easy. The new "weak" countries were required to fix their currencies rates to gold. For so doing, governments had to raise exportation and attract finance from other countries. This proved to be hard as governments had to limit their expenditures to balance their budgets.

2.2.2.2 The Collapse of the Gold Standard

Returning to the gold standard was a prerogative to go back to the stability of the international monetary system and trade of the pre-war period. To this end, governments cut spending and salaries to lower prices for commodities and products, and deflate prices. This led to a downward movement in economies and the labor strife in Britain and the rest

of the world. Those deflationary policies culminated in reducing demand and the collapse of the gold standard. The latter resulted in the absence of a standard, and in the inability to found coordination among international economies which led to the spread of international economic anarchy.

For the economic historian Charles Kindelberger (1973), countries which remained on the gold standard after 1931 suffered more. Levels of prices were declining as the demand for gold kept rising. While European countries were losers of the War, the United States emerged as the world's superpower. Its economy witnessed its golden age. During the War, it was the world's biggest creditor. The whole world depended on American loans.

2.2.2.3 Overproduction and Overinvestment

After the War, the United States witnessed a sharp recession (1920-22). Industrial as well as agricultural prices dropped sharply. The *depression* hit farmers hard. During Wilson's presidency (1913-1921), farmers could find loans for longer periods of time under the Farm Credit System. Subsequently, the United States became more efficient in agriculture. Additionally, the society's face changed as soon as the country embarked on a great manufacturing and consuming spree.

About half of what the country produced was consumed by Americans. The annual average wage was less than fifteen hundred dollars per year[36]. As a matter of fact, they had to rely on credits to consume goods such as cars, radios, and telephones which were mass-produced. The high demand of loans furnished an arsenal for loan-sharking.

Nevertheless, in the midst of this prosperity, Americans invested more and more in the stock market leading up to turning the market into a bubble. Americans were zealous to

[36] Charles R. Geisst, Wall Street: a History, Oxford: Oxford University Press, 1997, p 154

have their own shares of wealth as disparities in wealth were enormous. All Americans were speculating in the market. That was a way to avoid taxes on profits as salaries were highly taxed. Speculation was based on borrowed money.

Prior to the War, only small banks, credit companies, and individuals issued loans. During the boom following the War, Commercial and Trust banks loaned large sums of money to brokers who lent them to investors of all sorts, as this was more lucrative. Interest rates for broker loans were higher compared to other loans. Investors enjoyed dominating the markets through bonds speculation. Bonds constituted about 75% of all securities coming to markets.

It is apparent that too much money was invested in stocks. An investor who owned stocks could borrow $1000 from a bank to buy more stocks, or bonds, or real estate. When the Stock market crashed, the investor found himself indebted to his broker and to the bank. Not only individuals who did this, even financial institutions like banks, credit unions, pension fund, and insurance companies put the large amounts of cash they had in hand in purchasing stocks. When stock values declined, the assets of those institutions fell, too.

Even foreign companies were involved in speculation. For instance, the United States intervened to help stabilize the mark through the Dawes loan to Germany, which was a two-part bond. Likewise, strong Anglo-American financial relations were forged through the agreement between the Bank of England and the Federal Reserve Bank of New York to close the London stock market and keep American interest rates lower to force investors to go to New York[37].

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[37] It was President Hoover who encouraged the Federal Reserve Board to raise discount interest rate.

In an attempt to stabilize its economy, England restricted the flow of gold to the United States through raising discount rate of interest. British investors resorted to the American stock market. This agreement proved satisfactory as the New York markets boomed. The country became a creditor nation.

2.2.3 The Wall Street

As far as Wall Street is concerned, the most profitable line of its business was issuing bonds to foreign borrowers who came from different places such as Canada, Newfoundland, Latin America, and Eastern Europe. American markets became a source of capital for foreigners. Commissions and fees were quite healthy. During the Coolidge presidency (1923-29), Herbert Hoover (1874-1964) being a Secretary of Commerce questioned this new issue activity. He tried hard to restrict foreign borrowers' use of funds to their competition with American industrial companies. Yet, those efforts were in vein. Wall Street did not cease affording loans to foreigners.

Foreign companies had some speculator deals. One of the European best-known financiers and industrial builders was Ivar Kreuger of Sweden. One of Kreuger's holdings borrowed money from the Yankee bond market and loaned it to European governments. By so doing, Kreuger gained European reliability, and he became their intermediary in the American market.

On the other hand, Kreuger gained strong hostility from Wall Street. In 1923, in corporation with Lee Higginson, Kreuger founded the International Match Corporation which sold shares in the American markets. Kreuger transferred about $25 million of the company's proceeds to his personnel accounts without publishing any financial statements. Higginson, then, realized that Kreuger was but a swindler who was used to borrow money, and use the proceeds to pay dividends on the stock of his companies.

Although this way of enhancing one's speculative capacity was very common before 1929, no one noticed it till the failure of Kreuger's companies during the Depression. Another speculator deal committed by Kreuger was the substitution of some securities pledged to Yankee bond by other collateral with lower and worthless quality.

Higginson found himself in an embarrassing position. Kreuger's deals put Wall Street in an intricate situation. The United States opened the markets to foreigners not to supply itself with money but rather to provide capital to foreign investors. Subsequently, the Federal Reserve was created to cool down the market via raising interest rates aggressively with undue haste.

Wall Street was also involved in tax avoidance. Once the War was over, taxes were no longer related to patriotism. Soon after the War, an anti-tax movement emerged. Many investors pledged to avoid paying taxes during the 1920s. As a response an anti-Prohibition Movement emerged to oppose the income tax. The movement seemed to repeal the Prohibition Amendment. The latter prohibited alcoholic beverages in the United States. It took effect on January 16th, 1920.

Shortly after the passage of the Eighteenth Amendment, the Association Against Prohibition Amendment, referred to as AAPA, was founded to roll back the Volstead Act.[38]The AAPA, through the campaign to repeal the Amendment, sought the abolishment of the income taxes. Andrew Mellon, Secretary of the Treasury at the time, suggested cutting taxes to increase revenues. Subsequently, wages, profits, as well as productivity all increased leading the country to a long expansion.

Nevertheless, this prosperity did lead to the Great Crash. Investors lost more than their margin. Then, Wall Street panicked after the fall of Dow Jones Industrial Index which

[38] It is the National Prohibition Act whereby the intent of the Eighteenth Amendment was carried out.

lost one fourth of its value in two days only. Many firms were forced into insolvency. Markets were propagators of decline, believed John Maynard Keynes (1963). At the international scale, bank failures took place in many European countries since capital was flowed into the US to cover its losses. Countries, one after another, were engulfed in the crisis, acceleratingly. The financial downturn spread across Europe, through Austria, Germany, France, and Great Britain. The United States proved unable to act as last lender of resort. It could not stabilize the market so long as it, like many other countries, hasted to protect its national interest.[39] Kindelberger (1973) explained the way the Depression was transmitted to and across countries by stating that,

> New lending stopped because of falling prices, and prices kept falling because of no new lending. As the less developed countries lost access to loans and spent their gold and foreign-exchange reserves, they were forced to sell old quantities of primary products for what the market would bring. Deflation spiraled. (Kindelberger Qtd in Calomiris 1993)

Beside this erroneous economic leadership, there was an absence of intellectual guidance of economic policy. Present day economists believe that to overcome a crisis, there must be a need to spend more, reduce taxes, cut interest rates, and reduce tariffs to promote free trade. To deal with Great Depression, governments, misguided and desperate, cut spending and raised taxes, instead. The situation worsened. The more the governments taxed the more the economy declined.

[39] Kindleberger (1986) stated that this reflected America's wrong financial leadership that caused the Depression. Additionally, Matziorinis (2007) blamed the US for the Depression since it applied the Smoot-Hawley Tariff of 1930. Through the Act, Congress raised tariffs on foreign products from 15% in 1929 to 60% in 1930. Consequently, there was shrinkage in world trade of one sixth of its pre-crash level. Economists blamed the US for not leaving its market open for countries to export their products and support their economies.

Milton Freedman and Anna Schwartz in a seminar work on the monetary history of the United States came up to the conclusion that the Great Depression was not the outcome of the Stock Market crash but of the wrong economic policies adopted by Britain and the United States in particular. They stated,

> The stock market crash in 1929 was a momentous event, but it did not produce the Great Depression and it was not a major factor in the Depression's severity. A sharp but not unprecedented contraction was converted into a catastrophe by bad monetary policy. Whatever happens in a stock market, it cannot lead to a great depression unless it produces or is accompanied by a monetary collapse. (Freedman & Schwartz 1963)

This view has also been re-emphasized by Brotherland in his book "America's First Great Depression" when he stated that some crises could be precipitated by governmental action and government intervention in the market. As for the 1929 crisis, people, with a weak confidence, distrusted banks and triggered a deflationary run in the banking system. Actually, this decline in production and business activity was preceded by a great boom that began in 1921. The country's money supply reached $45.3 billion in that year. There was an abrupt leveling off of the money supply during the first half of 1929.

2.2.4 Production Decline

The fundamental cause of the Great Depression in the United States was a decline in aggregate demand which led to a decline of 47% in production, as manufacturers and merchandisers noticed a low demand to raise inventories, employment, wages, and investment.

The sources of the contraction in spending in the United States varied over the course of the Depression, but they cumulated into a monumental decline in aggregate

demand. The American decline was transmitted to the rest of the world largely through the gold standard.

Economists who examined the American economy of the late 1920s inferred that industries, which made its strength, such as home building and automobile industry, were already experiencing weaknesses and problems during the first six years of that period. (See figure 2.1) Americans reduced consumption and purchasing, curtailing not only the need for houses and cars but also for steel and other raw materials. Simultaneously, railroads dropped.

This inference suggested that supplying money without encouraging consumption did little good to the country. One may wonder why consumption declined. The American economy of the late 1920s witnessed a great shift from old industries to new ones like chemicals and customer services. Such transition required a delay of unemployment and great expense to convert workers to new industries.

In addition, there was an urgent need of redistributing investment and capital. More importantly, the new industries could not finance their production or promote the demand for their products and services when the market crash hit the economy. The catastrophic collapse took place at a time when neither old industries nor new ones could keep the economy moving.

In brief, two dominant theories can be referred to when accounting for what really caused the Great Depression: the monetary-hypothesis and the consumption theory. The former ascribed the Great Depression to the failure of the Federal Reserve to provide money supply to banks which failed at that period of time.

This theory focused only on the first two years of the crisis. The missing explanation could be provided by the consumption theory. The lack of demand for goods, products, and services in a time of great excess was a fundamental cause of the Depression.

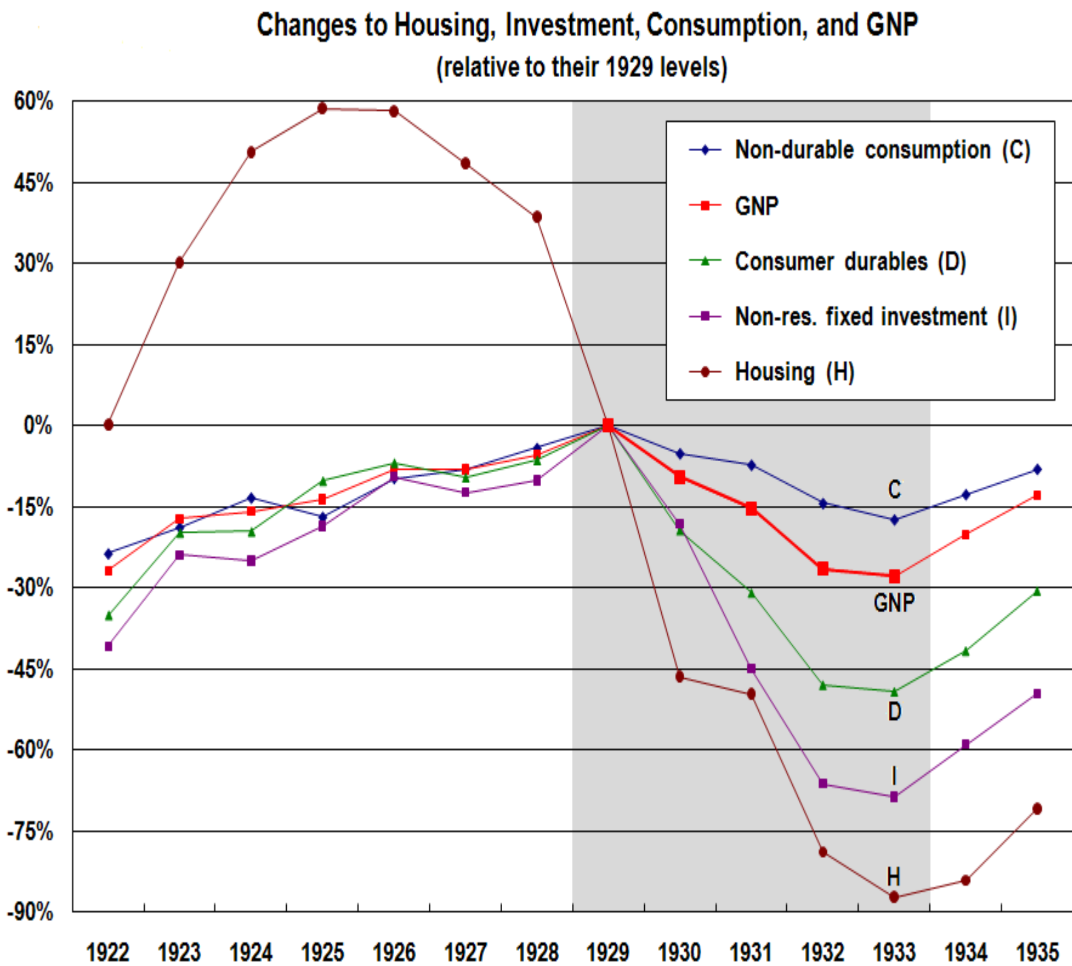

Figure 2.1: Changes in GNP and its Components before, during, an after the Great Depression (Gjerstad & Smith 2010 p 9)

2.2.5 Stock Market Crash

The production of automobile and its associated industries developed economy. American investors borrowed large sums though the production increased in a moderate way; something that led to the transformation of the stock market. The initial decline in

output in the United States in the summer of 1929 is widely believed to have stemmed from tight U.S. monetary policy which aimed at limiting stock market speculation.

The 1920s had been a prosperous decade, but not an exceptional boom period; wholesale goods prices had remained nearly constant throughout the decade and there had been mild recessions in both 1924 and 1927. The one obvious area of excess was the stock market.

By 1929, stock prices reached their peak. To slow down this rapid increase, the Federal Reserve increased interest rates. When minor events led to gradual decline in stock prices, investments as well as production decreased. Investors started liquidating their holdings, exacerbating decrease in prices. Stock prices fell by 33% in a period of two months. This dramatic decline is known as the Great Crash. The table below shows the decrease of prices

YEAR	PRICES
1929	141
1930	118
1931	89
1932	74
1933	82

Table 2.1: Decrease of prices[40]

The Great Crash of 1929 is but a decline in US stock prices. October 1929 witnessed a gradual price decline, something that pushed investors to sell up their assets, thus aggravate the fall in prices. The crash worsened American demand and wealth.

[40] M. Broadus, Depression Decade From New Era Through New Deal, 1929-1941, New York, 1947, p 302

Consequently, uncertainty about future income rose sharply and real output fell rapidly. The crash of stock prices caused the decline in production, in commodity prices, import process, and in employment.

By 1932 and 1933, industrial stocks could preserve only 20% of their real value; and unemployment reached 23.6%. These were the two worst years of the Great Depression. The two tables below demonstrate how production decreased and unemployment increased respectively

PERIOD	PRODUCTION
1929-1932	-19.7%
1932-1937	-14.7%
1937-1938	-22.7%

Table 2.2 Production decline[41]

YEAR	UNEMPLOYMENT RATE

[41] Ibid, p 303

1929	3.1%
1930	8.7%
1931	15.8%
1932	23.5%
1933	24.7%
1934	21.6%
1935	20.0%
1936	16.8%
1937	14.2%
1938	18.9%

Table 2.3: Unemployment increase[42]

Many economists and historians attributed the Great Depression to the fall of the stock market in an untested connection. However, L. Douglass (1999) stated that stock market crashes do not necessarily lead to depressions of long term, giving the example of the crash of October 1987 when stocks declined twice as much as in 1929 without spiraling economy into a depression. The Great Crash is far to be blamed for a depression of similar losses, depth, and duration.

2.2.6 Bank Failures

Upon the whole, there were about five thousands banking failures during the 1920s; an average of 600 banks failed each year. The American banks experienced several panics in the fall of 1930 when the Bank of New York went bankrupt, the spring of 1931, the fall of 1931, and the fall of 1932. These were subsequent consequences of the depositors' demand to have their deposits paid to them in cash.

[42] Ibid, p 306

Depositors' losses reached $565 million from 1921 to 1929. Losses rose to $1.3 billion in the three years between 1930 and 1933.[43] Banks had to liquidate loans to raise the required cash. Friedman and Schwartz believed that this series of banking crises reduced the money stock.

The Federal Reserve proved unable to rely on the discount window to offset loans to banks. This culminated in a drastic contraction in economic activity.[44] According to Calomiris (1993), persistent withdrawals of depositors all along with contraction in the money supply led to an unprecedented destabilizing deflation. The heights and the costs to depositors because of these bank failures were unprecedented, too.

Even in winter 1932, the wave of bank panics continued, pushing President Franklin Delano Roosevelt to declare 'bank holiday'. The latter closed all banks provided that they could reopen only after being declared solvent by government inspectors.

2.3 The New Deal: a Way to Recovery

In the midst of the despair, Franklin Delano Roosevelt was elected President in 1932 without a specific program. He adopted the New Deal.

2.3.1 The Election of Franklin Delano Roosevelt

. Franklin Delano Roosevelt, born into an upper-middle class in New York in 1882, was the fifth cousin to the 26th president of the United States Theodore Roosevelt (1858-1919). At the age of 26 years, and after three years as a lawyer, FD Roosevelt sought public office. As soon as he won election to New York State Senate in 1901 as a

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[43] Charles W. Calomiris, Financial Factors in the Great Depression, in Journal of Economic Perspectives, Volume 7, Number 2, Spring 1993, pages 61-85, pp 9.

[44] The country witnessed a recovery from 1933 to 1936. According to Friedman and Schwartz, this monetary ease was soon contracted doubling the reverse ration required for banks to reduce excess.

Democrat, he was referred to as a successful politician devoted to social and economic reforms.

Prior to his election as president, Roosevelt held strong beliefs that the Depression was caused by domestic factors, rather than by international ones, as Republicans believed. For Roosevelt, the strength of the free market was the source of its malaise. He feared that capitalism would sweep away, in its undertow, freedom and democracy.

Two different philosophies were under contest during the presidential campaign. Roosevelt relied on a highly eclectic group of advisors and academics of Columbia University, known as the *brain trust,* who patched together many programs, known as the New Deal, the end of which was to apply social values. Being aware of the origins of the Great Depression made Roosevelt more mindful of the importance of the creation of the social welfare state. The *brain trust* furnished a platform whereby the country could get out of economic quagmire.[45]

Having academics' intervention to regulate commerce annoyed Wall Street. Governmental intervention and regulation of economic power was anathema to Republicans and investors as well. President Roosevelt blamed bankers and financiers for the crisis in his Inaugural Speech when he assumed the office. He said,

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[45] The economist John Maynard Keynes welcomed the election of Roosevelt. In June 1933, he was one of the few experts to approve his attitude at the London Conference. Through Felix Frankfurter, who then stays in Britain, he gets in touch with the president at the end of 1933. On December 31, the New York Times publishes an open letter from the economist. He says that he wishes the success of the New Deal, "If you fail, it will change the world, leaving orthodoxy and revolution to fight it out. But if you succeed, new and bold methods will be tried everywhere, and we may date the first chapter of a new economic era of your accession to office". Keynes, however, does not conceal his reservations about the monetary manipulations which preceded the devaluation of January 1934 and the insufficiency of the sums allocated to major works. His strongest criticism is that he has not respected the order of priorities between recovery and long-term reform : the NRA, in particular, may, in his view, hinder the resumption of activity. Roosevelt writes to Frankfurter that he can tell the professor that the sums spent by the Federal Government in major works will almost be doubled in the coming fiscal year, but that "there is a practical limit to 'State can borrow'.

> Primarily this is because rulers of the exchange of mankind's goods have failed through their own stubbornness and their own incompetence, have admitted their failure, and have abdicated. Faced by failure of credit they have proposed only the lending of more money. Stripped of the lyre of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for resorted confidence.... The measure of restoration lies in the extent to which we apply social values more noble than mere monetary profit. (FD Roosevelt, March 4th, 1933)

The President sought the eradication of the tyranny created by the concentration of economic power. Roosevelt's request to have a broad executive power was a turning point in the stature of the presidency. Presidents, in the United States, enjoyed but subordinate power, except in war times.

They could not act without being subjects to the lawmaking branch. During Roosevelt's presidency, however, things changed. He created the 'modern presidency' through expanding federal government to meet the exigencies of the Great Depression. He stated: "*I shall ask Congress for the one remaining instrument to meet the crisis-broad Executive power to wage a war against the emergency, as great as the power that would be given to me if we were in fact invaded by a foreign foe.*"

Government spending increased from 8.0% of GNP under Hoover in 1932 to 10.2% of GNP in 1936. While Roosevelt balanced the regular budget, the emergency budget was funded by debt, which increased from 33.6% of GNP in 1932 to 40.9% in 1936. Deficit spending had been recommended by some economists, most notably John Maynard Keynes in Britain.

Keynes was the only individual who played an important role in setting forth theory and policy tools to deal with crises through his famous book The General Theory of Employment, Interest and Money which appeared in 1936.

2.3.2 Intensive Legislative Activity, Timeline

Prior to the election of F D Roosevelt, Congress was spurred to pass the Federal Home Loan Bank Act. As million families lost their homes because of foreclosure proceedings, Hoover responded by urging the designation of the aforementioned act. People became able to buy their own homes at lower costs of home ownership thanks to increasing the money supply devoted to the housing market.[46]

Hoover was blamed for his unwillingness to put an end to policies which proved unsatisfactory to business and financial communities. His measures proved unable to promote recovery or decrease the tide of unemployment. There were no measures for direct federal relief. Hoover's too little too late actions paved the way for the democrat candidate to win the election by a large margin, who adopted the following intensive legislative activity[47]

Year		Congressional Acts
First New Deal	1933	Agricultural Adjustment Act, National Industrial Recovery Act, Emergency Banking Relief Act, Banking Act of 1933, Federal Securities Act, Tennessee Valley Authority Act, Gold Repeal Joint Resolution, Farm Credit Act, Emergency Railroad Transport Act, Emergency Farm Mortgage Act, Home Owners Loan Corporation Act
	1934	Creation of Federal Communications Commission, the National Mediation Board and the Securities

[46] This can lead us to deduce that some provisions of Roosevelt's New Deal were not totally new. Hoover's Reconstruction Finance Corporation which played the role of lender of last resort inspired Roosevelt to sustain financial institutions in times of downturns (FDI). Roosevelt, too, adopted Hoover's policy to enlarge budget deficits relative to GNP.

[47] Economists such as Benjamin Anderson (1979) and Badger (1989) endorsed the idea that New Deal measures threatened private property rights.

		and Exchange Commission, Gold Reserve Act, Railway Labor Act
Second New Deal	1935	Creation of Works Progress Administration, the National Labor Relations Board and the Rural Electrification Administration, The passage of the Banking Act and the Emergency Relief Appropriation Act, the National Labor Relations Act, and the Social Security Act, Revenue Act of 1935, Public Utilities Holding Company Act, Farm Mortgage Moratorium Act, Connally Act, Bituminous Coal Stabilization Act
	1936	Soil Conservation and Domestic Allotment Act, Federal Anti-Price Discrimination Act, Revenue Act of 1936
	1937	Bituminous Coal Act, Revenue Act of 1937, National Housing Act, Enabling (Miller-Tydings) Act
	1938	Agricultural Adjustment Act, Fail Labor Standard Act, Civil Aeronautics Act, Food, Drug, and Cosmetics Act
	1939	Administrative Reorganization Act
	1940	Investment Company Act, Revenue Act of 1940, Second Revenue Act of 1940

2.3.2.1 The First New Deal, 1933-1934

To eliminate such crises, the New Deal and the Federal Reserve Act were enacted during the early years of 1930's. The economic program focused on the three Rs: Relief for the poor and the unemployed, Recovery of economy, and Reform of the financial structure. Through *relief* and *recovery*, the President tried to compensate for the damages caused by business failures.

Reform meant reconsidering the Federal Revere System, the stock market, and wealth distribution. Roosevelt believed that unemployment and the drop in industrial production had to be remedied before any other effective actions. During the period

between March 9th and June 16th of the year 1933, Roosevelt sent a number of bills which were easily approved by Congress.

The Federal Emergency Relief Administration, which distributed relief to the unemployed, along with the Civilian Conservation Corps hired unemployed workers to jobs anew. The Public Works Administration of 1933 generated jobs for jobless people. Mortgage relief was provided to farmers and homeowners. Agricultural relief was an important priority to President Roosevelt. He established the first Agricultural Adjustment Administration (AAA) which paid farmers to take land out of corps and cut herbs; thus, implementing higher prices for commodities.

For *Recovery*, Congress passed the Emergency Banking Act declaring a "bank holiday". Later on, the President signed the Glass Steagall Act whereby the Federal Deposit Insurance Corporation (FDIC) was created. The Act separated commercial banks from investments banks. While the former took deposits and extended loans, the latter underwrote, issued, and distributed stocks and bonds. Additionally, it regulated interbank control and prevented speculation.[48]

The National Recovery Administration (NRA) did set minimum prices and wages in all industries. It increased the purchasing power of the working class by 93%. It ended deflation by suspending the Gold Standard. It made it possible for farmers to earn a living from farming by cutting farm production and raising prices. Enacted in June 16th, 1933, It authorized the President to regulate commerce and establish national works program to the end of promoting economic stability. Roosevelt held a strong belief that the problem was not a lack of money but rather the inability of people to buy goods and services. Therefore he put money in people's hands to promote demand.

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[48] All this was set forth in the Pecora Commission on Banking and Commission, held in 1932 and established by US Senate, after studying the causes of the crash.

His target was to decrease production, enlarge the populace purchase power, and increase demand. The NRA was, nevertheless, declared unconstitutional by the Supreme Court in March 1935. [49]It was the second New Deal Act to be declared unconstitutional by the "Nine Old Men" through unanimous decision on May 27th, 1935. Subsequently, Roosevelt started losing confidence in the NRA.

Roosevelt was blamed for adopting a mechanism, whereby his policies were formulated and carried out, based on the centralization of decision making. On the other hand, John Kenneth Galbraith, the president of the American economic association, concluded that Roosevelt's policies stimulated the creation of the middle class in the United States. Wage earners and farmers could enjoy a boosted buying power thanks to the distribution of wealth. He believed, just as Roosevelt did, that government must establish and maintain the welfare state. He sought to protect the people rather than the nation. He succeeded in changing people's sentiment towards the government.

As illiquidity plays an important role in any economic crisis, gauging the interrelation between illiquidity and insolvency determines the central bank response to panics. So, extending credits to quell a panic is vigorously required. Federal spending was deemed the key to recovery via 'pump-priming'. Enormous amount financed New Deal programs. $ 3.3 billion was invested to stimulate economy.

For *Reform*, the National Industrial Recovery Act was adopted. It invited industrial leaders to set forth codes that established rules of operation such as minimum prices,

[49] Conservative justices Wills Van Devanter, James McReynolds, Pierce Butler, and George Sutherland ; and the moderate justices Charles Evans Hughes and Owen J Roberts overturned not only the NIRA but also the AAA. One may wonder if the series of the New Deal had serious problems to warrant the Court to deem them unconstitutional, or simply overturning them was the judges' will to inject their political beliefs into constitutional laws. R.J. Allison (1999) came to the conclusion that striking down the New Deal was due to the judges' narrow political biases. On the other hand, supporters of the New Deal, later on; admitted that there were problems with the NIRA and the AAA.

agreements not to compete, and production restrictions. Those codes were approved by NRA members.

The president, too, issued an Executive Order 6102 whereby he ordered Americans owning Gold, with the exception of jewelers and coin collectors, to sell it to the U S Treasury. Gold price increased from $20 per ounce to $35. This helped countering deflation.

2.3.2.2 The Second New Deal (1935-1936)

It is commonly known that the Second New Deal (1935-1936) focused more on social reforms as compared to the First New Deal which attempted to promote an economic recovery. It started after the Congressional elections of 1934 which granted Roosevelt with the majority in both houses. The Second New Deal challenged the business community and led to a critical attack of Roosevelt likening him to Karl Marx and Lenin. On the other hand, those measures helped Roosevelt be reelected.

Among the Second New Deal measures, there were the National Labor Relations, the Social Security Act, and the Works Progress Administration passed early in 1935. The latter tried to absorb unemployment. It provided a relief wage. President Roosevelt was authorized to use the Federal Emergency Relief Act's money to finance the WPA. About $ 4.9 billion, what equaled 7% of the national income was used to provide employment to those deemed eligible by their states for relief.[50] By the fall of 1933, government clearly proved unable to get all the unemployed back to work. Sooner, Harry Hopkins the appointed director of FERA suggested the establishment of the Civil Works

[50] Although the WPA placed the United States as the world leader in social policy effort, scholars interested in political economy concluded that the measure's purposes were not clearly defined. By 1938, it faced congressional opposition. By 1942, when the United States was engaged in the WWII, unemployment rate was less than 5%, President Roosevelt declared that the WPA was no longer necessary and he "asked that the WPA be liquidated."

Administration (CWA) which was designed to get men back to work quickly. Later, thanks to the WPA, hundreds of airports, thousands of bridges and public buildings, and thousands of miles of city streets and sidewalks and rural highways were constructed.

Even cultural centers were created to give art classes to people of all ages. They even conducted training programs for vocational skills. Actually, the WPA was able enough to change not only the economy as needed but also the everyday life of Americans. Under the WPA Americans could “do the best from a bad job”. WPA Women’s division employed thousands of women in their sewing projects. Books were given back to libraries since they were unable to buy new books. Actors and theater technicians performed their newly produced plays on roads to give the opportunity to the people who had never attended a theater performance to see live professional performances. Even writers and musicians were employed in this manner. Allison (1999) claimed that writers, artists, and photographs were paid, under the New Deal, to record the country’s ups and downs during the Depression. He believed some of records were not faithful to the program’s advantages. Harry Hopkins, with an enthusiastic tone, described the WPA. He said,

> Only a work program can answer…..all aspects of the unemployment problem. Only a job can answer the problem of a jobless man; only a wage will increase purchasing power, for a basket of groceries starts no dollars circulating; only through work can these people make their contribution to our national well-being.

Among other New Deal innovations is the Civilian Conservation Corps (CCC), deemed the most successful. Young men of 16 to 23 years of age were trained to work in parks and forests. They planted trees, built low dams, expanded zoos, and constructed

picnic facilities. They were compelled to send a portion of their monthly wages to their families.

New Deal measures met great oppositions from the Supreme Court.

2.4 The Supreme Court and the New Deal

The American Supreme Court annihilated an important number of laws passed by Congress. In the years between 1920 and 1933, it struck down laws or provisions twenty-two times. However, by early 1935, the Court displayed more activism. The months that followed the enactment of New Deal measures witnessed active procedures in the nation's courts. Ultimately, it was the Supreme Court which ruled over their constitutionality. The Court declared some measures, which changed the nature of the federal government, unconstitutional. Among a series of twelve decisions, the judiciary deemed eleven pieces of the New Deal as violative.

The Supreme Court was presided by the 11th Chief Justice Charles Evans Hughes (1862- 1948), who was a progressive Republican. It was overwhelmed by conservatism as it comprised four Conservatives, referred to as 'the four horsemen': Willis Van Devanter, George Sutherland, Pierce Butler, and James McReynolds. In addition, there were 'the three musketeers' Harlan Fiske Stone, Benjamin Cardozo, and Louis Brandeis who were liberals. Owen Roberts' vote was decisive to create balance from within the Court.

2.4.1 The Court Vs the NIRA

To start with, the Court in *Panama Refining Company Vs Ryan* (January, 1935) ruled a section of National Industrial Recovery Act of 1933 unconstitutional. A provision of the NIRA bestowed the President with an unlimited power to prohibit interstate shipment of oil. The President made an Executive Order whereby he enacted this prohibition. The plaintiff sought to interdict the defendants from enforcing the Executive

Order through a lawsuit. The case was then brought in front of the Supreme Court to question the ability of Congress to delegate unlimited authority to the President in making laws. In so doing, Congress violated both *Article 1, Section 1*; and *Article 1, Section 8* of the Constitution, ruled the Hughes Court in 8-1 decision. Thus, the provision of the NIRA was declared unconstitutional.

In May 1935, the Court delivered two other detrimental decisions, among many others. First, it declared the Railroad Retirement Pension Act of 1934 unconstitutional. The case *Retirement Board Vs Alton Railroad Co*. challenged the validity of the Railroad Retirement Act in its way up through the Court.

Under the Act, workers on common carriers were provided with pensions. Two express companies sought restraining the enforcement of the Act claiming that it was unconstitutional. When it came on for hearings in the Supreme Court, the provisions of the Act were declared a violation of due process so long as it deprived a person from his property to give it to another person.

The Court did not only deem the provisions arbitrary and unreasonable taking of employees' properties but also invalid in all respects. It stated that pensions were established under the guise of regulating interstate commerce; and that pensions had no relationship with commerce. Additionally, the Court held that Congress was not bestowed with the power to pass any railway pension plan. Commentators predicted that any legislation related to social security passed by Congress might be smashed by the Court.

Second, in *Schechter Poultry Corporation Vs United States*, the Court confirmed the unconstitutionality of the flagship of the New Deal, NIRA. Section 3 of the Act promulgated the power of the President to approve the Live Poultry Code which regulated trades, industries, prices, wages, and business practices; and provided fining violators who might commit transactions which might impact interstate or foreign commerce.

In the District Court, Schechter Poultry Corporation were convicted of violating the Code. However, they held that the Code furnished an intrusion of federal government, which could only govern interstate trade, into local commerce.

The Supreme Court ruled unanimously that the Code was unconstitutional so long as it transferred illegally Congressional legislative functions, vested to Congress in the language of *Article 1* of the Constitution of the United States, to *others*. Additionally, it declared that federal government overstepped its powers in trying to regulate Schechter Poultry Corporation business. Roosevelt considered the decision the worst since *Dred Scot Case (1875).* New Dealers referred to it as 'Black Monday'.

2.4.2 The Court Vs the AAA

In addition to striking down the NIRA, the Court continued its work against the Agricultural Adjustment Act of 1933 through *The United States Vs Butler (1936)* and *Morehead Vs New York ex rel.Tipaldo (1936),* to name only these, respectively. In the former, the federal taxing power was put under the Court's scrutiny. Under the Act, a tax was imposed on companies whose production exceeded the limits set forth by the Secretary of Agriculture.

The goal of the Act was to control production and regulate crops' prices. Farmers who reduced their production would receive benefit payments. Congress was authorized to collect the tax from farmers who first processed commodities and expended it for those farmers who decreased their acreage and crops as agreed with the Secretary of Agriculture. An owner of crops, Butler, sued the United States federal government believing that the AAA was unconstitutional. In a 6-3 decision, the Supreme Court announced the unconstitutionality of the AAA.

It held that the power to control agricultural production is delegated to states not to the federal government. Then, the congressional power to 'provide for the general welfare'

could not be dependent from its power to 'lay and collect taxes'. Appropriating taxes to pay farmers and effectuate whatever end was far beyond the scope of the Constitution. This was supposed to be subject to state regulation. The Federal government could by no means usurp state jurisdiction.

The Supreme Court was to determine whether or not provisions of the AAA transgress the Federal Constitution and the powers given to it by the people. So long as controlling agriculture was a state issue, vested by the Constitution, rather than a federal issue, the Act was deemed unconstitutional violating the *10th Amendment*. Robert Jackson, Solicitor General, five years after the decision, stated that "*it is doubtful whether any judiciary tribunal anywhere at any time has rendered a decision of such far reaching and disastrous economic consequences."* (Qtd in R. Allison 1999)

Then, in *Morehead Vs New York ex rel. Tipaldo* (1936), the Supreme Court held the unconstitutionality and the validity of the minimum wage salary for women and children. The petitioner, a laundry manager, was accused of refusing to apply the mandatory minimum wage set for women and children by the state industrial commissioner. Once appealing to the New York Supreme Court, the Act was found paradoxical to the due process clause expressed in the pair of the *Fifth* and the *Fourteenth Amendments* of the US Constitution.

The US Supreme Court granted certiorari in a 5-4 decision upholding the state court opinion. The decision is best explained in the following passage,

> Upon the face of the Act, the question arises whether the state may impose upon the employers state-made minimum wage rates for all competent experienced women workers whom they may have in their service. That question involves another one. It is whether the State has

> power similarly to subject to state-made wages all adult women employed in trade, industry, or business other than house and farm work.
>
> These were the questions decided in the *Adkins* case. So far, at least, as concerns the validity of the enactment under consideration, the restraint imposed by the due process clause of the Fourteenth Amendment upon legislative power of the State is the same as that imposed by the corresponding provision of the Fifth Amendment upon the legislative power of the United States……
>
> The decision and the reasoning upon which it rests clearly show that the State is without power, by any form of legislation, to prohibit, change, or nullify contracts between employers and adult women workers as to the amount of wages to be paid. (U S Supreme Court N° 838 / 298 U.S. 587 (1936))

This opinion does reflect the narrow view about the minimum wage of the conservative justices serving on the bench at that era. President Roosevelt feared that such decisions striking down New Deal legislations might strengthen people's fear about the Second New Deal, and satisfy business leaders. He stated: "*our difficulty with the Court today rises not from the Court as an institution but from human beings within it. But we cannot yield our constitutional destiny to the personal judgment of a few men who, being fearful of the future, would deny us the necessary means of dealing with the present.*" (Qtd in Péréon & Trogrlic 2013 84)

2.5 F.D. Roosevelt Packing the Court

In his speech addressed to the American people, Roosevelt claimed that Americans enjoyed democracy, under the Federal Constitution, the way they did a century ago. He invited the Judiciary to deliver a comprehensive interpretation of the Constitution adequate

to the exigencies of the current circumstances. Roosevelt stated that he wanted to prevent the Court from "*blocking what he believed to be fundamentals of American democracy*" as he wanted, too, to prevent it from "*wrecking any more of his attempts to achieve reform and recovery*".

Through the NRA and AAA, Roosevelt made great changes in economy and society. This created critical oppositions from conservative members of Congress who believed New Deal measures encroached upon the Federal Constitution. The latter left economic issues broadly expressed in *Article 1, Section 8*. Roosevelt invited the Judiciary to deliver enlightened interpretation of the *commerce clause*.

Yet, he never unveiled his intents to his audience. It was not until 20th of January that he announced his will to pass institutional reforms to the judiciary and the executive branches. Roosevelt asserted,

> During the past year there has been a growing belief that there is little fault to be found with the Constitution of the United States as it stands today. The vital need is not an alteration of our fundamental law but an increasingly enlightened view with reference to it. Difficulties have grown out of its interpretation; but rightly considered, it can be used as an instrument of progress and not as a device for prevention of action

2.5.1 Proposals to Pack the Court

The President had to find means whereby he could create harmony between legislative actions and judicial interpretations to preserve a progressive democracy. His councilors Thomas G. Corcoran (1900-1981) and Benjamin V. Cohen (1894-1983) suggested amending the Constitution to bestow Congress with the authority to override

Supreme Court decisions.[51] The proposal proved unsatisfactory as the amending process expressed in *Article V* of the Constitution is complicated.

His Attorney General Homer Cummings suggested rather enacting a law whereby membership to the Judiciary might be modified. Actually the Federal Constitution did not fix the number of the members of the Supreme Court. It was fixed to nine justices under the Judiciary Act of 1869 which declared that "*the Supreme Court of the United States shall hereafter consist of the Chief Justice of the United States and eight associate justices, any six of whom shall constitute a quorum; and for the purposes of this act there shall be appointed an additional associate justice of said court*".

Roosevelt settled on Cummings' proposal, under which the president could appoint up to six justices since there were six Justices who had celebrated their seventieth birthdays. Conservative Congressmen hid their strong opposition while the Vice-President John N. Garner (1868-1967) declared it as he believed that enlarging the Supreme Court might put too much power in the President's hands.

Democrats, who controlled overwhelmingly the executive and the legislative branches, got divided and never voted for the bill in the House or the Senate. Nevertheless, the President adopted Cummings' audacious plan in spite of several fierce oppositions. Roosevelt announced his plan on 5th February.

Buoyed by his electoral victory and as response to the Court's rescinding New Deal legislation, during his second term as president, Roosevelt, without consulting congressional leaders or members of the bench, suggested nominating an additional justice for every justice over the age of seventy who did not retire, and up to 44 judges to lower federal courts.

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[51] Both Corcoran and Cohen were Roosevelt's advisers and members of the *Brain Trust*.

He could finish by having fifteen members in the Supreme Court. Had he not ignored congressional leaders' opinion before announcing the project, Roosevelt might have relied on many men like Hatton Sumners, the Chairman of the House Judiciary Committee, to shepherd the bill. Sumners would suggest Congress to pass adequate pension legislation to encourage Justices to retire.

He strongly opposed Roosevelt's proposal. Sumners kept the bill bottled up in the Judiciary Committee the whole summer of that year. Then, it was reported out unfavorably. Likewise, any other modification to the original bill or its substitutes were rejected.

According to Cummings the rejection was due to manifold factors. Cummings wrote in his diary in July 1937, collected and published by the library of Virginia University, that

> the set-up of the Judiciary Committee was known to be adverse from the beginning and, under the archaic procedure in the Senate, public measures are more or less at the mercy of the Committee to which they are submitted. The Senate Judiciary Committee exercised its power to the limit. It had public hearings unnecessarily drawn out and, after such hearings were closed, held the measure for weeks before reporting upon it. In the meantime the most terrific barrage of propaganda was let loose upon the administration, the President, and all of the friends of judicial reform. We stood up under this pretty well for quite a long while, but they had more money and more newspapers than we had.

2.5.2 The Failure of the Plan

The paramount factor behind the failure of the plan was the long time the Senate Judiciary Committee took to consider the bill and deliver the report. It was discussed in

summer '*when everyone wanted to escape the heat of the capital*.' In the course of time, advocators of the bill on whose votes and aid Roosevelt relied split away. The number of opponents grew over time.

Additionally, a ruling delivered by the Senate Chairman, allowed opponents of any new amendment to speak twice. Thus, filibuster was more and more facilitated. Similarly, the bill could not pass the House. Many historians believed that the bill was to be defeated from the outset. Burns (1956) concluded that

> The court bill probably never had a chance of passing seems now quite clear. Roosevelt's original proposal evidently never commanded a majority in the Senate. In the House it would have run up against the unyielding Sumners, and then against a conservative Rules Committee capable of blocking the bill for weeks. From the start Democratic leaders in the House were worried about the bill's prospects in that chamber. Robinson's compromise plan might have gone through the Senate if he had lived. More likely, though, it would have failed in the face of a dogged Senate filibuster, or later in the House.

Recently, many other historians associated themselves with Burns and asserted that the plan did not have any chance of being passed in the Senate or the House. Roosevelt's oldest son and Secretary during the court fight, James, expected the bill's death on arrival. So, neither Joseph T. Robinson's death nor Van Devanter's retirement caused the proposal's inevitable death.[52]

On the surface, the end of such a 'political bomb' was to expedite the Court's work, but in reality the President wanted to put in the Court men who would support his

[52] Joseph T. Robinson was the advocator of the bill in the Senate.

programs. American people, being aware of the importance of an independent judiciary which would protect their liberties, did spring back the idea of packing it.

President Roosevelt sought to pack the Court but his attempt outraged the public at the beginning. Actually, the plan roused great opposition, basically from conservative members of Congress, the press, and different organizations and interest groups.[53] Opposition to the "Court-packing" plan coalesced with congressional apprehension of federal spending, and the growing number of the sit-down strikes; and the Democrats' discontent about the unexpected encroachment of New Deal.

The plan, instead, alienated many Democrats and Progressives who once supported Roosevelt and strengthened his senatorial coalition; and helped united Republicans "*of all political and economic shadings*" with previous Democrats.

On March 9th, 1937, the President addressed the American people to clarify his concerns about the Supreme Court and make an end to the misunderstandings of his wills and purposes. First, he questioned the meaning of the phrase 'packing the Court'. According to him, neither a trustworthy elected president nor honorable Senators would appoint and confirm 'spineless puppets' who might disregard laws for the sole sake of satisfying the President's personal wills.

If appointing justices who would not work hard to vote judgment of the Congress on legislative policy down could be called "packing the Court", Roosevelt, then, favored doing it. He stated that he wanted to add justices to the bench in order to save America from constitutional usages and abuse; and to boost the flow of "new and younger blood into the Judiciary". He concluded by saying,

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[53] Just like "packing the Court", Roosevelt tried to reorganize the executive branch in 1937 and 1938. He wanted to transform the National Resources Board into National Resources Planning Board which would be in charge of "continuous central planning and program coordination." It was first defeated in the House of Representatives in 1938; then it was quickly enacted when introduced in 1939. This law, whereby Roosevelt created the Executive Office of the President and Office of Emergency Management, marked a great shift in power from Congress to President. Opponents described this as an attempt to import European forms of totalitarianism into the democratic institutions of the United States which might erode business confidence.

> This plan of mine is no attack on the Court; it seeks to restore the Court to its rightful and historic place in our Constitutional Government and to have it resume its high task of building anew on the Constitution "a system of living law." The Court itself can best undo what the Court has done.

He, who was elected by the majority twice to resolve the country's economic distress, was defeated by the minority who wanted to inject their narrow political views into their roles as judges, hampering the people in carrying out their wishes. Nevertheless, this controversy helped the nation have the right to discuss issues and cases revolving around national agendas in front of the judicial institution whose justices say what the constitution is.

The Court was saved by Roosevelt who made its reform sufficient. Without lessening the independence of the Court, Roosevelt rendered it more responsive to political issues via accepting broader federal powers and amending its views about constitutional powers. In the end, actually, it was Roosevelt who won the constitutional war, though the Court plan failed. Péréon & Trogrhic (2013) stated that

> Au sujet du *Court-Packing Plan*, Roosevelt avait coutume de dire que s'il avait perdu une bataille, il avait gagné la guerre. …Remodelée par Roosevelt, la Cour suprême des décennies ultérieures autorisera l'Etat fédéral à l'intervenir activement dans le domaine de l'économie et de la protection sociale et jouera un rôle décisif dans l'affirmation des libertés individuelles et des droits civiques. Il serait donc légitime de parler de « révolution constitutionnelle de 1937.
>
> Reshaped by Roosevelt, the Supreme Court of later decades will allow the federal state to intervene actively in the economic and social protection

spheres; and will play a decisive role in affirming individual freedom and civil rights. Therefore, it would be legitimate to speak about the Constitutional revolution of 1937.

2.5.3 Roosevelt Re-shaping the Court: a Constitutional War over the New Deal

Other historians, however, admitted that the Supreme Court witnessed major changes in its jurisdiction in the early 1930s. G. Edward White stated in his book *The Constitution and the New Deal: a Reassessment* (2000) that the evolution of the constitutional jurisprudence started during the early beginning of the twentieth century; and was ultimately achieved in 1940.

Roosevelt nominated more men to the Court. The President named the New Dealer Hugho Black to replace Van Devanter. His nomination was ratified in the Senate with a great majority. He named Stanely Reed to replace the resigning Sutherland. He would later on name six justices: Felix Frankfurter and William O. Douglass in 1939, Frank Murphy in 1940, James Byrnes and Robert Jackson in 1941, and finally, Wiley Rutledge in 1943. The Court, then, upheld crucial provisions of the New Deal legislation such as the National Labor Relations Act and Social Security through *National Labor Relations Board v. Jones & Laughlin Steel Corporation* (1937), *Helvering v. Davis,* and *Carmichael vs. Southern Coal & Coke Co. and Gulf States Paper,* to name only these. [54]

The constitutional war between the White House and the Judiciary about the "court-packing" created endless conflicts between the President and his former congressional partners; the sole and the ultimate *loser* was the New Deal.

After the Court fight ended, Roosevelt became unable to persuade Congress to pass any of the bills he requested. During the congressional session that followed, Roosevelt could but have the new Agricultural Adjustment Act passed and other work programs.

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[54] The Court, henceforth, abandoned the reference to the *Due Process Clause*. Thereafter, businesspeople realized that they might be object to more legislative and executive incursions.

Finally and after long consideration and revision, Congress approved the Fair Labor Standards Act, the-would-to-be Roosevelt's last achievement. Provisions revolving around monetary policy, government lending, and housing were annihilated.

The anti-New Deal *conspiracy* rose critically as Republicans dominated both the Senate and the House after the mid-term elections of 1938. The Court fight ignited the "end of reform". Claude Pepper (1900-1989), a Democrat Senator from Florida, accused the "unrighteous" alliances of scuttling both the American government and the American people simply because they hated Roosevelt, who pioneered securing American workers and promoted economic emancipation. Historians expected that any advocator of social change would encounter fierce congressional opposition.

All in all, packing the court did not fail because it was illegitimate but because systematic features like the judicial review, the amending process, the congressional committee system, and the Senate filibuster stood against it. Even Chief Justice Evans Hughes would later on question the possibility of having a more deliberate judgment to help the American people get what they really wanted.

2.6 New Deal Innovative Features

Although there were some major weaknesses in the New Deal, its innovative and revolutionary characteristic features are not to be denied. Primarily the New Deal promoted an era of distinct political changes. It also had an important impact on the American society. Political reforms, reverberating throughout all levels of society, led up to social reforms. The relation of the federal government to its citizens changed.

2.6.1 Federal Government and Public Relationship

The elected officials got closer to the people, the President could reach millions of homes thanks to radio chats, and the distance between society and government was nearly

altered. Certainly, the 1930s gave to the American government and society different and distinct shapes and directions which in their turns shaped later developments.

The Tennessee Valley Authority (TVA) of 1933 is a good example to illustrate the government's will to establish a noninterventionist relation with its citizens. TVA guaranteed providing electricity to rural areas along the Tennessee River, and implementing programs for soil conservation and reforestation. Although this governmental action was first favored by former political and social reformers, it was until the New Deal Era that it saw light. Thanks to the TVA, the quality of life of million people was enhanced. This reflects Roosevelt's zeal to forge a nationwide system the end of which was to revitalize rural areas. In the same development, new labor relations were spawned by the New Deal.

2.6.2 Government and Labor Unions

In the language of *section 7* of the NIRA and the Wagner Act, federal government supported labor unions in unprecedented levels. The right of workers to found unions was explicitly expressed therein. U. S. Bureau of Census reported that membership to labor unions rose from 3.8 million in 1935 to 10.2 million in 1941. A clear cut with the past was significantly implied in Roosevelt's efforts to put federal government's power in sustaining workers against factory owners.

Such activist actions resulted in the creation of Congress of Industrial Organizations. Unskilled workers, women as well as minorities were welcomed by the CIO. The latter also considered previously ignored areas such as textile factory workers. The table below illustrates how membership to labor unions increased thereafter

year	Million member	Percentage
1930	3.401	11.6
1931	3.310	12.4

1932	3.050	12.9
1933	2.689	11.3
1934	3.088	11.9
1935	3.584	13.2
1936	3.989	13.7
1937	7.001	22.6
1938	8.034	27.5
1939	8.763	28.6
1940	8.717	26.9

Table 2.4 :Union Membership Data, US Bureau of Labor Statistics[55]

Just like the TVA and CIO, the Social Security Act of 1935 and the Federal Emergency Relief Administration did but mirror new government policies as it gave birth to the welfare state. The country which was once overwhelmed by individualism and volunteerism became by then obsessed by providing support and aid to elderly, disabled and unemployed people; and children. Historian Leuchtenburg (1968) stated that the programs of the New Deal "*represented an advance over the barbaric pre-depression practices that constituted a difference not in degree but in kind….The Roosevelt administration gave such assistance not as a matter of charity but of right.*"

2.7 New Deal and Minorities

The New Deal promoted new opportunities for minorities like women, African Americans, and Indian Americans

2.7.1 New Deal for Women

The New Deal made great advances for women and minorities. Although benefits reached women and other minorities too slowly, Roosevelt by nominating females in

[55] From 1941 to 1947, membership increased from 10.2 million to 14.8 million.

public offices initiated a new stage for them. The First Lady Eleanor Roosevelt and the first woman to hold a cabinet office as Secretary of Labor, Frances Perkins, motivated American women to lobby for social-welfare programs. Winifred D. Wandersee (1981) stated that the New Deal opened new doors to women.

Women played an important role in and carrying out New Deal reforms. Perkins stated, in 1940, that women won the struggle for industrial and social insurance programs. Such gain was ironically attributed to social reformers rather than to feminists. The New Deal, being a bleak catalog of contradictions, paradoxically made advances for women in some areas and limited them in others reinforcing the traditional societal pressures that characterized the era.

Since the industrial era, women's predominant issue was the tension between family and work that characterized their domestic and economic experiences. Because of the Depression, women faced a curious ambiguity. On the one hand, the Depression pushed women to work to meet the current economic pressures. However, women avoided wage work in the interest of jobs for men to foster unity within their families.

New Deal reforms intensified this ambiguity since they preserved women's traditional long-range place in the labor arena. Wandersee (1981) emphasized this issue by referring to the NIRA. She stated that although the NIRA covered one-half of all employed women, it neglected those who were working in the worst conditions of jobs such as public services, domestic services, laundries, and dressmaking.

More importantly, NIRA codes did little good to women as 135 out of 233 codes established lower minimum wages for women compared to those of men. The difference varied between 10% and 20%. The codes also decreased the number of hours particularly for women and unskilled employees. Shorter work days culminated in lower wages; and wages of the better-paid workers were to be reduced to pay the lower-paid workers.

Yet, the codes, basically the Wagner Act, had their blessings on women. The Act, being the most influential labor legislation ever signed by an American president, fostered the foundation of organizations like Congress of Industrial Organizations (CIO) and the American Federation of Labor (AFL) to which women adhered increasingly during the 1930s.

While women working in textiles, paper products, restaurants, laundries, and cigar and confectionary manufacturing affiliated to the AFL, women hired in heavy industries joined the CIO. Women in the automobile and the rubber industries suffered wages reduction and long working hours. It was thanks to the United Rubber workers, organized by the CIO, that wages increased twofold and the working hours decreased to eight hours per day. Nevertheless, discriminatory characteristic features such as sex-defined job categories, wage differentials, and the opposition of married women affiliations constituted most of contracts.

In addition, unemployed women never received relief the same way unemployed men did. The New Deal did but reflect societal attitudes towards women, and never considered their issue more than temporary. The FERA, the WPA, and the National Youth Administration (NYA)[56] never intended to see women more than servants and housewives. Out of the 372 thousand women employed on WPA projects about 185 thousands worked in canning and sewing. It was not until July 1937 that the Household Service Demonstration Projects provided jobs such as teaching and demonstration for women.

Two years thereafter, thousands of women received training; and thousands of trainers were placed with almost 100%.

The WPA proved to be the most sympathetic to the needs of women among other relief agencies. Its projects tended to place women in white-collar occupations. One third

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[56] The NYA set forth programs to provide relief to young people who attended school. It also trained young people who were unemployed and did not attend school to prepare them for jobs in the future.

of all women employed under the WPA projects were clerical, professional, and technical workers. Still, they were underrepresented and limited. For example, the resident educational camps, under the NYA, excluded women from higher achievements. They were put into limited channels of achievement discarding their potentialities.

Thus, women's low economic status was reinforced. Likewise, their social security was dependent upon men. The Social Security Act of 1935 did not only exclude unemployed married women but also women working in farm labor and charitable and hospital services. It left one third of all employed married women without welfare relief.

On the other hand, another form of direct relief was incorporated within the Aid to Dependent Children. Women commuted work relief to ADC. Though the programs did not move beyond the traditional status of women, they encouraged women to pursue careers in public life. Most of those who advocated for a New Deal for women held important positions in federal government agencies. The 'half-loaf' achievement was accepted by female reformers who viewed the limited opportunities for work, training, and social welfare as victories.

The experience of women during the New Deal era can be seen as parallel to another group traditionally outside politics in the United States, Blacks. Both groups received unprecedented opportunities of employment, training, welfare security, and governmental activity, though limited.

2.7.2 New Deal and Black Issues

As for African Americans, historians acknowledged the emergence of the Civil Rights Movement to the New Deal. Before the Depression, African Americans suffered segregation. They could not old positions in presidential administrations. They could not go to the same cafeterias as White federal employees. Cases revolving around racial

segregation and violence issues were rejected in local and federal Courts. Many of them were deprived from their right to vote.

During the depression, African Americans suffered hard as most of them lost their jobs. Many African American farmers and tenants lost their lands. Federal relief agencies rallied to sustain whites and ignored the blacks. When President Roosevelt assumed office, African Americans worried that they would undergo the same hardships and ignorance.

During its first hundred years, New Deal did little good to the African Americans. While NIRA codes enhanced white workers conditions, it did not only exclude many black workers from wage codes but it also left them at the mercy of their white employers. Likewise, the AAA was not administrated in favor of African Americans. Local officers discarded them from federal payments. White farmers denied proportionate shares of their black tenants and sharecroppers.

The Civil Conservation Corps (CCC), too, was discriminatory. Although it accepted African Americans in its programs, it separated their campus from those of the Whites. Black leaders referred to the New Deal as the "Raw Deal". Similarly, the acronym NRA which stands for the National Recovery Administration was referred to as "Negroes Run Around" by African Americans. By 1934, things changed and Blacks were pleasantly surprised.

Lobbied by Eleanor Roosevelt, the National Association for the Advancement of the Colored People (NAACP) and civil rights organizations sought integration of more African Americans within New Deal programs. With important anti-segregationist strenuous efforts of progressive New Dealers like Harold Ickes, Harry Hopkins, and Aubrey Williams New Deal programs were applied with less racial bias.

Thereafter, 30% of the jobs created by WPA were devoted to African Americans. Provisions provided relief to millions of African Americans, hired millions of them to

work, and restored African American schools. Many teachers were put back to their jobs; and hundred thousand African Americans learnt to read and write. They could even write and perform plays.

Though the Tennessee Valley Authority did not put blacks in construction work, other New Deal programs helped hire many skilled workers, keep their homes far from foreclosure; and offered fifty thousand farmers, sharecroppers, and tenants direct relief to buy farms.

In 1936, Roosevelt disintegrated the Jim Crow code and welcomed African Americans in the Democratic National Convention by raising the White House inclusion spirit. In addition, he created the "Black Cabinet" by appointing African Americans to important positions. E. Roosevelt, urged by Mary McLeod Bethune of the National Youth Administration, wrote a memo to the President on November 22nd, 1941 to persuade him to appoint an African American in a high position who would help decide upon issues related to the black community. She wrote,

> I have been asked to call your attention to the importance of having a Negro in a position who can actually confer with the President occasionally on problems that are pertinent to Negroes, and who can have a very close affiliation with the Under- Secretaries of the President as to the Negro's cause.

About forty five African Americans were appointed to New Deal administrations. Historian Nancy J. Weiss (1983) stated that "*the Black Cabinet was important to Blacks because it signified that the government was paying attention to them in ways that had never been the case before*." They founded the Federal Council of the Negro Affairs whose target was to render the programs more responsive to the blacks' needs and issues.

Recommendations were given to the First Lady who would urge their implementation. They could either amend or pass New Deal legislation although they were trumped because of their resistance to Southerners' target to lynch Black people.

During the worst years of the Great Depression, the lynching of African Americans spiked throughout Southern states. Both the white supremacy and the Jim Crow discriminatory laws hindered any efforts to realize justice in dealing with the lynching. Lynching Black people was "*a vile form of collective murder ….a deliberate and definite disobedience of the Commandment, Thou shalt not kill*" for Roosevelt, and he stated that he could by no means excuse those who condoned lynch law.

Yet, he dismissed to pass a bill introduced by Senators Edward Costigan and Robert Wagner which would classify lynching as a federal crime in case state and local officials might fail. Walter White, the head of the National Administration for the Advancement of Colored People (NAACP) wrote a letter to the President to persuade him to pass anti-lynching legislation, but in vein. He wrote,

> From reports which come to us from authentic sources in various parts of the country, the recent strenuous efforts to prevent lynchings have been due almost entirely to fear of federal legislation. These reports give ground for belief that should the Costigan-Wagner Bill fail of passage there will be new and bloody outbreaks which may result in a terrible situation….We strongly urge that the President make the request of the leaders of Congress that the bill be voted for on prior to adjournment. We do not believe that there need any fear of a sustained filibuster.

When he was asked about, Roosevelt claimed that he did not want to dissipate Southern Democrats' votes which he might need to pass bills that would "*keep America from collapsing.*" His refusal to pass the bill led Eleanor Roosevelt and Walter White to

renew their pressure on the President. Governors, mayors, newspaper editors, judges, and private organizations signed a petition with White to convince Roosevelt that the Costigan-Wagner Bill had a wide public support. The petition, however, was buried in the files of the White House as Roosevelt could not challenge his party leadership in Congress, although he held a strong private support to the bill. However, many of New Deal programs prescribed ant-lynching provisions.

A clear anti-lynching legislation was urgently recommended though it failed repeatedly in front of Congress because of filibuster by Southern Democrats. Such bill was never voted for during Roosevelt's presidency. Still, there was an overwhelmed certainty in the whole country that the president opposed bitterly racial segregation.

The Roosevelts worked hard to enhance blacks' conditions. Frank Murphy, Roosevelt's Attorney General, established Civil Liberties Unit in the Department of Justice, which was designed to protect African Americans' civil rights. Murphy believed that what America had given to civilization, liberty, had to be given to all.

Lynching, mob violence, and other forms of civil liberties violations were subject to federal prosecutions under the Civil Rights Section of 1941. The latter became an important precursor that spurred the Civil Rights Division of 1957 and 1964. By 1941, when the country was preparing to enter WWII, black leaders like A. Philip Randolph, with the help of the First Lady, asked for integration in the military and condemnation of race discrimination therein. Although the President declined the integration, he promised to pass an executive order (Executive Order 8802) whereby he barred discrimination in war-related industries, and created the Fair Employment Practices Commission (FEPC), the function of which was to investigate complaints of discrimination and overturn segregation in the field.

The E0 8802 read:

> There is established in the Office of Production Management a Committee on Fair Employment Practice, which shall consist of a chairman and four other members to be appointed by the President. The chairman and members of the Committee shall serve as such without compensation but shall be entitled to actual and necessary transportation, subsistence, and other expenses incidental to performance of their duties. The Committee shall receive and investigate complaints of discrimination in violation of the provisions of this order.

In a memorandum sent to government department heads on September 3rd 1941, the President recommended government agencies and departments to open their doors to qualified workers no matter their skin color or origin. He wrote,

> With the view to improving the situation, it is my desire that all departments and independent establishments in the Federal Government make a thorough examination of their personnel policies and practices to the end that they may be able to assure me that in the Federal Service the doors of employment are open to loyal and qualified workers regardless of race, creed, or national origin.

By the end of the War, African Americans could finally hold war-industry jobs. Thousands of them quitted farm and domestic work, seeking better paid jobs in the North and West. The War helped Roosevelt take action against discrimination. The Executive Order 8802 could also bring economic benefits gained by the prosperity of the war to African Americans. Consequently, racial tensions progressively spread, leading up to severe race riots. Roosevelt responded by sending federal troops in many states to help calm down the situation.

When African American servicemen came back to the United States after WWII was over, segregationist policies of treating black veterans threatened stability in the country. Once again Roosevelt was required to ban discrimination and protect black civil rights.

Roosevelt, too, helped safeguard black civil rights through the appointments he made to the Supreme Court after the constitutional war of 1937. Hugo Black and Stanley Reed appointed in 1937 and 1938 respectively paved the way to desegregation decisions through landmark decision in *Missouri ex rel. Gaines V. Canada* which validated a challenge against the University of Missouri Law School. In the course of time, most of Roosevelt's appointees to the Supreme Court joined Black and Reed in defending black civil liberties.

African Americans could ultimately enjoy equality in education, transportation, and elections through a series of cases such as *Mitchell V. U.S.* (1941), among many others. In 1954, Roosevelt's appointees dismantled Jim Crow Codes and ruled against "separate but equal clause" *through Brown V. Board of Education.*

The First Lady Eleanor Roosevelt met their leaders, visited black communities, and addressed them in her speeches as 'my people'; and she helped African American leaders be closer to the President. This marked an important shift in the electoral behavior. Prior to the passage of the New Deal, African Americans voted for the 'Party of Lincoln'. By 1936, they voted for Democrats. They put an end to the long allegiance to the Republican Party, and became an important voting bloc for the Democratic Party.

Robert Higgs (1997) explained this electoral historic shift by the relief payment African Americans received thanks to some New Deal measures. This was rather a political support than a social one, stated Higgs.[57]

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[57] Gavin Wright (2010), too, pointed out to Roosevelt's Machiavellian will to spend money to be reelected.

However, because of the Poll tax almost all African Americans were disenfranchised in Southern states. As response to a petition sent to him to urge the abolition of the Poll Tax on the ground that those disenfranchised were sent "*far-off battle fronts of the world to fight corruption*", President Roosevelt suggested to his Attorney General Francis Biddle to consider the constitutionality of the Poll Tax. The Attorney General did not carry on any court actions. The Roosevelts did, however.

They tried hard to repeal the tax at the state level. Then, southern states, one by one, repealed the Poll Tax. Roosevelt's endeavor to abolish the Poll Tax which started in 1939 led in motion to the adoption of the Twenty-fourth Amendment. To sum up, Roosevelt did not help enhance African Americans' conditions through New Deal measures but also through other orders and actions he undertook with the First Lady to vanquish provisions which extended back to colonial days, just as he did for American Indians.

2.7.3 New Deal and Indian Americans

As for American Indians, there was a clear cut with past discriminatory policies through the designation of Indian Reorganization Act (the Wheeler-Howard Act of 1935), also referred to as the Indian New Deal. Indians were given right to manage their own affairs and lands ownership. The Act was intended to replace the Dawes Act of 1887. In retrospect, the federal government provided lands to Native Americans but this created more problems between Indians and the U S army. To settle down the conflicts, Indians were forced onto reservations where they could manage their own affairs and preserve their traditions and culture. Yet, conflicts were not solved once and for all.

Whites engaged in endless conflicts with Native Americans about land issues. In the course of time, Whites rallied for the assimilation of Native Americans to make end to their 'barbaric' traditions. Thus, Indians could become 'true' Americans. This idea became

embodied within the Dawes Act. Under the Act, the President was bestowed with an authority to confiscate and redistribute Natives' tribal lands. Indians who accepted to live in individual parcels were allowed to gain U S citizenship.

Indian landholdings decreased from 139 million acres in 1880 to 48 million acres in 1928. Some Indians sold their lands to White farmers. Although the 1920s were prosperous years in the United States, Indians' per capita income was less than $2OO per year. The assimilation policy was even worse; Indians suffered cultural disintegration. Initiatives to improve conditions of Indians had clearly failed. Efforts to disable the allotment process, to establish tribal councils, to impose taxes on the leased lands, and to found corporations which would manage tribal resources were all engulfed by the Great Depression.

The Roosevelt Administration pioneered amending the Dawes Act. In 1933, Harold Ickes, Secretary of the Interior, recommended President Roosevelt to nominate John Collier, the spokesman for the militant American Indian Defense Association, as Commissioner of Indian Affairs. Collier advanced approaches which emphasized community participation. Local rural communities could be integrated within the federal policy process, under the Indian Service.

Senator Burton K. Wheeler of Montana and Congressman Edgar Howard of Oklahoma introduced a bill to Congress with provisions for the ultimate diminution of allotment and restrictions of selling Indian lands. They suggested financing Indians with a credit fund of $10 million to help them purchase new lands. The Interior Department could therein buy lands for landless Indians.

The bill encountered serious oppositions from Western representatives and politicians as it allowed tribal governments to achieve consolidation via forcing landowners to sell their lands to the tribe or exchange them for shares in tribal

corporations. The Wheeler-Howard Act was then signed into law as the Indian Reorganization Act of 1934. It was an all-inclusive act that mingled the views of reformers of Indian Affairs and of Western politicians who defended Western interests.

In the economic sphere, tribal governments' interference in regulating businesses had been limited. With regard to land ownership, Indians' lands increased by 7.400.000 acres as $12 million were used to finance tribal enterprises in livestock, lumbering, land and water reclamation, and tourism. Thanks to the Act, Indians got expanded activity on the political scene, too. Unlike the Dawes Act, the Indian New Deal promoted a strong tribal identity and self-determination, putting aside federal government frivolous policy toward Indians.

In his article entitled the *Native American New Deal*, Graham D. Taylor stated,

> Collier's administration did more to improve the physical and psychological conditions of Indian life than any administration before or since….the Collier period marked the one instance in the grim history of relations between the Indian and the White governments where a genuine and farsighted effort was made to bridge a cultural chasm and allow the Indians to build a new society on the foundations of traditional institutions. (Taylor 218)

In spite of this success, the Organization Act met resistance from some tribes. Cultural and communal unity was not yet revived. This failure is not thoroughly related to administrative misdemeanors. Minorities like the full-blood group argued about the authority bestowed within the tribal council. To avoid friction among Indians, advisers from different federal agencies divided the projects among and between different Indian minorities. Thus, more cohesion was achieved. Any systematic attempt to obstruct

reorganization goals was to be blotted vocally. Such success is attributed to the Roosevelt administration.

2.8 The End of the Depression*:* the Great Escape

Historians, economists, and political sciences scholars disclosed that although the New Deal programs helped decrease unemployment and promoted production, restored social peace and humanitarianism, and change the people's sentiment towards federal government, they could not end the depression. They conceded the ultimate failure of the New Deal.

There are two different explanations about the actual factors behind bringing the Depression to an end. Some historians claimed that F. D. Roosevelt was unable to foster demand on U S economy, thus, he did not alleviate the hard conditions caused by the Great Depression. They accredited the end of the Depression to World War II. The War stimulated economy as it increased the European demand for American products. The government revived old industries such as textiles and steel; and spurred new industries such as petroleum, chemicals, aviation, and electronics to meet the War's exigencies and demands. Even the automobile industry boomed during the War. Consequently, a wealth of jobs was created decreasing unemployment.

World War II did also open American economy to international trade. U. S. surplus goods had been exported to other markets. U. S. war allies resorted to American exports to meet their civilian and war needs. Actually American exports reached about $5.9 billion. Even defense output expanded during the War. National defense expenditures totaled $13.8 billion in 1941. In the years between 1940 and 1944, agricultural production and goods production rose by 20 percent and 60 percent respectively. Two years after it joined the war, the United States could reach the employment.

The data provided did but confirm that World War II was a turning point for American economy. It ended the Great Depression and brought prosperity to the nation[58] through war-command economy. Advocators of this opinion believed that had Roosevelt not passed the New Deal, the Great Depression might have ended sooner. This argument was strongly supported by Republicans; and it was re-emphasized by the American historian interested in contemporary politics and economy Thomas E. Woods JR,

Year	Unemployment rate
1939	17,2
1940	14,6
1941	9,9
1942	4,7
1943	1,9
1944	1,2
1945	1,9
1946	3,9
1947	3,9

Table 2.5: Labor force status of the non-institutional population 14 years and over, annual averages 1929-1947, US Bureau of Labor Statistics,

First, Woods (1999) stated that unemployment rate reached 14.3% during Roosevelt's best year, 1937. This implies that economy was still as bad as when Roosevelt first assumed office. It reached its lowest rate, 1.2%, in 1944 when production was diverted to war materials. The history of the United States revealed that unemployment rate increase during recessions and decrease during wars. The New Deal did but ease the Depression. Between 1931 and 1939, unemployment never fell below 14.3% even with the passage of Fair Labor Standard Act of 1938.

Then, Woods blamed the NIRA whereby some Americans enjoyed high wages while million others had no wages at all. Roosevelt and his administration failed to realize that wages resulted from doing business. Because American business passed through

[58] Economic historians stated that economy in the United States enjoyed high prosperity, low unemployment rate and, high real GDP in 1947.

depressed conditions, companies proved unable to pay high wages to their workers. They laid them off.

Woods also raised an intriguing point about the Agricultural Adjustment Act. As Roosevelt believed that falling prices was among the principal causes of the Depression, he deemed it pretty necessary to increase prices by any means. Therefore, farmers were paid to destroy crops and livestock. Woods questioned the utility of such an Act in a time when 'one-third of the nation was ill-fed and ill-clad'. The Department of Agriculture revealed that the United States was not producing enough food for its population. Farmers, too, deemed it immoral to stop production while people were hungry.

More importantly, reports delivered by the Department of Agriculture in 1936, revealed that the AAA was responsible for leading two million people to joblessness; and decreasing farm incomes.

On the surface, the AAA was designed to stabilize agriculture. Its main goal was to create a balance between production and consumption. Government wanted to restore farmers' purchasing power of the pre-depression period. For the sole sake of boosting prices, the government reduced agricultural supply. Farmers were asked to plow up cotton, take acres of their lands out of production, and slaughter millions of hogs.

The AAA was attacked because of its uneven distribution of benefits; while Western farmers received thousands of dollars, Southerners were given but hundreds of dollars. Actually, it was the government which conducted agriculture instead of farmers. As a subsequent consequence, the AAA was declared unconstitutional by the Supreme Court in January 1936 given that regulating agriculture was a state issue. However, farmers' sufferings continued as Congress approved a new AAA in 1938.

Other economists stated that the program created problems instead of providing relief. It led to an increase in the unemployment rate as it offered federal funds to farmers

to buy machines which replaced sharecroppers and tenants. As a response, they founded groups such as the National Farmers Process Tax Recovery Association and Farmers Union to denounce New Deal policies.

The leader of the Farmers Union, Milo Reno, declared Farmers Holiday '*stay at home- buy nothing-sell nothing*' to protest the AAA. Farmers suggested that government would intervene to regulate rates for agricultural workers the way it did for industrial workers.

Robert J. Allison (1999) stated that the "crisis" of agriculture in America was dated back to the pre-depression period. The country shifted from being an agricultural society to an industrial nation. By 1920, farm income lagged as farmers produced more and earned less. 10% of American farms were foreclosed between 1927 and 1932.

During the prosperous years, American farmers' existence was threatened as their plight reached its zenith. Additionally, because of the depression, farmers could not sell their products to European countries. Hoover afforded buying the agricultural surplus, but he could not compel Europeans to buy them. The Roosevelt administration promised to solve farmers' struggles 'to survive' via convincing farmers not to produce more instead of buying surplus. Production lowered by 25%.

Corn and hog producers received $ 300 million from federal government; farmers who removed their land out of production received $ 100 million; and cotton farmers received $ 200 million. After all, in a two-year period, farm income increased to 1.2 billion. (Allison 1999) The Roosevelt administration, too, created the Federal Land Banks and the Commodity Credit Corporation to support individual crops.

Unlike Hoover, who repudiated providing direct loans to farmers, the two lending agencies, the FLD and the CCC, lent money to farmers to finance their farms and homes as well. Furthermore, the Frazier-Lemke Farm Bankruptcy Act, passed by Congress in June

1934, gave farmers effective ways to compensate for their lost properties. In such a way the New Deal helped, to a given extent, stabilize America's farms.

Similarly, other historians found that the AAA and other New Deal measures made up a coherent program designated to end the Depression rather than being a hodgepodge of different ideas and programs which failed to reach their ends.

The New Deal was designed to protect the rights of workers and support wages as it imposed regulations on businesses and restored the purchasing power. It could, to a given extent, restore prosperity. Businessmen and investors might get great uncertainty about economic prosperity because of the New Deal.

A research conducted by the economic historian Robert Higgs (1997) revealed that businessmen moved away from long-term investments which were recommended for economic recovery because of their pervasive uncertainty. Likewise, Kenneth D. Roose (1954) found out that Federal Enactments adopted from 1935 onward, which promoted interventionist policies, strengthened businessmen and investors' fear that economy might not survive

Badger (1989) ironically pointed out to the controversy within the New Deal. On the one hand, the Roosevelt Administration relied on private businessmen's funding for recovery. On the other hand, most of its measures obstructed confidence to invest. Likewise, Roosevelt faced more hostility from the business community when he passed the Wealth tax incorporated within the Revenue Tax of 1935. It aimed to raise corporate income taxes. Taxes on estate, intercorporate dividends, and surtax on incomes greater than $50.000 increased; and a graduated surtax on corporate incomes was, later on, approved by Congress.

Roosevelt could put an end to tax avoidance and any other loopholes incorporated within holding companies. According to Higgs (1997), the President through the Congress

intended to extract wealth from those who made decisions about private investment. This would stimulate more hostility to Roosevelt and discourage investment leading up to the recession of 1937-38, concluded Elliot Brownlee (1985 417). Actually private investment fell drastically from 1935 to 1940. Thus, capital accumulation, needed for economic growth, lacked.

Actually, economists pointed out to various factors behind this Recession in the midst of recovery. Countries like Britain, France, and Canada were experiencing economic downturn during the same period. In addition, the United States witnessed a shift in the monetary policy. Money grew by 9%, 14%, and 13% in 1933, 1934, and 1935 respectively.

This growth is attributed to gold devaluation. Prior to 1933, one ounce of gold equaled $20.67. It reached $35 later on. Milton Freidman and Anna Schwartz attributed the money growth to the devaluation of gold rather than to the enhancement of business, though prices marked a sluggish recovery. Money growth reached only 4.2% in 1936 and 1937. The money supply fell to 2.4% in 1938. It was this change that ignited the recession.

Other factors were behind the recession. The Fed increased reserve requirements since the money supply witnessed an important growth, and prices increased in motion. Consequently, business confidence collapsed as interest rates rose. Some economists support the idea that had the recession not taken place, economy might have achieved a moderate recovery. Still, soon after the Fed reduced reserve requirements and discount rates leading up to the resumption of the money growth.

In retrospect, even the Tennessee Valley Authority and Securities and Exchange Act discouraged investing through business regulations therein. In a recent study elaborated by the economic historian Gene Smiley in 1994, the writer concluded that businesses were "*further discouraged from investing by the new capital market regulations generated, the government's entry into the utility industry, and the continued tax*

increases……Roosevelt administration abruptly and dramatically altered the institutional framework within which private business decisions were made, not just once but several times." (p 136)

The people, however, shared great confidence and good sentiment towards the federal government thanks to the New Deal. Peter Fearon stated that among Roosevelt's triumph was the restoration of hope for Americans. The GDP declined consistently in the period between 1930 and 1935, and it increased in the period between 1935 and 1937. This change, however, cannot help assessing the New Deal's effectiveness alone.

David M. Kennedy (1999) admitted that the New Deal proved satisfactory in offering Americans security, notwithstanding its inability to achieve full economic recovery reflected in the unemployment average which was still high throughout the 1930s. Margo (1993) ironically stated that Americans who "enjoyed" work relief, under the New Deal, suffered more long-term unemployment as compared to those who did not. They were still classified as unemployed, but unable to find gainful private employment.

Still, initiatives such as Federal Deposit Insurance (FDI) and Securities and Exchange Commission (SEC) made life less risky. Thanks to the FDI, Americans were encouraged to put their money in banks as they were guaranteed that they money would be insured. Thus, such financial institutions could restore their reliable reputation. In addition, Americans, for the first time, could purchase their own homes thanks to loans. Kennedy additionally referred to the measurable number of jobs created by the Civilian Conservation Corps (CCC), Works Progress Administration (WPA), and the Public Works Administration (PWA).

Hanngen and Papademitriou (2009) reported that about 15 % of the unemployed population was hired in those programs. Unemployment rate was reduced as the number of employed reached 3.5 million. Such jobs fostered both stability and security. Farmers, too,

were provided with money to mechanize agriculture. Efficiency was achieved as farmers could produce more.

Another recent evaluation of the New Deal provided by David Weiman in 2011 revealed that relief spending did not delay economic recovery as stated by some economists. On the contrary, it created jobs, and enhanced people's life. Its decrease, however, led to the dip recession of 1937-38. Weiman also pointed out to the long-term benefits of PWA and the WPA.

Thanks to these two programs, current as well as future generations would reap benefits of about thousands of miles of paved roads, bridges and tunnels; and hundreds of miles of runways and railroad lines. States became more connected. Then, Weiman finished by stating that these infrastructural constructions helped promote a rapid economic expansion after the Second World War. Others are still used in the present time America. Assessing the current impacts of what Roosevelt did would do little good to the New Deal. The latter's long-term advantages are worth noting.

As for other programs such as the NIRA, which has been harshly criticized, Gauti B. Eggertsson (2012) highlighted the importance of the implementation of the NIRA in achieving a recovery during the Depression. In economy, it is admitted that consumers would decrease their spending when they expect a future decline of prices. This may lead to deflation. Eggertsson believed that the NIRA balanced between spending and expectation through increasing both prices and wages, though it lasted for two years only.

As a matter of fact, deflation was eliminated. Although the NIRA created many opposing opinions and controversies among historians and economists, its role in promoting recovery is withstanding.

Still, some economists reckoned that neither WWII nor the New Deal ended the Depression. The Great Escape was rather achieved by the return to "normalcy" as defined

by G. Warren Harding. He stated that America was in a bad need of normalcy rather than of nostrums. Harding's audience would determine normalcy as a rejection of the Progressive Era spirit.

Normalcy expressed a pledge of a return to the age of simpler economics and politics, social tranquility, limited government, and a focus on internal affairs. Yet, this was doomed since the values and political bias of earlier times could not meet the exigencies of the current period. Less regulations, regimentation, and taxation allowed American economy to recover.

After the outbreak of WWII, Roosevelt focused more on foreign and military affairs. Since any capitalist country would rely on businessmen in times of war, the President, to achieve an effective rearmament, changed the leadership of different committees and agencies. By 1940, businessmen and lawyers were put into offices of high authority replacing new dealers in FD Roosevelt's administration.

He named Henry L. Stimson and Frank Knox as Secretaries of war and of the navy, respectively. The former Wall Street investment banker James V. Forrestal was named Under Secretary of the Navy. Many other business executives were put in federal war agencies in motion. Politics as well as economy were moving away from the New Deal.

Roosevelt himself believed that businessmen would demonstrate greater promptness in responding to orders delivered to them by other businessmen than to orders delivered by "hostile" federal government. In addition, business leaders mastered the management of industries within war spheres much better than politicians and lawyers. In the course of time, more and more New Dealers lost their positions in federal agencies. This lessened the threat on investors who willingly engaged in investment required for recovery, stated Higgs (1997).

With the death of Roosevelt and the election of Harry S. Truman (1884-1972), the uncertainty regime that investors feared shifted to a more confident atmosphere of security for the property rights. Henceforth, investors, freed from governmental restraints, furnished an economic boom and sustained prosperity during the postwar period.

Truman's policy relied on intermittent reforms far from New Deal reforms. He filled the vacancies after the resignations of New Dealers with more businessmen. After WWII, American economy blossomed putting an end to the great duration of the Great Depression.

Nonetheless, Americans classify F. D. Roosevelt among the "great presidents" just like the tutelary figures of George Washington (1732-1799) and Abraham Lincoln (1809-1865). His successor Truman is appreciated as his presidency adopted a posteriori sample of Roosevelt's administration. Truman's *Fair Deal* covered his agenda, which revolved around issues of education, health insurance, and fair employment reminded us of the New Deal. Truman made some Roosevelt's proposals a reality. Even the *First Lady* Bess Truman took over what Eleanor Roosevelt has pioneered. Bess Truman occupied the first Lady position in the shadow of Eleanor Roosevelt, who remained active until her death in 1962.

The influence of Roosevelt is felt far beyond the mandate of his successors of the Post World War II period like John F. Kennedy who also took office in a time of an economic downturn. Democrats and Republicans accept the New Deal legacy, which is either the increased powers of the presidency, the regulatory role of the Federal State, or the *Welfare State* inaugurated by the Social Security Act of 1935. However, the 1980s denote a turning point. Ronald Reagan never ceases to proclaim his admiration for Roosevelt, reminding his leadership qualities; and considering him as a suspicious conservative towards the excessive intervention of the *Big Government*. Yet, he engages a

withdrawal of the Federal State from social action and a dismantling of the regulatory framework put in place during the 1930s.

In many respects, the *Reaganian Revolution* (studied in the third Chapter) is a questioning of New Deal. It continued during the term of office of his successors: it was during the presidency of the Democrat Bill Clinton who put an end to the strict separation between the savings banks and investment banks inherited from the *Glass-Steagall Act*. It finds an echo in the rhetoric of the partisans of the *least State*, so quite recently that of the *Tea Party*.

This ideological evolution, combined with the remoteness of the 1930s and 1940s, could have led to a progressive forgetting of the Roosevelt years. The 2008 Economic Crisis, on the contrary, has revived memory, as witnessed by countless articles in the press, editorials and magazine covers. The Great Recession did well in referring to the Great Depression; the Democratic candidate, Barak Obama frequently cited the example of Roosevelt - and compared his opponent and his predecessor to Herbert Hoover; the first hundred days of his first term were evaluated during the hundred-day period of 1933. The reform of health insurance voted in 2010, finally, continued the construction of the bill projected in 1935.

2.9 Conclusion

The Great Depression for historians and economists is just like the Big Bang for physicians, an unprecedented event**.** The Great Depression is arguably the most severe economic downturn that the United States ever witnessed. It reflected various flaws within the American economic system. Millions of Americans could not retrieve their money from banks, thousands of farmers and homeowners lost their properties, and a quarter of the population was unemployed. Without prior experience with such a desperate

atmosphere amongst Americans, F. D. Roosevelt was sworn into office, and instated the New Deal. Taken as a whole the measures met critical oppositions not only from Justices serving on the Supreme Court but also from some economists and historians.

Examining the relationship between the New Deal initiatives and the long-term developments of the American society is more utile. One may wonder why the reforms instituted therein had unanticipated consequences. New Dealers wished to promote national health insurance program; instead they paved the way for private medical insurance plans. They aimed to keep people on the land; instead they saw Americans fleeing from their lands. They aimed to enhance inner cities and small towns; instead suburbs spread out. Yet, New Dealers did not ignore the failures, the weaknesses, and the gaps within their programs, and wished to refine them in due course as deficiencies were exposed and problems were identified. Black problems could elucidate this view. Agencies like PWA, WPA, and Farm Security Administration reflected the significant change in treating Blacks, which was far from White preoccupations before.

It is undoubtedly unwise not to denote the failures of the New Deal. Reformers' hopes to secure an uneven distribution of wealth and full control of the nation's natural resources, promote permanent employment and an all-inclusive welfare state, and a strong assault on poverty evaporated. Likewise, it is undoubtedly unwise not to denote the treacherous restrictions that the New Deal encountered. The political and economic environment imposed external constraints that handicapped the new deal. The structure of the federal government along with the transgressed the dominance of the Conservatives in Congress, the difficulty of policy-making process in times of crises, and the Roosevelt administration lack of valour limited the scope of the New Deal. The New Deal is 'loved, hated, and remembered for many things.'

A fair assessment of the New Deal would reveal that the New Deal programs had their efficiencies and inefficiencies. Disparity lies between historians and economists. While the majority of historians claimed that the New Deal helped restore hope, security, good sentiment vis-à-vis federal government, and economic recovery; most economists claimed that New Deal programs deepened and lengthened the Great Depression. They believed that had the New Deal not been passed, economy would have recovered sooner. Nevertheless, ultimate economic recovery and stabilization are to be attributed to the WWII; and long-term confidence, security, and lasting benefits of the infrastructural constructions are to be attributed to the New Deal.

3.1 Introduction

After WWII, the United States emerged as the world's largest economic and political power and the clear 'winner'; the US dollar emerged as the dominant currency. European countries, however, were struggling with the widespread destruction they experienced during the War. The United States and Great Britain, with many other

European countries, held the Bretton Woods meeting in 1944 to decide upon measures required to stabilize the financial system and help rebuild Europe. Stabilizing economic system required fixing exchange rates to the dollar, and the dollar to gold. The dollar was exchanged at $35 per ounce of gold, while European currencies were adjusted within 1% of their dollar parities. Thus, the dollar was put as the center of the world economy. Thereafter, the United States witnessed an important increase in per capita income as compared to European countries.

Under the Bretton Woods, the United States had to remain passive in foreign exchanges without holding reserves of foreign exchange. It was also required to open its markets to foreign borrowers and/or depositors, promoting free trade. The rules of the 'game' dictated for the United States to play the role of a net international creditor; and to maintain a monetary policy whereby it could anchor the dollar price level for tradable goods. Though economists classify the Bretton Woods as a mere fiasco, they claim that it could prevent large-scale crises thanks to the economic stability it provided. Most of the economic downturns witnessed between the 1950s and the 1960s, the Bretton Woods period, are classified as mild recessions.

3.2 The Bretton Woods Period Recessions

WWII ended promoting a full-fledged economic recovery from the Great Depression to the United States. Yet, the post-war period witnessed repeated recessions. A critical review of these recessions would reveal that each of them had its own distinctive features, though they shared some common elements.

It is commonly agreed that events leading up to recessions are not purely economic. They may occur during times of unprecedented wage, price, and credit controls, as they may occur during wars and/ or strikes. The table below summarizes the different recessions

between 1948 and 1991, whose severity varied greatly from one to another. Economists agree upon the conclusion that the more the recession is severe the slower the expansion will be achieved.

Recession	Diffusion	Depth	
	Industries with Declining Employment (Maximum%)	Real GNP (Change %) (1982 $)	Real GNP (Change %) (Different Weights)[59]
Nov. 1948-Oct.	90	-2.0	-1.6
1949	87	-3.0	-3.4
July 1953-May	88	-3.5	-3.9
1954	80	-1.0	-1.6
Aug. 1957-Apr.	80	-1.1	-1.0
1958	88	-4.3	-4.9
Apr. 1960-Feb.	63	-2.4	-2.4
1961	72	-3.4	-3.4
Dec. 1969-Nov.	73	-1.2	-1.3
1970			
Nov. 1973-			
Mar. 1975			
Jan. 1980-.luly			
1980			
July 1981-Nov.			
1982			

[59] The 1948, 1953, 1957 and 1960 recession declines are in 1958 dollars, the 1969 and 1973 recessions are in 1972 dollars; the 1980 and 1981 recessions are in 1982 dollars; the 1990 recession is in 1987 dollars.

July 1990- Apr.

1991

Table 3.1: Recessions in the United States during the Post-War II Period[60]

3.2.1 The 1948-49 Recession

The recession of 1948 interrupted the economic upswing which began in 1945. It is worth referring to the 1948-49 recession since it is the first post-war crisis that tested the war economy and the recovery achieved during and after the Great Depression. Actually, this episode was ignited by the reconversion from war to peacetime industries that caused massive unemployment; and the Employment Act of 1946 which made government the sole responsible for promoting and maintaining healthy economy.

3.2.1. 1 Causes of the Recession

The mild recession of 1948, as economists classified it, is an inventory recession which means that it was impacted by the accumulation of inventories. Investment in inventories changed radically from a positive value of $6.5 billion in 1948 to a negative value of $ -3.7 billion in 1949 (Hamberg 1952). The most important drops were in

[60] Stephen K. McNees. The 1990-91 Recession in Historical Perspective. In *New England Economic Review*: Federal Reserve Bank of Boston, January/ February 1992, p 2.

machinery, motor vehicles, and equipment industries. Private investments of durable products and building construction declined only $1.4 billion below their value of 1948. Nondurable goods, like textiles and chemicals witnessed rather a trivial drop. Yet, price and inventories declines did not take long time to be readjusted. It was but a quick and minor pause of the boom that started after WWII.

R. A. Gordon (1952) explained the three factors that initiated the recession. First, prices, particularly of agricultural products, decreased drastically because of the availability of goods at home and abroad. Subsequently, the second factor leading up to the recession was the consumers' demand which leveled off. Third, investments declined as they could not maintain their expansion rate. A decline in total output led to a decline in final sales growth. Actually, Department Store sales fell by 22%. Subsequently, the decline in GNP reached $10 billion; while business inventories lost about $12.5 billion. (Caplan 1956)

Consumption, investment activity, government purchases of goods and services, merchandise exports, and foreign investment declined, too. Likewise, the Federal Reserve index of industrial production recorded a decline of 34 points, which continued until July 1949. The table below illustrates the salient declines in the economic activity that characterized the period. There were declines at accelerated rates till February 1949.

Component	**Fourth Quarter of 1948**	**Fourth Quarter of 1949**

Gross National Product	276.0	256.8
Personal consumption	101.4	99.1
Gross private investment	45.7	31.0
Net foreign investment	1.2	-0.5
Government purchase of goods and services	40.3	43.3

Table 3.2: Changes in Gross National Product, 1948-1949 (billions of dollars), (adapted from Caplan 1959)

Prices, too, began a decline by February 1948. Farm prices and processed foods, after a short recovery in June drifted down. Under the influence of foods declined, consumers' prices declined following the same pattern. In the labor force, unemployment increased during the last quarter of 1948. About 5.5% of the labor force became unemployed; unemployment increased from 2million workers to 3.5 millions. Surprisingly, wages did not fall, instead they rose slightly.

Hamberg (1952) believed that the decline of merchandise exports which reached $2.5 billion played an important role in causing the recession. According to him, the assistance Europe received under the Marshall Plan fostered recovery; therefore it led up to the reduction of merchandise exports. Additionally, many European countries encountered difficulties while obtaining dollar exchange, let alone the reductions in their purchasing power. Nevertheless, Hamberg classified this factor as secondary, since he believed that there were some restrictive monetary and fiscal policies that caused the contraction.

The Contraction coincided with the attempts of the Federal Reserve System and the Treasury to tighten the conditions of credits. The Treasury retired marketable debt which equaled $8 billion through spending $8 billion of its cash surplus. Consequently, securities of the Federal Reserve, which held 70% of the amount retired, rose between one-eighth

and three-eighth, leading to an increase in reserve requirements which reached $1billion. Henceforth, banks were compelled to sell government securities to benefit from those reserve requirements. As a result, the holdings of government securities by the banking system were reduced to $6.5 billion.

There were, also, indicators of a decline in the monetary expansion. The rate of the expansion of bank credits declined. For instance, loans at commercial banks reached $3.2 billion in 1948, although it reached $5.2 billion in 1947. Consumer credits were hardly hit, too. Bank lending to consumers abruptly ceased; sales of consumer durables lagged behind. These declines did but echo the controls over consumer credits imposed by the Federal Reserve System.

Hamberg (1952) believed that both the decline of consumer sales and the accumulation of inventories led to a decline of the overall demand for funds by businesses. Additionally, he related the shrinkage of demand for funds to other factors.

Prior to the recession, business could record high profits out of their investment programs. Likewise, they could finance larger investments. During the recession, however, dividends lowered by 10% and 13% in the second and the third quarters of 1949 respectively. Additionally, investors could obtain funds from the flotation of securities to non-bank lenders. Actually, about 50 % of what financial institutions like life insurance companies and savings banks earned from credits to private borrowers went to businesses.

However, during the recession, the sales of government securities to the Federal Reserve System by non-bank investors stopped. Thereafter, investors increased their holdings; and the demand for funds declined more and more.

Although the aforementioned factors of the decline are important to explain the recession, economists relate the recession to the decline of consumption. It is recorded that

consumption fell 3 percentage points. This implies that consumption drifted after it peaked in the post-war period. The ongoing decline of consumption culminated eventually in the fall of retail sales. Upon the whole, controls imposed on credits as fiscal and monetary measures led to the recession.

Yet, in the midst of those declines, the residential construction industry was increasing thanks to the Federal Reserve's easy conditions of attributing real estate credits. Likewise, the automobile industry expanded.

3.2.1.2 Government Response to the Recession

Overwhelmed by the economic prosperity of the post-war period, the government willingly neglected the dangers of inflation which was predicted by the Council of Economic Advisors[61]. The government held an optimistic view about its ability to maintain full employment, incorporated within the Employment Act of 1946, even during recessions. The Act provided that

> The Congress hereby declares that it is the continuing policy and responsibility of the federal government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy with the assistance and cooperation of industry, agriculture, labor, and state and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free and competitive enterprise and the general welfare, conditions under which there will be afforded useful employment for those able, willing, and seeking

[61] The Council of Economic Advisers was created by the Employment Act of 1946 passed on February 20th, 1946 by President Truman. It was composed of three advisers whose task was to advise the president on economic issues, and forecast future economic states, among many other tasks.

> work, and to promote maximum employment, production, and purchasing power. (Qtd. in Bailey 1950)

Prior to the recession, in the middle of 1946, the government was more concerned with wage developments than with dealing with price and inflation control. Its actions were unsatisfactory since the Council failed to forecast the post war downturn. Caplan (1956) referred to historical, international, budgetary, and political reasons that hindered the government from diagnosing the economic scene and forecast the downturn.

Although there was a sharp rise in prices during 1946 and a slowdown in the economic activity during 1947, the Council held an optimistic view that there would be immediate readjustment after downturn. At the international level, there were great conflicts in different European countries. Such international tension required an urgent expansion of the defense program. This expenditure along with the tax reduction passed by Congress led up to a decline in government receipts. Thus, in the first half of 1948, federal cash decreased from $12.6 billion to $3.9 billion.

By the second half of 1948, the President urgently called for an extraordinary congressional session to deal with inflation. The President submitted a ten-point program, the end of which was to control inflation. He suggested increasing productivity, suspending payments, restricting bank credit expansion, expanding savings bond campaign, controlling commodities exchanges, and imposing allocations. The Republicans in Congress voted for granting the President only the authority to control export, transportation facilities and equipments, and agricultural programs. Actually, the essence of Truman's anti-inflationary program was not approved. Congress instead reduced taxes, increased defense spending,

and adopted the Marshall Plan.[62] Actions that would worsen the situation as prices upsurged.

In the course of time, inflation became ‘public enemy number one’. Congress, aware of the economic turning point and the great public fear of inflation especially after the great break in the prices agricultural products, responded favorably to the President’s second request to pass the anti-inflationary program.

The president was bestowed with a temporary power to impose consumer credit controls and increase reserve requirements. Subsequently, demand deposits and time deposits raised by 2% and 1.5% respectively. Then, investment in housing initiated recovery. Thereafter, durable goods lagged behind. Economy had its own capacity to find a way out of the recession. Production had to rise to meet the high consumption demands. The Government, too, contributed to the recovery via its expenditure and unemployment compensation program.

The President reversed his anti-inflationary program when he suggested enlarging the purchase power. It was a reversal from inflation to deflation. He improved the social security program, and the tax system; and promoted foreign trade. Still, there was great uncertainty about public confidence that might spark another economic downturn. The Council reported that,

> The weight of evidence as we see it does not support so gloomy an outlook. But we may still face an unsatisfactory alternative. While the decline may be halted or even reversed, a satisfactory expansion might not follow. Our

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[62] The Marshall Plan was an American aid program to help Western European countries to recover after WWII. Such aid would enable the US to require nations to balance their budgets and engage in trade stabilization. The Marshall Plan supported the Bretton Woods as it encouraged European countries to export to the United States. Thereafter; the United States could invest abroad through maintaining a large current account surplus.

> real need is for industrial production not only to rebound to the level of present consumption but also for both production and consumption to continue to rise sufficiently to absorb a labor force which is both growing in size and increasing in productivity per man. (Qtd. in Caplan 1959, 50-51)

After four years of economic stability, 'the satisfactory expansion' suffered another decline leading up to the Post-Korean War recession of 1953.

3.2.2 The Post-Korean War Recession 1953-54

Holmans (1958) stated that the recession of 1953-54 afforded an opportunity to examine the differences between Democratic and Republican Administrations while dealing with panics, and trying to maintain full employment. The Republican thinking in the United States about Keynesian countercyclical policy, which had been previously employed by Democratic Administrations, was tested during the recession.

During the Great Depression, Republicans denounced the Roosevelt Administration's deficit financing and public works expenditures. The Republican attitude that running a deficit, expenditures for public works, and the balanced budget, among many other Keynesian policies, were regarded as unsound and dangerous prevailed before the recession. Yet, such an attitude had to vanish during the Eisenhower Presidency to help end the recession of 1953-54.

3.2.2.1 Causes of the Recession

The President D. Dwight Eisenhower (1890-1969) after assuming office and delivering his inaugural message, appointed Arthur F. Burns, a research director of the National Bureau of Economic Research (NBER), as his economic advisor. He became later on the chairman of the Economic Council of Advisors. Burns advocated the appointment of the second member of the Council Neil H. Jacob. The latter was a specialist in taxation,

and a member of the Research Advisory Board of the Committee for Economic Development.

The third member to the Council was Walter W. Stewart, an expert on monetary theory. The Council's ability to predict the 1953 recession was acknowledeged. The Council, however, proved unable to deliver reliable unemployment rate statistics in the Economic Report of 1954.

It was rather Dexter M. Keezer, a business economist, who could genuinely forecast the deflation. He stated: "there is some danger that the principal policy makers will wear themselves out fighting inflation when the real problem has become that of deflation." (Qtd. in Engelbourg, 196) Few weeks after, signals of a near downturn became visible. By early June 1953, Jacob admitted that there was a slight rise in the unemployment rate.

In retrospect, economy had been stimulated thanks to federal spending during the Korean War. By the outbreak of the Korean War, the government spending rose by three times. Taxes had increased temporarily to sustain it more. Once the War ended, government cut sharply its spending by about 20% anticipating a recession. In addition, there was a prompt supply cut because of the excess caused by overproduction, and the stock market began its slide during the second quarter of 1953.

Subsequently, the Federal Reserve Board reacted by easing credit, while the Treasury, was tightening it because of overproduction. Such policy along with the reduction in federal government spending impacted the economy negatively.[63] Soldiers who came back after the Korean War was over found it difficult to obtain jobs. Additionally, GNP plummeted during the third and the fourth quarters of 1953 and the year

[63] Jacob believed that the economy went down because of the reduction of the military spending.

after. While equipment, commercial, and residential construction did not undergo any decline, inventory investments declined; a fact that caused a high unemployment rate.

The latter reached 2.9% by the end of 1953 (see figure 3). Once unemployment was held at a plateau of 5.8%, the contraction was aggravated, and Eisenhower's hope that the situation might improve, expressed publically, swept away. Consequently, the President urged the Council to furnish a counter-depression strategy. Burns named some economists who were supposed to submit counter-cyclical proposals, and a committee which revised budget estimates based on unemployment rates.

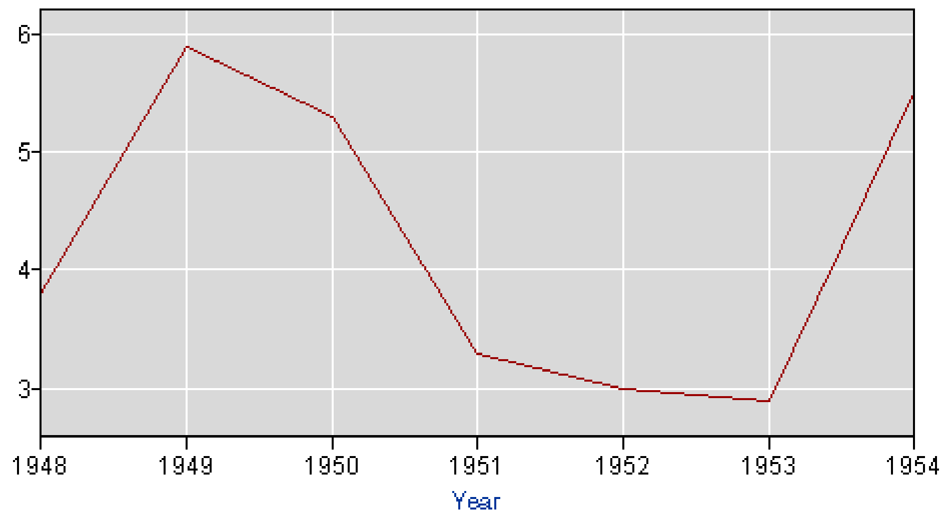

Figure 3.1: Unemployment Behavior from 1948 to 1954 (U S Department of Labor, Bureau of Labor Statistics)

3.2.2.2 The Council's Endeavour to end the Recession

The Council issued administrative and legislative actions at the federal and the local levels, as well as actions by the business community. Jacob recommended the Eisenhower Administration to extend the existing monetary and fiscal policies. He aimed to make the monetary policy favorable to private investments as he believed that housing constructions could be better stimulated. Jacob and his associates deemed it pretty important to remind

businesses about the expiration of the excess profits tax by January 1st, 1954.[64] They called for bestowing the President with a larger authority in the home mortgage field, and promoting non-residential constructions. The Council questioned the Federal Government ability to finance public works undertaken by state governments.

Eisenhower adopted tax reduction to meet the high rate of unemployment. He, then, delivered the Internal Revenue Code of 1954, leaving the Secretary of the Treasury George Magoffin Humphrey with no choice but to comply. Jacob deemed this decision as paramount. He wrote,

> The Eisenhower Administration in 1954, and this was a personal decision of Eisenhower, deliberately decided to accept large tax reductions even in the face of an unbalanced budget for the sake of expanding consumer buying power and helping to end the recession…Keynesian economic thinking played a key role in the recession of 1954 under Eisenhower. (Qtd. in Engelbourg 1980, 208)

The Internal Revenue Code of 1954 was enacted to revise the internal revenue laws of the United States. Section 1 of the first chapter of the Code, presented in the economic report issued by the President, determined the tax imposed on individuals other than heads of households as follows:

The Income	The Tax
Not over $2,000	20% of the taxable income
Over $2,000 but not over $4,000	$400, plus 22% of excess over $2,000
Over $4,000 but not over	$840, plus 26% of excess over $4,000
$6,000 Over $6,000 but not over $8,000	$1,360, plus 30% of excess over $6,000

[64] On May 20th, 1953, the President asked to delay the expiration of the excess profits tax, which was programmed for June 3Oth, 1953, till January 1st, 1954.

Over $8,000 but not over $10,000	$1,960, plus 34% of excess over $8,000
Over $10,000 but not over $12,000	$2,640, plus 38% of excess over $10,000
Over $12,000 but not over $14,000	$3,400, plus 43% of excess over $12,000
Over $14,000 but not over $16,000	$4,260, plus 47% of excess over $14,000
Over $16,000 but not over $18,000	$5,200, plus 50% of excess over $16,000
Over $18,000 but not over $20,000	$6,200, plus 53% of excess over $18,000
Over $20,000 but not over $22,000	$7,260, plus 56% of excess over $20,000
Over $22,000 but not over $26,000	$8,380, plus 59% of excess over $22,000
Over $26,000 but not over $32,000	$10,740, plus 62% of excess over $26,000
Over $32,000 but not over $38,000	$14,460, plus 65% of excess over $32,000
Over $38,000 but not over $44,000	$18,360, plus 69% of excess over $38,000
Over $44,000 but not over $50,000	$22,500, plus 72% of excess over $44,000
Over $50,000 but not over $60,000	$26,820, plus 75% of excess over $50,000
Over $60,000 but not over $70,000	$34,320, plus 78% of excess over $60,000
Over $70,000 but not over $80.000	$42,120, plus 81% of excess over $70,000
Over $80,000 but not over $90,000	$50,220, plus 84% of excess over $80,000
Over $90,000 but not over $100,000	$58,620, plus 87% of excess over $90,000
Over $100,000 but not over $150,000	$67,320, plus 89% of excess over $100,000
Over $150,000 but not over $200,000	$111,820, plus 90% of excess over $150,000
Over $200,000	$156,820, plus 91% of excess over $200,000.

Although Burns believed that “it was difficult to know what to do because the recession had been so mild”, he urged the Advisory Board of Economic Growth and Stability to suggest solutions to speed recovery other than the acceleration of government expenditures. Later on, Jacob recommended the Federal Reserve to provide more abundant and cheaper credits. Cutting taxes helped offset the decline in federal spending, and bring recession to an end. The Council, too, advised Eisenhower to accelerate public works programs, facilitate federal loans and lending, provide aid to foster housing and business, promote relax measures of Federal Reserve credits; and before all, the Council rallied to push the President to pass tax reduction.

It was thanks to these policies that the recession of 1953-54 was relatively short and mild. Jacob stated that: “the measures taken to meet this ominous development were adequate and well timed. It was seen that strong forces of contraction, capable of producing a serious recession, would have to be offset by powerful means_ both direct and supporting_ to expand private demand for goods and services.” Burns attributed the recovery mainly to the discretionary tax cut and the expansion of credits. In a perceptible movement, economy turned upward, unemployment in non-agricultural sectors had been readjusted. Slowly and gradually, the trough for employment in other sectors like non-durable manufacturing and durable manufacturing was reached. Henceforth, economy rebounded, Burns pronounced.

In its report, delivered in 1955, the Council commented on its experience during the recession by declaring that: “by deliberately pursuing monetary, tax, and expenditure policies that inspired widespread confidence on the part of the people, the Federal Government helped them to act in ways that were economically constructive”

When the recession was over, the new president of the Council of Economic Advisors attributed the prompt recovery to his predecessor and New Deal policies by claiming that: "Significantly, in 1954, the bipartisan character of expansionary fiscal policies was established for the first time, as the Republican Administration of President Eisenhower adopted measures that had previously been linked to the New Deal and Keynesian economics."

The slow and weak recovery from the recession of 1953-54 anticipated the recession of 1957-58, which was preceded by an acceleration of the inflation rate.

3.2.3 Recession of 1957-58: The Eisenhower Recession

As compared to other recession, the 1957-58 recession is a moderate one as it did not last long, and declines in production and income were not that serious (see the table on the next page).

Period	Duration (Months)	Percentage Change			
		Nonagricultural Employment		Industrial Production	Personal Income
		Total (Census)	Wage and Salary Workers		
1929-33	43		-30.7	-50.8	-49.8
1937-38	13		-10.0	-32.3	-11.2
1948-49	11	-0.7	-4.1	-7.7	-3.4
1953-54	13	-2.5	-3.4	-9.6	-0.1
1957-58	9	-1.7	-4.4	-12.4	

-0.9

Table 3.3 Duration and Extent of Declines in Recessions from 1929 to 1957
(adapted from the Economic Report of the President transmitted to the Congress on January 20th, 1959)

3.2.3.1 Extent and Factors of the Decline

The decline started during the third quarter of 1957 when the country's national output of goods and services fell by about 5.5%, while the industrial output witnessed a sharp decrease of 13%. The first six months of the contraction witnessed a slow decline in employment in manufacturing industries.

Then it declined rapidly to reach 11% by May 1958, the lowest point ever recorded in the business activity. The unemployment rate was below 4.5 % between 1955 and 1956. Then, about five million workers became unemployed during the second and the third quarters of 1958 (see Figure 3.2). Industrial and mining areas suffered the highest rate of unemployment. The low level of employment reflected the reduction in incomes earned by individuals. Personal incomes dropped with only 1%.

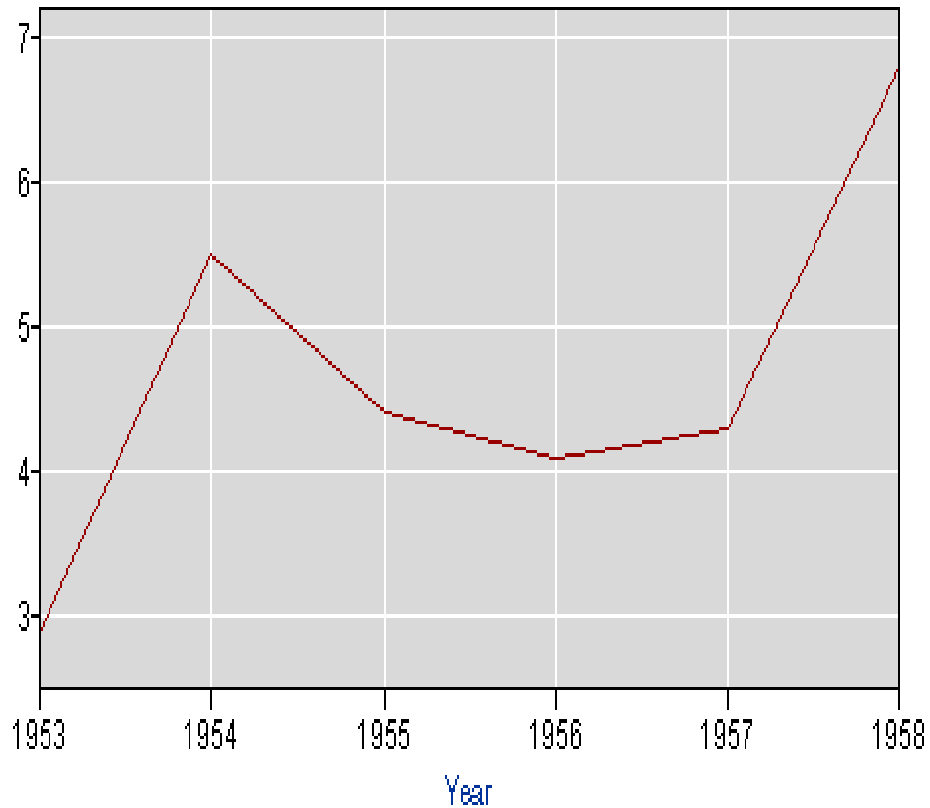

Figure 3.2: Unemployment Rate, Source: Bureau of Labor Statistics

Other sectors of the economy were affected by the recession. Productions of consumer durable goods, steel and machinery, and automobiles declined critically between July 1957 and April 1958. The economic scene was then characterized by lower expenditures of business concerns on machinery, equipment, and new facilities. This downturn was preceded by a moderate rate of contraction, which tended to fall during the early months of 1958. Businesses restricted their expansion programs as financing them became too costly. Businesses could not achieve equilibrium between supplies and spending. New capacities required more money as compared to the prices of industrial output. Contraction was but an obvious outcome of the pressure to curtail financing expansion programs, which mounted rapidly.

The sudden cut of investments reduced expenditures of plant and equipment sharply. The apparent rise of domestic investments from 1954 to 1956 had promptly declined during the third and the fourth quarters of 1957. The Department of Commerce delivered the following totals:

Year	Billions of Dollars
1953	38.5
1954	37.9
1955	46.6
1956	47.6
1957	44.4

Table 3.4: Domestic Investments (in billions of 1947 dollars),

Upon the whole, from the second quarter of 1957 onwards, there was a general decline in the economic activity of the country. Additionally, merchandise exports underwent reductions. In the course of time, exports of wheat, cotton, petroleum, metals, machinery, and manufacturing goods declined respectively from the second quarter of 1957 till the first quarter of 1958.

The decline in exports can be explained by the reduction of Japan and some industrialized Western European countries' demands for American merchandise. Likewise, Canada, another important market for the United States, suffered an industrial contraction which led to the shrinkage of its demand for American exports. Some less developed countries reduced importing American products, too. Henceforth, the pressure on economic activity was reinforced as the country's net exports decreased by $4 billion at an annual rate basis.

The situation became worse as the demand of the Department of Defense for production items declined by 50% in 1957 as compared to its annual rate of 1956. The

Eisenhower Administration, under the influence of some big business organizations, cut its war outlays by 4% in the period between the second and the third quarters of 1957 (see table below). The purchase of goods and services by national defense reached $43.9 billion during the fourth quarter of 1957, while during the two previous quarters of the year it reached $44.9 billion.

However, such a decline in defense expenditures was not that serious since federal expenditures for nondefense goods continued to rise. Subsequently, both defense and nondefense expenditures at all levels -Federal, state, and local - increased. They reached $53.8 billion during the fourth quarter of 1958. Still, economists of the Federal Reserve believed that cutting purchases of the Department of Defense contributed strongly to the recession.

Period	War outlays
Quarter I	12.9%
Quarter II	13.0%
Quarter III	12.5%
Quarter IV	12.5%

Table 3.5: 1957 Quarterly Ratios of War Outlays to Total Production (T.N. Vance 1958)

Another factor of the decline was the irregular movement of the purchases of consumer durable goods. They witnessed a sharp decline in the fourth quarter of 1957 and the first quarter of 1958 respectively. About 80% of the decline was recorded in the reduced purchases of automobiles. Though the decline was sharp and unprecedented in the recession, economists classified it as “unusually large in the view of the small reduction of 1% in the amount of income available to consumers after payment of taxes.”

The last and major factor in the decline was the change in inventory policies of businesses. Uncertainties about future sales and prices, and the difficulties of providing

inventories with appropriate financing culminated in a noticeable slackening in the rate of inventory accumulation. It is commonly known that a slight decline in sales may affect largely production and employment through a shift from inventory accumulation to inventory liquidation. By the early beginning of 1958, inventories decreased by $9.5 billion since businesses reduced their productions below the rate of sales they were making. This led to a decline in the gross national product of $11.7 billion.

In fact, the reduction of inventories related to machinery, aircraft, and automobiles covered one-half of the decline in the total business inventories. Large reductions were recorded in the output of supplying industries. Other additional elements influenced inventory policies, too.

Unbalanced relationships between sales and inventory holdings along with problems of excess capacity impacted negatively industries like petroleum, chemicals, and paper. Likewise, the production of consumer durable goods was sharply cut when the downturn began for the end of reaching adjustment. Although consumer purchases were well maintained, distributers decreased their sales from producers and drew down their inventories. Then, the first quarter of 1958 witnessed the sharp cut of inventories trade.

Saulnier (1975) stated that the recession was a virtual certainty of expansionist policies which resulted in an outbreak of inflation while trying to accelerate growth. Government shift from stimulating to restraining would inevitably create a danger of the recession. The major factor behind the recession of 1957 was the abrupt economic movement to promote full employment which caused an outbreak of wage and price inflation. The inflation of the mid-fifties was astonishing, yet it has been underestimated. In addition, the installment credit terms created a spurt in automobiles sales. Domestic sales of new automobiles climbed to 7.4 million in 1955, while it was only 5 million per year in 1951-54. This culminated in great economic imbalances.

Housing, too, did rise quickly since building permits delivered to private businesses as well as contracts and orders for new plants and equipments reached very high levels. Likewise, the sales of machinery and equipment were at their peak during the second quarter of 1957. In the process, however, the demand and producer goods waned inevitably in an economic scene overwhelmed by monetary restraint to control inflation. Yet, this created 'the classic combination of inflation and recession'. The Eisenhower Administration became unable to know how to deal with the former without denying efforts to deal with the latter.

3.2.3.2 Resistance to the Contraction

Saulnier (1975) stated,

> The indispensable element in a program to overcome inflation is monetary policy. Although inflation is a far more complicated process than fits the typical formulations of the monetarists, it is essentially a monetary phenomenon and can be overcome only in a disinflationary monetary and credit context. Operationally, a policy is needed that slows the rate of increase of credit and thus of money the supply. A program that does not start from that premise can go nowhere. (p 30)

To overcome the inflation, the Eisenhower Administration adopted a disinflationary policy.

To counteract the recession and limit the high drops in production and employment, many measures were taken in 1957 and 1958. The first major measure was the maintenance of an over-all consumer demand. This was rather achieved through consumer confidence and government maintenance of moderate personal income. It was elucidated through the slight decline in aggregate consumer expenditures which equaled only $2 billion and the decline in personal disposal income of about $4 billion, though the gross national product was $20 billion below its annual rate.

In fact, personal income was maintained since many employees were employed in industries which were not impacted greatly by the changes in the business arena. In addition, wage rates increased during 1957-58 period leading up to an increase in the pay of the employed persons and a moderate reduction in incomes earned by those who were working a shorter week.[65]

However, these factors which helped maintain moderate personal income pressed corporate income. Government revenues from corporate income taxes declined sharply during the recession. Economists attributed the small decline in personal income of factory workers to the rise in farm income during the recession. Actually, farm income was 10% higher in the first quarter of 1985 than its rate recorded in 1957.

Compensation measures for unemployment payment increased as employment and income were falling. In addition to strengthening the recovery, the unemployment compensation payments, notably those which were under private plans, helped maintain personal incomes and consumption expenditures. Other legislated programs of public social security resulted in a great number of persons receiving benefits and maintaining their personal incomes.

The payments made were large. $2.6 billion were spent between the third quarter of 1957 and the first quarter of the year that followed. Then, another $2.6 billion were spent during the third quarter of the same year. President Eisenhower in his economic report that he transmitted to Congress on January 1959 wrote that

> The primary objective of our Federal-State system of unemployment insurance is directly to aid those experiencing involuntary loss of employment. However, by sustaining the aggregate purchasing power of consumers at a level higher than would otherwise prevail, these payments

[65] The President noted in his Economic Report transmitted to the Congress on January, 1959 that this was also an obstacle to re-employment since it might lead to high prices and induce reductions in the working force.

> contribute significantly to the stabilization of the whole economy. In both these respects, benefit payments were materially helpful during the 1957-58 recession. Payments rose moderately in the third quarter of 1957 and very sharply in the fourth quarter and after the turn of the year, as unemployment mounted. From July 1957 to April 1958, they directly offset about one-third of the decline in wage and salary disbursements and, because they are not taxable, their effect in maintaining disposable personal income was even greater. (Economic Report 1959, p 40)

Finally, the purchasing power declined less than the flow in personal income thanks to a decline in tax obligations. Tax reduction gained more consideration as compared to expenditures increase while trying to overcome the recession. Upon the whole, maintaining a moderate personal income, the great proportion of compensation payments, and the reduction of taxes on personal income led to an offset in the fall of consumer income available for spending. Consumers had to reduce their purchases of goods and services slightly according to the slight fall in their income. The short duration of the recession was also due to the absence of adverse financial developments which aggravated business contractions in previous recessions.

The Recovery, too, was attributed to Eisenhower's Interstate Highway System. Congress passed the Federal-Aid Highway Act of 1958 to increase funding. Larger allocations were therein possible for the construction of the project. Eisenhower sought to spur employment during the recession.

As far as the 1957-58 recession is concerned, economists drew a critical attention to the paradoxical relationship between the apparent continuing rise of prices, basically consumer prices, and the decline in employment and production. Consumer prices rose by 2 percent because of higher food prices and the increase of costs of various services used

by consumers, while prices of other manufactured products such as new and used cars remained stable. Early in 1958 the government managed to restore the stability in prices. In the course of time, prices of raw materials, and manufactured products continued to recover throughout 1958(See figure 3. 3 on the next page).

It might be unwise not to emphasis the importance of the continuing strength of some industries during periods of contraction and inflation in moderating cutbacks of production. This prevailed in the 1957-58 recession. While some heavy industries and production of consumer durable goods were declining sharply, service industries expanded, state and local governments' purchases were rising, and production and sales of consumer nondurable goods fell but slightly. This pattern helped restore the economic activities. Henceforth, the demand for goods and services began to rise, and the decline of exports was eliminated.

Beside lowering the interest rate, controlling the money markets, and making credits conditions much easier, the government adopted other economic measures for foreign trade and military expenditures. There was also an effort to increase federal spending and keep federal outlays in harmony with revenues. The first quarter of 1958 witnessed an important increase in government purchases of nondefense goods and services. Likewise, defense outlays rose significantly at an annual rate of $400 million during the first and the second quarters of 1958 respectively. In addition, contracts for the purchase of military goods increased sharply. This helped halt the liquidation of inventories.

Just as for the help of military expenditures in overcoming the contraction, home building promoted an apparent upturn. Expenditures for residential construction turned to high levels. Then, inventory policies of producers and distributors of building materials and consumer goods were influenced favorably since new dwelling units had been built

increasingly. More than $175 million was spent to spur the building activity. By February 1958, the Federal Home Loan Bank Board launched a new program.

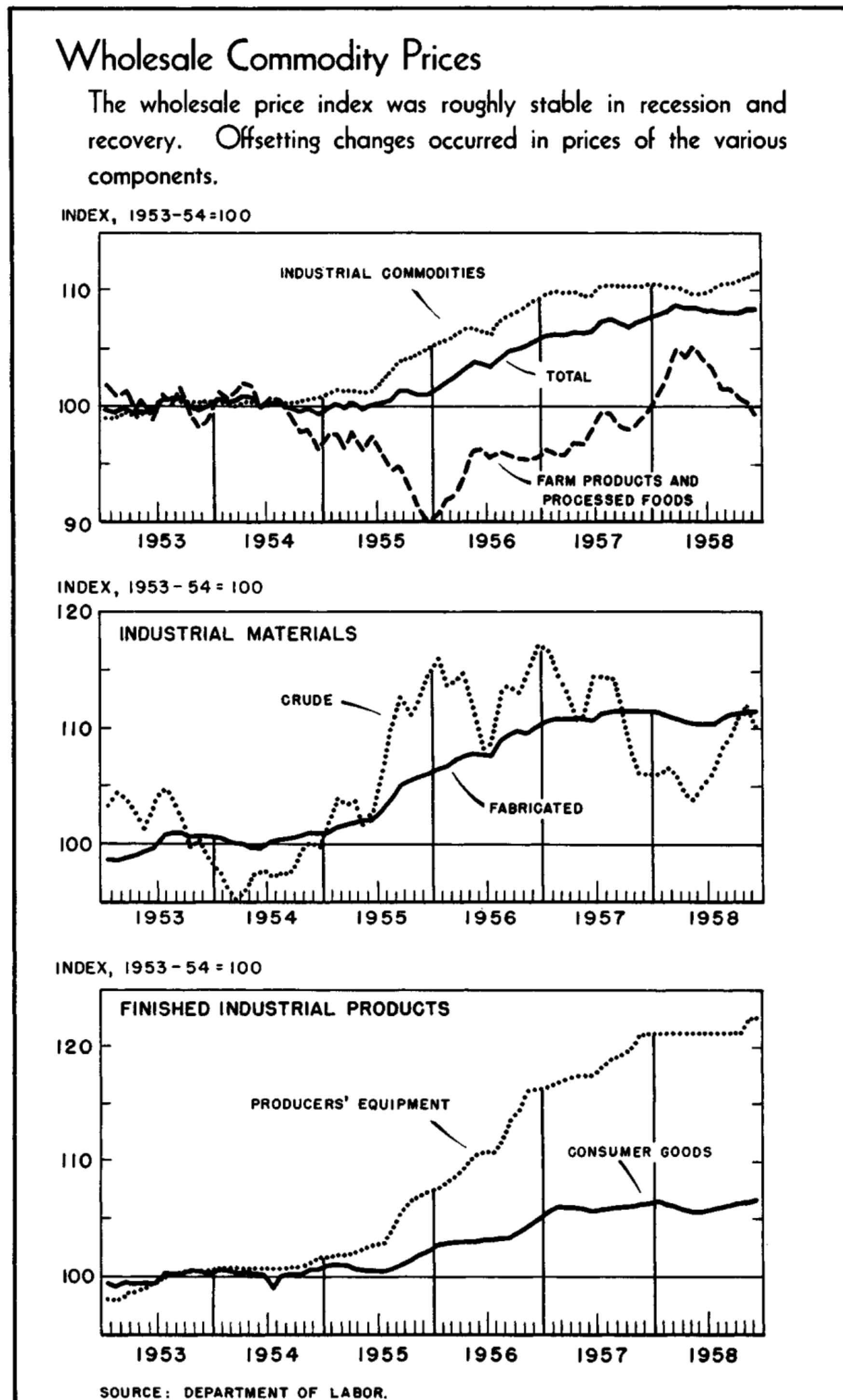

Figure 3.3: Increase of Manufactured Products' prices (Economic Report, 1959 p 19)

It issued loans to member associations on a five-year basis. The Federal National Mortgage Association (FNMA) was provided with $200 million to buy mortgages. The Housing and Home Financing Agency (HHFA), along with other legislations, was another agency directed to realize constructions of projects for college housing, urban renewal, and public housing. the increase in output and sales of these industries led to a rise in personal income and transfer payments, and a recovery of corporate profits.

These measures reflected Eisenhower's political philosophy and conviction. Saulnier (1975) wrote: "this reflected the President's political philosophy_ his determination to resist intrusion of government in matters better handled by private efforts_ and his basic financial conservatism_ his conviction that economic improvement would be achieved best in an environment of budgetary balance as against one in which large deficits occurred in good times as well as bad."

The establishment of the Cabinet Committee on Federal Activities Affecting Costs and Prices in 1959 was another factor behind the stoppage of inflation during the late fifties. The Cabinet assured that activities such as procurement, contracting, stockpiling, direct lending and loan insurance, setting wage floors, and establishing import quotas, among many others, would be consistent in stopping inflation. The Cabinet, despite its short existence, met great opposition from some departments and agencies.

Republicans claimed that Eisenhower eliminated not only Truman's Fair Deal but also Roosevelt's New Deal. However, the historian Pach J. stated that Americans still remember the "happy days" they spent during the Eisenhower's presidency thanks to his economic beliefs. He wrote,

> Eisenhower favored a more moderate course, one that he called Modern Republicanism, which preserved individual freedom and the market economy yet insured that government would provide necessary assistance to workers who had lost their jobs or to the ill or aged, who through no fault of their own, could not provide for themselves. He intended to lead the country down the middle of the road between the unfettered power of concentrated wealth . . . and the unbridled power of statism or partisan interests.

To conclude, to end the recession, Eisenhower expanded Social Security, increased minimum wage, and created the Department of Health, Education and Welfare. Henceforth, economic activity expanded. Yet, the recovery did not progress far, economy moved again to a deficit during the 1960-61 recession.

3.2.4 The 1960-61 Recession

Compared to its predecessor, the 1960-61recession was singularly mild. Yet, the fact that it followed so closely the recession of 1957-58 suggested it was more pervasive on the postwar American economic scene. Still, “the rolling Adjustment”, as it is also referred to, was ignored in public discussions as well as in the public statements delivered by the two political parties during presidential campaigns. Stephen K. McNees (1992) wrote,

> In contrast to most other recessions, no one dominant factor characterizes the relatively mild 1960-61 recession. It is perhaps best viewed as the net result of a combination of several factors, their only common thread a mistaken reading of the strength of the real economy and the threat of inflation. Indeed, the 1960-61 recession may be the first and perhaps clearest postwar example of a recession due to a forecast error. (pp 6-8)

3.2.4.1 Factors behind this Mild Recession

The downturn started during the second quarter of 1960, when the presidential campaign was under way. Subsequent quarters witnessed high rates of unemployment and low rates of GNP. John F. Kennedy, in his electoral campaign, promised to 'get America moving again'. However, the Eisenhower Administration ignored the downturn. Economists and historians classified this recession as being unique since it was ignited by a combination of several factors.

To start with, the strong recovery from the previous recession raised concerns and fears of inflation. The Federal Reserve responded by increasing the federal funds rate from under 0.7 % in July 1958 to an average over 3 % in the second quarter of the year that followed. The Fed raised the funds rate to 4% during the fourth quarter of 1959 to curb the growth. During the third quarter of 1960, when housing and investment declined respectively, the Federal Reserve responded with a looser monetary policy.

Economists believed that the recession may have been avoided had the monetary tightening not been adopted. The rolling adjustment of 1960 was due to high inflation, high unemployment rate, and a low GNP rate. Actually, the unemployment rate reached 7.1%, while the GDP fell to 1.6%. The Fed being too fearful of inflation, caused the recession because of its contractionary monetary policy.

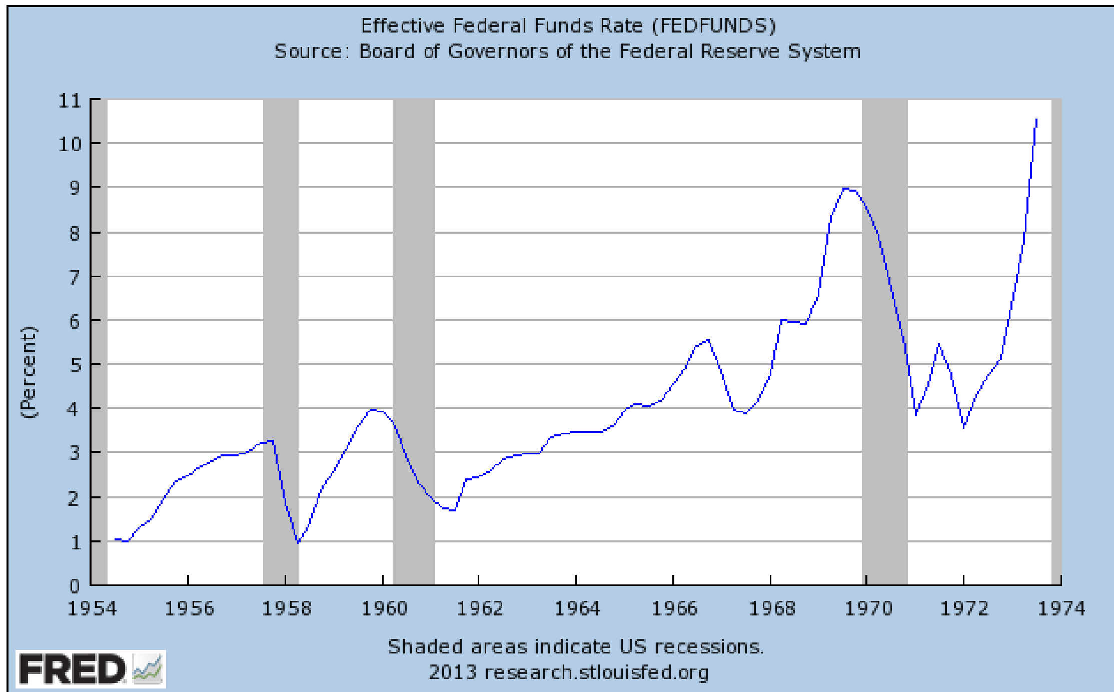

Figure 3.4: Federal Reserve Fund Rates 1954-1974,
(https://angrybearblog.com/2013/09/was-cause-of-1960-recession-psychological.html)

Christina Romer and David Romer (1994) in What Ends Recessions stated,

> Monetary policy makers of the 1950's had a deep-seated dislike of inflation and acted to control it. Their dislike of inflation was rooted in a model of the economy that emphasized the costs of inflation and the absence of a positive long-run trade-off between output and inflation. These findings provide important insights into the performance of the economy in the 1950's.

Another factor behind the 1960-61 recession was the considerable fall in housing. By the second quarter of 1960, housing declined $16.6 billion. Then, it witnessed its large plunge in the second quarter of the same year. From peak to trough, the decline in housing was estimated by $23.3 billion that is 30.2% larger than investment decline (See Figure 7 on the next page). Actually, in this recession, just like in many others, housing decline preceded investment decline.

The increase of imports of cars was another cause of the recession. There was an increasing demand for foreign made cars. For so many years, the American automotive industry boomed, and automobile manufacturers dominated the world market. After WWII, the United States produced about three quarters of all automobiles in the world. However, in the course of time, the auto-making business encountered great competition from foreign brands, after a period of complacency. By 1958, Japanese-made cars like Toyota and Datsun, which were more affordable and attractive, were imported into the American Market, leading up to great losses for the American automotive industry. Such a decline had an immense impact on the domestic economy.

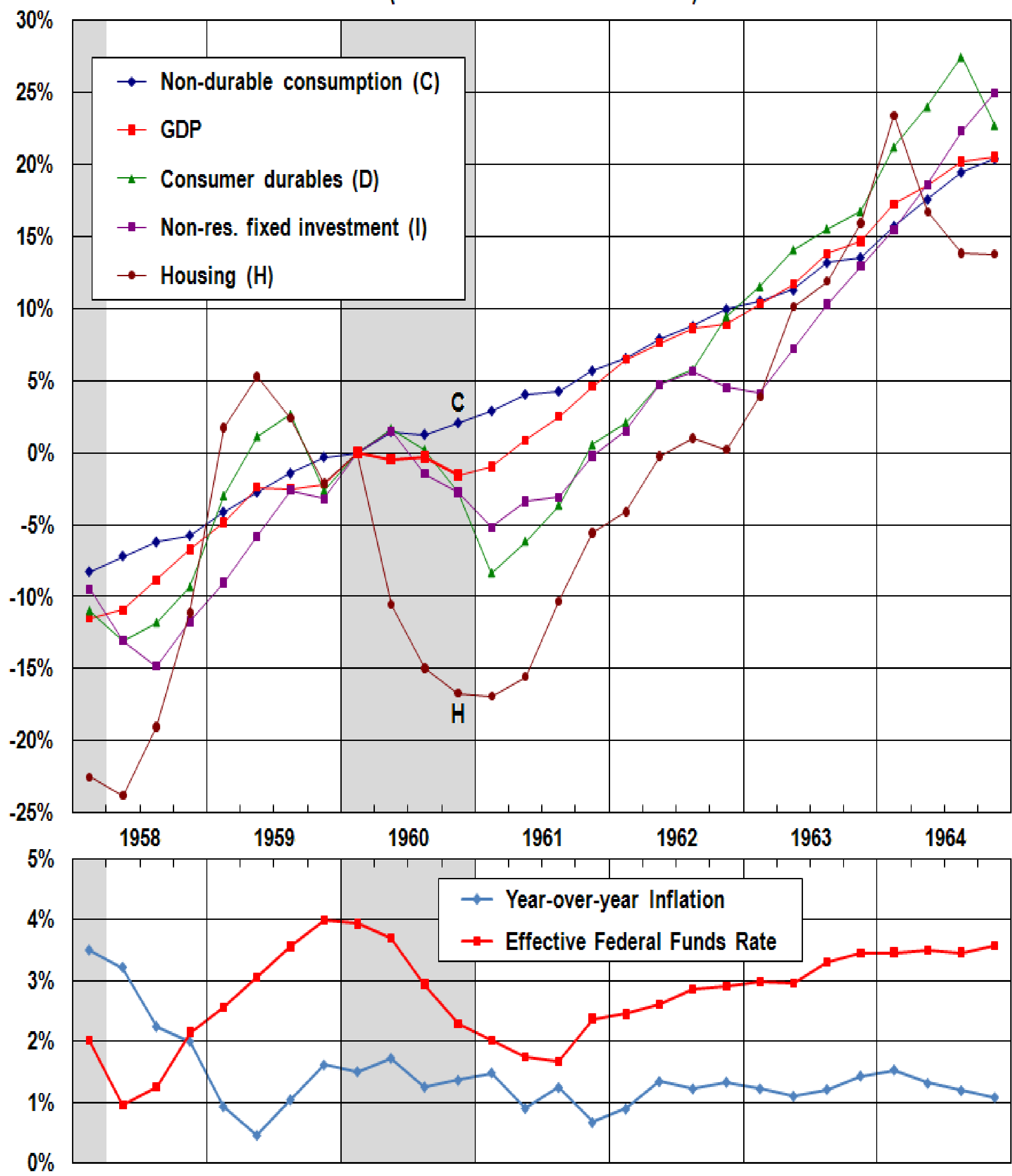

Figure 3.5: Changes in GDP and its Components before, during, and after the 1960-61 Recession Source: (Gjerstad & Smith 2010 pp.20)

3.2.4.2 The End of the Recession

Economists and historians attributed the end of the recession to John F. Kennedy (1917-1963). He ended it via two ways. In his Inaugural Address, the President inspired and implemented a new vision for the country. He stated,

> The energy, the faith, the devotion which we bring to this endeavor will light our country and all who serve it--and the glow from that fire can truly light the world. And so, my fellow Americans: ask not what your country can do for you--ask what you can do for your country. My fellow citizens of the world: ask not what America will do for you, but what together we can do for the freedom of man. (John F. Kennedy, Inaugural Address, January 20th, 1961)

In his first State of the Union Address, Kennedy stated,

> The present state of our economy is disturbing. We take office in the wake of seven months of recession 3 years of slack, 7 years of diminished economic growth, and 9 years of falling farm income. Business bankruptcies have reached their highest level since the Great Depression. Since 1951 farm income has been squeezed down by 25%. Save for a brief period in 1958, insured unemployment is at the highest peak in our history. Our recovery from the 1958 recession, moreover, was anemic and incomplete. Our Gross National Product never regained its full potential. Insured unemployment is at the highest peak in our history. In short, the American economy is in trouble. The most resourceful industrialized country on earth ranks among the last in economic growth. I will propose within the next 14 days measures aimed at insuring a prompt recovery and paving the way for increased long-range growth.

Once he assumed office, he started working to fulfill his campaign pledge. He directed all federal agencies to increase government spending, cut taxes, and increase funds for education as a way to face the slow-growing economy and high unemployment rate through pumping billions of dollars into the economy. In addition, Kennedy advocated the

payment of farm price supports and life insurance dividends. Measures to increase minimum wage, unemployment compensation, social security benefits, to provide vocational training for displaced workers, and to raise federal funds for home building and slum eradication were all advocated few days after taking office. Finally, the President asked the Fed to keep interest rates low.

Kennedy's deficit spending ended the recession as the national debt witnessed a moderate increase of $23 billion that is 8% of Eisenhower's last budget. Although he promoted an economic expansion that lasted for more than seven years, inflation did not end until the first quarter of 1963, and the unemployment rate remained stagnant at 6% through 1963 as he refused to deal with the recession through a New Deal style spending.

The most cherished period in the history of the country from 1961 to 1968, which was a result of "the mistake that led to the sequester mess" swung.

3.2.5 The Recession of 1969

Mazurak and Mielcova (2013) classified the 1996-70 recession as a minor one since it lasted for a few quarters; quarterly GDP decline was up to about 1.5%, and swift recovery was achieved within one year. This recession elucidates the relationship between monetary policy, inflation, investment, durable expenditures, and housing; the first of which initiated changes in the other variables.

3.2.5 .1 Extent and Factors behind the Slowdown

According to the National Bureau of Economic Research, the relatively mild recession followed a serious economic slump that began in 1968 making an end to the longest economic expansion ever recorded in the history of the United States. Actually the 1969-70 recession passed through two different stages. First, the initial downturn in the economic activity lasted from December 1969 until September 1970. The second phase is associated with the strike at General Motors which lasted from September 15th to

November 23rd, 1970. The NBER revealed that the recession was but a reflection of the GM strike. However, there were other factors that ignited the slowdown.

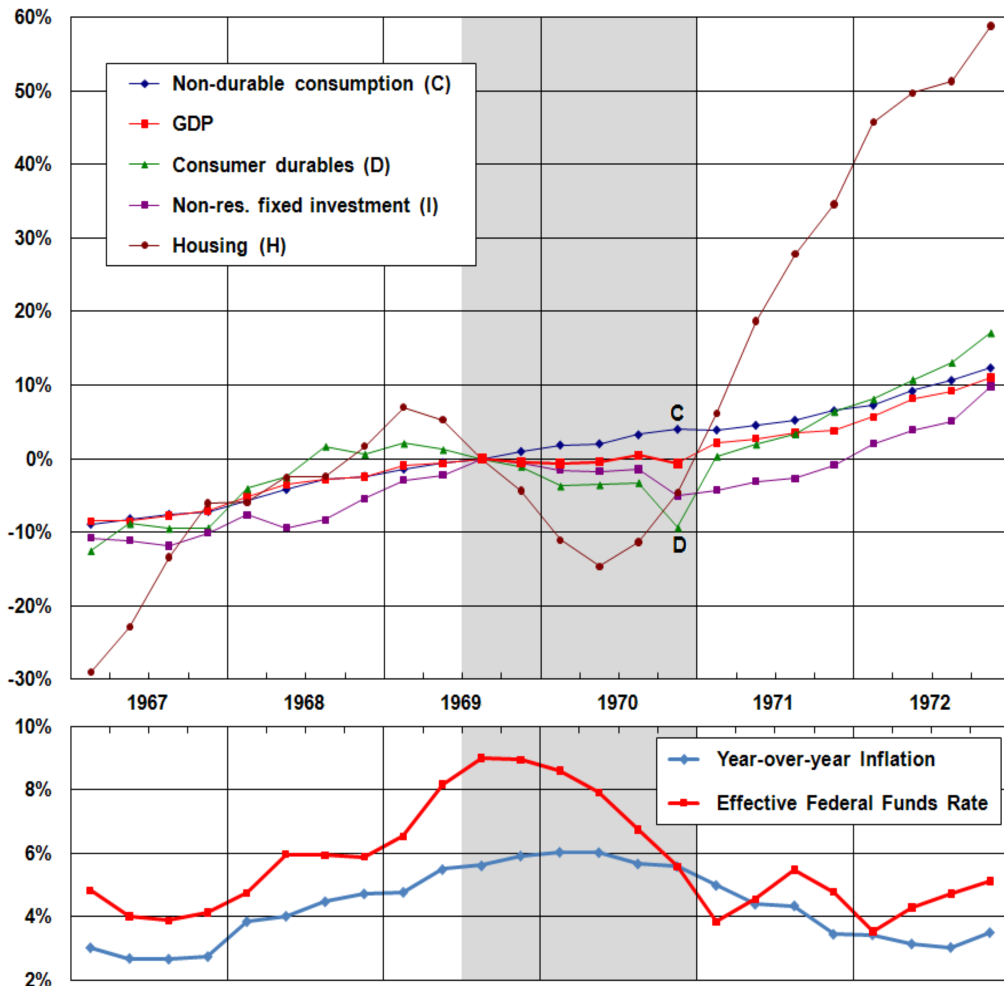

Figure 3.6: Changes in GDP and its components before, during, and after the 1969-70 Recession Source: Gjerstad & Smith 2010 p 21

The Federal government moved to balance its budget through ending its deficit spending. This would minimize long-term interest rates and avoid a credit crunch. The deficit spending resulted in an increase of inflation, however. After the Vietnam War, there was an attempt to close the budget deficit, and the Fed raised interest rates. This restrictive monetary policy was the major factor that caused the recession.

Foreign trade created a large imbalance of payment deficit. Foreign countries held $45.7 billion in gold, while the United States had only $ 14.5 billion (an ounce of gold was

redeemed for $35). The Fed responded by raising interest rates up to 6% to avoid the collapse of the gold-dollar exchange standard. However, the deficit for gold continued basically after the collapse of London Gold Pool. The Johnson Administration invalidated its decision to send more troops to serve in the War in Vietnam (1955-1975) as a measure to balance payments deficit and take off the pressure on the U S dollar.

Again, the Fed raised the interest rates to 9.19%. Nixon's first year as President witnessed an inflation of 6.2 % leading to an increase in unemployment rate to 6.1%, and a decline of 0.6 % in GDP as the income tax surcharge and the suspension of investment tax credit, which aimed at reducing the demand for credit used to finance capital investment, proved unable to stop the acceleration of inflation.

Housing began declining before the recession began. Then, along with investment, it dropped sharply. From peak to trough, housing fell to 20.2% while investment fell to 5.1%; durables fell 11.3% (see chart on the previous page). This decline resulted from the Fed tightening policy. Once the monetary policy was eased, housing reached its trough. Thereafter, inflation peaked.

3.2.5.2 The End of the Recession

The American domestic credit markets began to dry up as a result of providing the supply of credit. Henceforth, the Fed resumed its expansionary policies. It could then avoid a major collapse in prices, industrial production, and employment. Such a slow recovery was required for such a mild recession.

3.3 The Post Bretton Woods Recessions

The Bretton Woods system's target to fix exchange rates failed in 1971.European countries had to devalue their currencies to be adequate to the dollar. Henceforth, speculation against weak currencies increased. The dollar, too, witnessed a global inflation. While inflation was rising, the American supply of gold was dropping drastically. At the same time, President Nixon, as an attempt to reduce unemployment, lowered interest rates. He slapped a 10 % surcharge on imported goods to force other countries to revalue their currencies against the dollar.

Irwin (2013) named several events in the summer of 1971 which led to the closure of the gold window and the imposition of the import surcharge. First, John Connally, Secretary of Treasury, in trying to face the embarrassing situation of the shortage of gold, wanted the United States to put the burden of adjustment on other countries. In May, 1971, the Treasury staff argued to take advantage of the crisis and improve the country's balance-of-payments position of the United States.

Then, in July, the Williams Commission, which was appointed by Nixon to evaluate the economic problems of foreign countries that might influence the United States, recommended the United States to be ready to adopt the import tax and export subsidy temporarily to promote a change in exchange rate.

Also in July, it had been revealed that the United States was about to suffer an unexpectedly large merchandise trade deficit. Treasury secretary and officials, being convinced that dollar parities could no longer be maintained, got prepared to close the gold window well before being forced by foreign official requests for gold.

These events and actions, known as "Nixon Shock", worsened American deficits and anticipated a dollar crisis. Consequently, Nixon declared that the dollar would no longer be convertible to gold as a way to promote competition for American goods in the

global market. He also portrayed the import surcharge as a temporary measure to increase jobs for Americans. He stated in a televised speech on Sunday, August 15th, 1971

> I am taking one further step to protect the dollar, to improve our balance of payments, and to increase jobs for Americans. As a temporary measure, I am today imposing an additional tax of 10% on goods imported into the United States. This is a better solution for international trade than direct controls on the amount of imports. This import tax is a temporary action. It isn't directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well. As a result of these actions, the product of American labor will be more competitive, and the unfair edge that some of our foreign competition has will be removed. This is a major reason why our trade balance has eroded over the past 15 years. (Qtd in Irwin 2013 p 37-38)

Such announcement lowered the dollar's real exchange rate value as foreign trading partners were not given advance warning. The principal objective was to improve the American balance of payments position through adding $13 billion. To achieve such an end, the United States required foreign countries to have a substantial appreciation of their currencies against the dollar, to invalidate unfair trade practices, and to share in defense expenditures among European allies. Conflicts arose between and among countries as how to revalue the dollar.

To settle down the issue, world leaders met in the Smithsonian Institute in Washington DC, in December 1971, to set new exchange rates. They agreed to increase the price of gold to $38per ounce, and allowed the import surcharge to be lifted four months after its imposition. Paul Volcker, the Undersecretary of the Treasury, wrote that

> It was well short of what we felt we needed to restore a solid equilibrium in our external payments, even if we had succeeded in opening Japanese and European markets in trade talks. But the stonewalling of the Common Market and Japan had been effective. With the exchange rate realignment settled and the import surcharge removed, we had little negotiating leverage. (Qtd Irwin 2013 p 43)

The Dollar devaluation was highly required as some countries wanted to appreciate their currencies to the dollar. Consequently, in 1973, the system of exchange rate broke down. Thereafter, economies worldwide suffered currency risks. Financial institutions, trying to reduce currency risk, engaged in currency speculation and international interdependence in currency trading. Reducing and controlling currency risk proved unsatisfactory because reputable banks like the German Bankhaus I.D. Herstatt Bank of Cologne, and the American Franklin National Bank of New York failed respectively in 1974.

The other major change in the 1970s was the oil crisis of 1973-74 and that of 1978-79, which increased volatility in the world economy. In retrospect, in 1973, the October War started when Syria and Egypt attacked Israel. As a response to the American interference to provide Israel with aid, ministers of Organization of Arab Petrolum Exporting Countries (OAPEC), under the request of Saudi Arabia, doubled oil prices and cut production. Many countries other than oil producing nations suffered because of oil price increases. Exporting countries could, thereafter, impose their terms on importing ones.

Thereupon, the United States tried to create an alliance of oil importing countries against Middle East producers. France and Japan refused such an alliance in order not to engage in conflicts with Middle East producers. It was the Organization of Petroleum

Exporting Countries (OPEC) that settled down the problem through stabilizing oil prices. Yet, in the course of time, oil prices increased leading up to economic downturns basically in the United States, Great Britain, and Japan. Consumption was highly impacted either through the high cost of oil and gas, or through price control. This did not only lead to oil shortage in oil importing countries, but also to high inflation.

3.3.1 The Oil Crisis (1973-75)

Figure 3.7: Inflation and Unemployment Rate, 1968-1991, Source: U S Bureau of Labor Statistics, (.McNees 1992 p11)

As noted earlier, the oil crisis of 1973 and the fall of the Bretton Woods system after the Nixon Shock were mainly the causes that ignited the 1973-75 severe crisis. It was the most serious since 1973. There was a significant increase of unemployment, and a catastrophic decrease in real GDP and investment purchase

By the close of 1970, there was a brisk expansion due to General Motors strike. Then, it moderated briefly by the early beginnings of 1971 until the first quarter of 1973. From March to November of 1973, there was a slow growth in the economic activity. The

constant dollar sales of retail stores witnessed the sharpest early decline. Manufacturing and trade sales, too, witnessed a shift from high level of growth to a slow level. Likewise, personal income and GNP declined after March 1973. Finally, personal consumption expenditures on automobiles and on durable goods declined sharply.

3.3.1.1 Inflation as a Factor of the Crisis

Economists classified the recession as a U-shaped recession because of its long duration and severe contraction. The above graph demonstrates how significant the relationship of inflation and unemployment is. Both inflation and unemployment rose strongly at the beginning of 1974. It is clear that inflation started a year before the recession. Actually, the recession was not only preceded by a high inflation but also by a slow growth. Inflation rose unusually from 3.4 percent in 1972 to 7.4 percent in September 1973. Over the same period, the federal funds rate increased even more sharply, from less than 5 percent to 10.8 percent. During the acceleration of inflation, the federal funds rate had risen gradually from 12 percent in early 1973 to 14 percent in September 1974 (See figure 3.8 on the next page). Then, unemployment rate jumped from five percent level to nearly nine percent in about a year and a half.

It has also been proved that inflation tends to depress consumer demand. The more the uncertainty about the future increases, the more the probability of real income decline increases. As inflation persisted and accelerated, consumers considered more critically and became more aware of price changes. Such an outburst of inflation which led to unemployment and personal income decline was due mainly to stimulative monetary and fiscal policies adopted to overcome the high rate of unemployment of 1971; the rises in prices of food, oil, and importing goods; the consequences of the dollar depreciation; and the effects of wage and price controls.

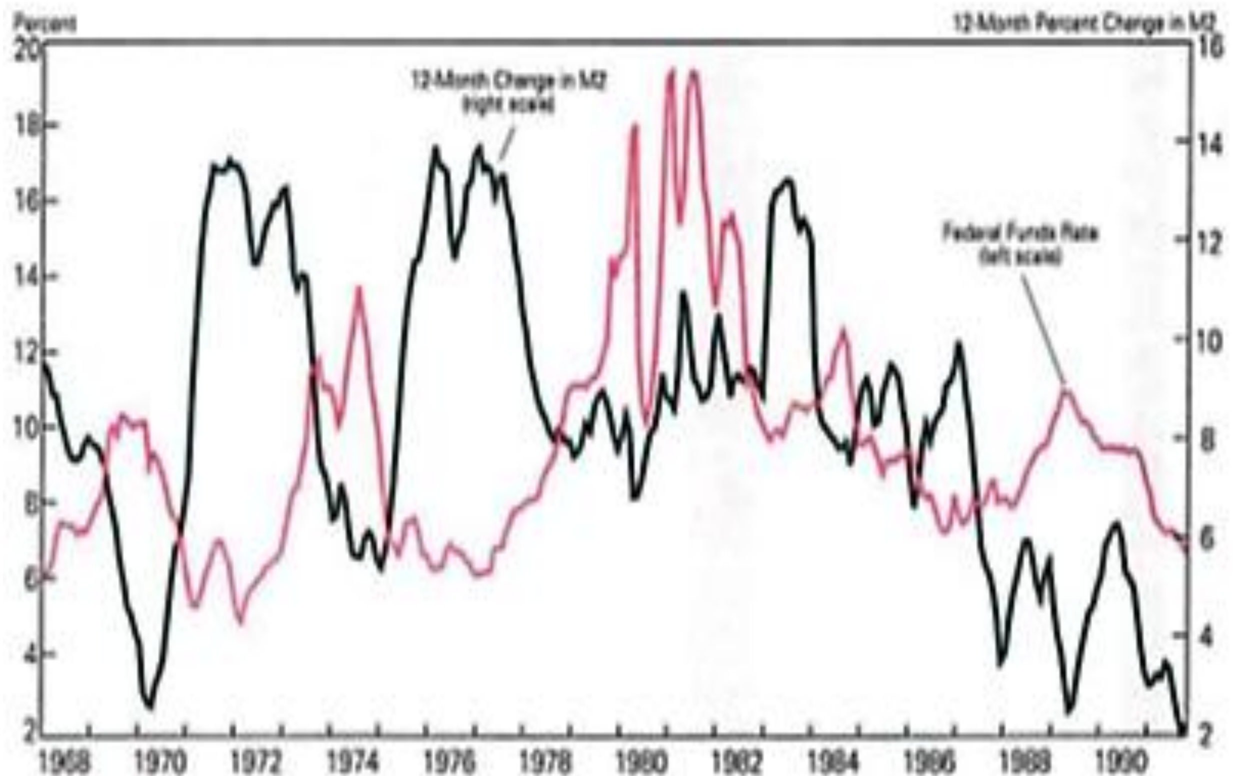

Figure3.8: Short-term Interest Rate and Money Growth, 1968-1991, Source: Board of Governors of the Federal Reserve System (McNees 1992 p11)

One major factor was the decline in investment purchases. All components of investment such as investment spending, producer equipment, producers' structures, residential structures, and business inventories decreased. From the fourth quarter of 1973 to the second of 1975, the level of investment purchases declined by 89 billion dollars (1972 value). Such a decline would equal a decline in GDP of about $178 billion. The actual decline in GDP was only about $84 billion.

The explanation for the discrepancy is that consumption was holding up better than was expected. Consumers' disposable income declined by $32 billion but consumer purchases did not decline. It actually increased by a small amount. This could be described as an upward shift in the consumption function. Government purchases stayed at about the same level over the period. Net exports increased by about $10 billion over the period.

The huge rise in the price of imported oil had a strong negative impact on the economy. Undoubtedly, the oil embargo caused a decline in industrial production as it included shortfalls in automotive gasoline and production cutbacks in the automobile industry. Substantially, construction of housing suffered, and inventory investment dropped sharply.

However, it might be unwise not to remember that inflation, decline in consumption and construction activity, and industrial production started well before the oil shock. The reduction of oil supply aggravated the situation since the economy was at the mercy of its dependence on oil imports, and short-term shifts in consumption and production proved unable to counter and absorb the damages effectively. Simultaneously, slowdowns that began to occur in some industrial countries had their adverse implications on the demand for American products. Altogether these shocks led immediately to more production cutbacks, high inflation rates, and more pressures on real income.

Other factors contributed to the 1973 recession. First, outlays on equipment, housing, and automobiles declined. Particularly, residential investment underwent an accelerated strong decline. Second, in late 1973, money and credit growth rates decreased, too. This slow growth of the money stock was a substantial culmination of the marked weakening of the demand for goods and services. Ultimately, short-term interest rates and long-term bonds turned downward leading up to a great reduction in the cost of credit. Yet, stock prices stopped falling in the fourth quarter of 1974, and consumer spending advanced strongly. Although it was not generally recognized at the time, the end of the recession was near.

3.3.1.2 The Recovery from the Oil Crisis

Both the tax cut and the fiscal stimulation contributed to the recovery, though some economists believed that economy would have recovered even without the former, and that signs of upturn were recorded well before the implementation of fiscal actions. V Zarnowitz & G. H. Moore (1977) found out that the initial strength of the recovery was derived from consumer spending. By the second quarter of 1975, real GNP reached 5.6 %; and personal consumption and residential construction reached 7% and 17% respectively.

The third quarter of the same year witnessed a reacceleration of both consumption expenditures and growth of real GNP rates. Furthermore, investment in residential structures and nonresidential spheres increased strongly during the same period. Data revealed that the expansion proceeded at a still slower pace in the second half of 1976. Though recovery was widespread, outlays on equipment and housing were still low. Labor productivity increased rapidly, too. Unemployment, however, remained very high during this recovery.

In the midst of this moderate recovery, the demand for external funds lowered as business capital outlays and the supply of internal funds grew rapidly. Short-term borrowing declined as a result of drastic inventory liquidation. In addition, to avoid business failures, members of the business community strengthened their debt structures through paying off large amounts of loans to banks, and building up ownership claims and liquid assets. Investment then could be financed by internal funds.

The improvement of the economic situation and recovery was also attributed to the moderation of inflation. Real wages as well as households' income raised thanks to the tax cut in May 1975 imposed by Ford. President Gerald R. Ford (1913-2006) was the first president to deal with the issue of stagflation. The latter was but an accumulation of large federal spending of L. Johnson, the growth in money supply of 1966, the surcharge of

1968, wage and price control of Nixon, devaluation of the dollar, and the oil embargo of 1973. Ford, the experienced congressman, sought unity in government to be able to face the economic problems the country was suffering from. He informed Congress that inflation, the domestic public enemy, was to be brought under control.

Ford was unable to have a clear choice between stimulating economy through large deficits and higher inflation or reduce inflation through lower deficits which might lead to a recession. On September 28, 1974, he established what he considered as the most important institutional innovation of his Administration, the Economic Policy Board (EPB) whose function was to coordinate and implement economic policies. Ford, members of the business community, and leaders of different economic sectors with economic advisers held a conference to come up with new ideas to fight against inflation. The Conference furnished the basis of Ford's program to decrease inflation and increase economic growth.

In his plan, Ford focused on important areas such as federal spending, food, energy, employment, and outlays. This plan met great opposition because of the 5% surcharge on individuals and corporate income. The Wall Street Journal criticized it by stating that it "was neither surprising nor bold."[66] Likewise, the New York Times stated: "in no sense add up to a program for an emergency."[67] The business community also condemned the program. Thereafter, Ford's relationship with Congress, the media, and the people witnessed 'an unhappy separation' not only because of his program but also because of his pardon to Nixon. However, he maintained his commitment to reduce inflation, and he began rethinking over his opinions. Ford's economic advisers focused their attention on the tax side of the budget to meet the economic circumstances of the early 1975.

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[66] Qtd in **Gerald R. Ford and the 1975 Tax Cut** Andrew D. Moran *Presidential Studies Quarterly* Vol. 26, No. 3, Reassessments of Presidents and First Ladies (Summer, 1996), pp. 738-754, p 741

[67] Ibid

The President sought advice from economists from inside and outside Congress. Representatives of labor and business suggested an urgent tax cut for low and middle income taxpayers, and an increase in the investment tax credit. The EPB and the Administration's economic policy had to be changed as a strong consensus for tax cut emerged in moderation. The Secretary of Treasury William E. Simon introduced the "Tax Proposals and Options" which named tax cut as a means to stimulate economy, and imposed tariffs on crude oil to stimulate production.

Simon's paper also suggested a moratorium on spending to avoid the threat on the achievements of lower interest rates and offset strains on the financial markets. Opinions on and about the paper proposals were mixed. Ultimately, Ford accepted the one year temporary tax reduction of $15 billion. He agreed to divide the personal and corporate tax income receipts into portions of two-thirds from individuals and one-third from corporations. Again, the EPB recommended accruing a negative surtax on individual income and increasing temporarily investment tax credit on corporations; Ford agreed. Likewise, Ford supported the imposition of $3 tax per barrel on crude oil. Special compensation for low and middle income taxpayers was included therein.

When discussions over the proposals were over, Ford met an ad hoc group that urged him to increase assistance to unemployment. As the economic activity became pervasive and the unemployment rate was expected to increase, a temporarily stimulus was highly required. About 81% of the unemployed population received compensation. Between 1975 and 1977, coverage of compensation exceeded 52%. Still, the long-term goal was to reduce inflation. The EPB recommended using the tax cut to stimulate economy rather than government spending. This with Simon's paper furnished the basis of Ford's program to end the recession. In spite of the division of opinions, a temporary tax cut of $15 billion was finally agreed upon.

The program's results were striking. Consumption rose to 63.1% 1975; and remained high through 1979. Personal income reached 90% in 1976; and remained so until the end of the decade. Investment could only recover by 1977. So Ford's stimulus package promoted increasing consumption through taxes and spending changes. This fiscal policy helped shape the monetary policy to sustain the president's plan.

Moran (1996) appraised Ford. He stated,

> That Ford had the strength to adopt and reverse the policy proposals he made on October 8th, 1974, in his first major economic address highlights an acceptance of economic reality and an awareness of political needs. After twenty-five years of representing the parochial Fifth District of Michigan, Ford, on January 15th, 1975, progressed from being a local politician to a national leader, responding to the needs and hopes of a country eager for stability and direction.

Meeropol (2001) in his report to the Economic Policy Institute concluded that tax cut for low and middle income families, which helped to stimulate private consumption, promotes the biggest boosts to weak economies. He stated,

> President Ford's tax cut was clearly focused on increasing consumption. Marginal rates were not cut, and instead all taxpayers and their dependents received a credit of $30 billion. In addition, the standard deduction was increased, and a refundable earned income tax was enacted. …It is clear that the 1975 tax cut, plus some increased spending in the form of extended unemployment compensation benefits, helped raise the federal deficit and increase aggregate demand. (p 2)

The recovery that began in the second quarter of 1975 was moderate in terms of output, employment, real income, and retail sales but weak in capital investment. The level of real GDP increased for the $1168 billion in 1975II to $1201 billion in 1975III. Real GDP then increased to $1217 billion in 1975IV (see table below). The recession was over.

Quarter	GDP Billion $
1975I	1157
1975II	1168
1975III	1201
1975IV	1217

Table 3.6: Real GDP Increase From first quarter to the fourth quarter of 1975

The longest peacetime economic expansion on record of the 1970s was then cut by a recession. Just like Ford, Ronald Reagan imposed a cut tax in 1981, which could by no means mitigate the recession of 1982 since it benefited those at the top of the economic scale.

3.3.2 The Energy Crisis Recession (1981-82)

Economists believed that the 1981-82 recession was a subsequent result of the previous efforts to fight against high inflation and poor forecasts.

3.3.2.1 Extent and Factors of the Recession

The National Bureau of Economic Research revealed that the short recession of 1980, and the short period of growth were followed by a sustained recession in 1981. The recession lasted 16 months, from July 1981 to November 1982, and was featured by a fair steady decline in employment and industrial production. Increases in revenues which resulted from increases in payroll tax for Social Security did lead to a decline in the federal

deficit. As compared to previous recessions, the 1981-82 recession was not very long, yet it caused serious economic damages since it was deeper; it is the apex of the post World War II era.

Actually, economy was in malaise one year before it had been officially admitted that the country was passing through a serious economic slowdown. The unemployment rate hovered from 7.4% in the first quarter of 1981 to 10.8% in the fourth quarter of 1982 through 1983 since housing, automobiles, steel, and other related industries were in a prolonged downturn. Likewise, investment purchases dropped in the third quarter of 1979, and continued downward through 1981 and 1982. While only few Americans believed that the economic situation would become worse, per capita GDP declined by3.4% from its annual rate.(See the chart on the next page) Although statistics reveal that the unemployment rate rose drastically and investment purchases was so disturbing, economists believed that Paul Volcker's tight money policy was clearly the cause of this recession. It was triggered by a tight monetary policy which was adopted in an attempt to fight high inflation.

Inflation persisted in the United States during the 1970s; the Fed carried out a money policy the end of which was to kill such a chronic phenomenon. The Fed increased the interest rate sharply. Volcker, Carter's appointee as a Chairman of the Federal Reserve, used the federal interest rate as an instrument to affect the money supply. He increased it from 9.6% to 19% eight months after he assumed office. By April, 1980, when the money supply was contracting, the Fed did only reduce its growth rate. Subsequently, the federal funds rate was reduced to 9.5%; it remained so until August, 1980. However, by January, 1981, the federal funds rate reached 20%.

Such monetary tightening policy had affected housing, among many other industries, so significantly. Between the third quarter of 1979 and the second quarter of 1980, housing declined by 34.8%. It witnessed an upturn from the third quarter of 1980, then it started declining again in the second quarter of 1981 when the monetary policy was tightened again. Housing increased to 92.0% when monetary policy was eased in the third quarter of 1982. Yet, the monetary tightness was not the sole cause of the recession.

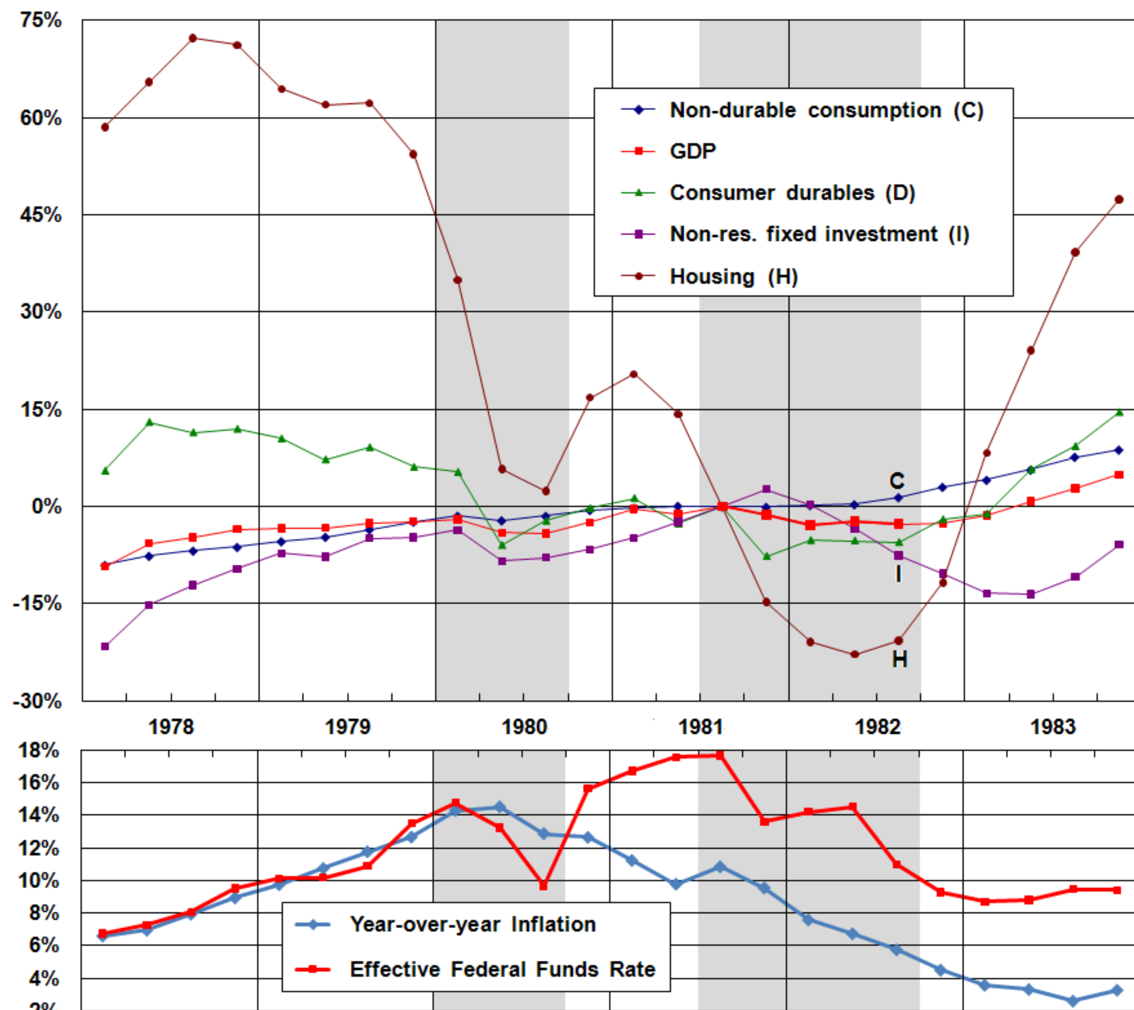

Figure 3.9: Changes to Housing, Investment, Consumption, and GDP from 1978 to 1983[68]

Another cause of the recession was the fiscal policy of the Reagan Administration. Just like the previous administration, the Reagan Administration adopted a tax package. The Reagan Tax Cut was viewed as a means to stimulate economy. It included a major

[68] (Gjerstad, Smith 2010 12)

increase in defense spending, a three-stage tax cut, and cuts in non-defense spending. Once he assumed office, so many Americans smiled on Reagan claiming that he would better their financial situations. By September 1982, however, they were far from being pleased with the worst economic scene. The tax cut did not include any transfer payments for unemployment compensations. In addition, it did not focus on low income individuals whose compensation increase could trigger out recovery. Reagan could not have the economy out of a slump since consumption did not rise, and investment recovery could not be induced.

Meeropol (2001) concluded that the Economic Recovery Tax Act of 1981 (ERTA), which set the tone for Reagan's economic policy, delayed recovery. He stated,

> As recent history makes clear, backloaded tax cuts delay the impact on aggregate demand and mute efforts to fight recessions. And tax cuts that neglect the individuals most likely to spend extra income do not work well when the goal is to combat recession. A large share of any stimulus should be focused on low- and moderate- income families. (p 4)

The high value of the dollar, as compared to other currencies, contributed in worsening the economic situation as it caused a trade deficit. (See table 16 on the next page.) The appreciation of the dollar impacted the behavior of import and export prices. American import prices fell 2.8%, a fact that contributed to a sharp reduction of American domestic prices' rate.

Exports to developing countries which accounted for more than one-third of American merchandise exports were reduced significantly. They declined by 7.1% from their annual rate of 1981. Prices of many products such as meat, fish, sugar, automobiles,

machine tools, telecommunication equipments, nonferrous metals, grain, textiles, and other miscellaneous manufactured products all declined in 1982.

Country and Currency	Percent change relative to dollar in 1982
Australia/Dollar	14.6
Belgium/Franc	24.0
Brazil/ Cruzeiro	100.4
Canada/Dollar	4.5
France/Franc	20.0
Germany/Deutschmark	7.1
Hong Kong/Dollar	16.1
Ireland/Dollar	12.5
Italy/Lira	15.9
Japan/Yen	10.5
Malaysia/Ringgit	4.7
Mexico/Peso	456.2
Norway/Krone	21.7
Singapore/Dollar	4.8
United Kingdom/Pound	15.1

Table 3.7: Foreign exchange rate changes of currencies of selected U.S. trading partners[69]

[69] Johnson 1983 p 23

The Iranian oil embargo aggravated the situation; it led the economy to its nadir. Iran, the world's largest producer of oil at that time, under a new regime after the revolution of 1979, changed its exporting strategy. It exported oil at lower volumes. All-import price index fell 3.7% driving prices up. GDP remained negatively low for 12 quarters (see table 17 below)[70]In addition, imports of crude oil dropped to 3.5 million barrels per day; domestic consumption of petroleum products fell 4.9%.

GDP Growth	Q1	Q2	Q3	Q4
1980	1.3%	-7.9%	-0.6%	7.6%
1981	8.5%	-2.9%	4.7%	-4.6%
1982	-6.5%	2.2%	-1.4%	0.4%

Table 3.8: GDP Growth from 1980 I to 1982 IV

Reagan described the situation, in a televised address to the American people on February 5th, 1981, as follows:

> I regret to say that we are in the worst economic mess since the Great Depression. . . . The Federal budget is out of control, and we face runaway deficits of almost $80 billion for this budget year that ends September 30th. That deficit is larger than the entire Federal budget in 1957, and so is the almost $80 billion we will pay in interest this year on the national debt. Twenty years ago, in 1960, our Federal Government payroll was less than $13 billion. Today it is $75 billion. During these 20 years our population has only increased by 23.3 percent. The Federal budget has gone up 528

[70] https://www.thebalance.com/the-history-of-recessions-in-the-united-states

> percent. Now, we have just had two years of back-to-back double-digit inflation — 13.3 percent in 1979, 12.4 percent last year. The last time this happened was in World War I. In 1960, mortgage interest rates averaged about 6 percent. They are 2½ times as high now, 15.4 percent.

3.3.2.2 Recovery from the Crisis

In spite of the severity of the recession, the recovery was both uneven and tenuous**.** While some economists credited Reagan's tax cut and high military spending for the recovery, others attributed it to the Fed's loosening of monetary policy. The recovery continued through Reagan's two-term presidency, and lasted for a decade. This economic expansion is the longest ever recorded. Per capita GDP increased by 23%.

President Reagan suggested forging 'a new beginning for America'. He wished to leave the American children 'with an unrepayable massive debt and a shattered economy, or we can leave them liberty in a land where every individual has the opportunity to be whatever God intended us to be.'

President Reagan presented an all-inclusive economic program to Congress on February 18th, 1981. The plan which reflected the "Reaganomics" included majors that might reduce the growth of government spending, cut taxes, reform and eliminate regulations, decrease the unemployment rate, and most importantly bring inflation under control. Although the plan met great opposition from Democrats and some Republicans, it was signed into law as the Recovery Act in August 1981.

The plan was not successful at first as unemployment skyrocketed, companies went bankrupt, farmers lost their land, and many Americans became homeless. However, things changed pleasantly during Reagan's second term. Economy began to rebound leading to

the longest peacetime expansion to date in the history of the country. Lou Cannon, Reagan's biographer, stated that while Reagan expected to provide 13 million new jobs, 18 million jobs were created; and the unemployment rate was reduced from 7.1% to 5.5%. In addition, by 1984, inflation which was so high, it averaged 4.4%.

While many economists blamed the Reagan program for the high budget deficit, the increase of the national debt, and the crisis for American trade, William Niskanen, Reagan's economic advisor, stated that stagflation and the economic malaise that the country suffered from during the period between 1973 and 1980 have been transformed into lower inflation and high growth thanks to the Recovery Act. They proved to be successful once they were fully implemented. Economy and the federal budget witnessed long run equilibrium changes thanks to Reagan's Economic Recovery Tax Act ERTA.

In addition, the Reagan years prospered thanks to the explosive growth in the stock market. After a real decline of 70% that featured the history of Wall Street from 1967 to 1982, the stock market began a stratospheric ascent. Even middle-class investors could enter the stock market. American families could enjoy more and more wealth. This lustrous Reagan economy did little good to those Americans who did not own any stake at the stock market, however. The wealthiest Americans saw their incomes increasing by 14%, while the poorest saw their income declining by 24%.

In brief, the Reagan recovery from the "Volcker" recession marked a departure from the earlier economic expansions of the 1940s, 1950s, and 1960s, which had generated smaller returns for investors but raised income levels across all classes of society. Nevertheless, this long peacetime expansion was brought to a close by the mild recession of 1990-91.

3.3.3 The 1990-91 Recession

Economists agreed that the 1990-91 recession was clearly one of the mildest, though probably not the mildest, in the postwar era, although it was preceded by a long moderate economic growth. By July, 1990, few signs of a recession were visible; only few forecasters anticipated a decline in real GNP. The increase in the unemployment rate was smaller as compared to previous recession. Yet, its impact on the American economy and the work force was quite severe.

3.3.3.1 Timing and Severity of the Recession

	1990-91	
Industry	**Number (in thousands)**	**Percent**
Nonfarm	-1.143	-1.0
employment	-1.006	-4.0
Goods producing	-5	-.7
Mining	-382	-7.5
Construction	-619	-3.2
Manufacturing	-490	-4.4
Durable goods	-129	-1.6
Nondurable goods	-137	-.2
Service producing	-31	-.5
Transportation	-86	-1.4
Wholesale trade	-286	-1.5
Retail trade	-22	-.3
Finance, insurance, and real estate	159	.6
Services	129	.7
Government		

Table 3.9: Change in Nonfarm Employment during the Official Span of the 1990-91 Recession by Industry[71]

The National Bureau of Economic Research stated that July 1990 and March 1991 were the official peak and trough of the recession, although employment continued to trend

[71] Adapted from Garner 1994 p 4

downward one year after the endpoint of the recession. During this period, employment decreased at a lower pace; the decline totaled 1.3%, rather a mild decrease as compared to the two previous contractions. Only few industries experienced employment drops, while others were not severely affected.

However, other sectors of economy such as construction, trade, real estate, services, and insurance registered an evident weakness in employment. (See table 3.9) Unemployment in construction, trade, and goods producing industry increased at a faster rate as compared to finance, insurance, and real estate. In contrast, mining and transportation experienced a milder employment decline. Manufacturing, too, recorded a smaller drop, though in previous recessions, it was associated with larger job losses.

Just like most post War recession, housing declined sharply in the 1990-91 recession. Similarly, durable goods and investment declined before the beginning of the economic downturn. From their peaks to their troughs, housing fell by 34.8%, investment fell by13.4%, and durable goods declined by 12.8%. (See figure 3.10)

Unlike the two recessions of the early 1980s, which resulted from policies to bring inflation down, the causes of the recession of the early 1990s were less apparent. Economists and historians cited the behavior of pessimistic consumers, the debt accumulations, the sudden increase of oil prices after the Gulf War, and the Fed's policies to lower inflation rate as being causes of the recession.

3.3.3.2 Factors behind the Recession

The recession was associated with a disproportionate decline in personal consumption expenditure. Due to the decline in real GNP, consumption recorded a 0.9% decline. There was a dramatic decline in prices relative to the growth path that started in mid-1990. Yet, economists do not express any factual support for the view that the recession culminated from a price shock. The spontaneous decline in consumption has

been designated as the proximate cause of the recession since its effects are long lasting. Also, it explains why the recovery was weak and slow.

The second major cause of the recession was debt accumulation. At the start of the 1980s, an increase in defense spending and substantial tax cuts continued to balloon the federal debt. By the end of the Reagan era, the national debt reached $2.7 trillion, as economy witnessed a large boom coupled with an insufficient funding of expenditures.

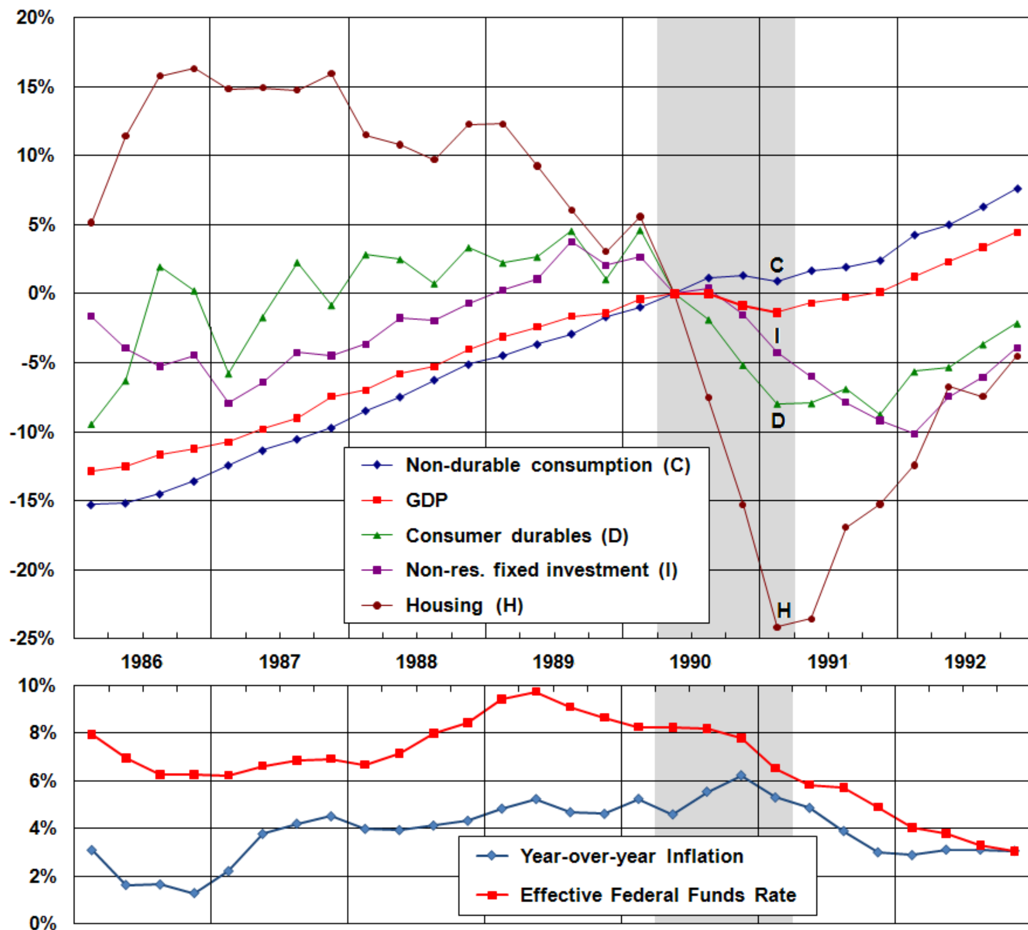

Figure3.10: Percentage changes to GDP and its major components before, during, and after the 1990-91recession[72]

Economists also associated the 1990-91 recession with the Savings and Loan Crisis. The latter is dated back to 1989 when more than one thousand of the nation's Savings and

[72] Gjerstad & Smith 2010 pp 22

Loans failed. It cost taxpayers $ 132 billion, in addition to $28 billion that the S&L industry paid. Because of the crisis sources of home mortgages and the idea of state-run bank insurance funds had been destroyed.

It is not uncommon that this recession, just like the two previous recessions of 1973 and of the early 1980s, is also remembered for its influence by the oil shock price which was a result of the Iraqi invasion of Kuwait. On August 2nd, 1990, Iraq started an occupation of Kuwait that lasted seven months. The invasion required an American-led intervention since it caused oil price spike. Price oil rose from $17 per barrel in July to $36 per barrel in October. Although the price spike was less extreme and shorter, coupled with the issue of inflation, it contributed in worsening economic scene

During the 1980s, the Fed aimed at keeping nominal GDP on a constant growth path. Inflation was below 2% for the first time since 1965. Even with the Fed's loose monetary policy, it began to rise through 1987. Then, by 1988, the Fed proved able to avoid inflation. However, by early 1989, it rose again; the Fed responded by tightening its monetary policy. Through 1990, while the recession was developing, inflation peaked. The contraction that started in mid-1990 took economy below the growth path; and continued to move downward ever since. The Fed began a sharper easing of monetary policy in the first quarter of 1991, just as inflation began to subside.

The 1990-91 recession was not only a frustration for the people who suffered from, but also for economists who could not discern its causes so easily. Nevertheless, the economy recovered, yet the unemployment rate continued to increase 15 months after the endpoint of the recession designated by NBER where growth was sluggish in spite of many labor market measures.

3.3.3.3 Jobless Recovery

The looser monetary policy and simulative fiscal policy were microeconomic responses to the recession. Housing construction played a major role in the recovery which was quite strong except for employment. Unemployment continued to rise even after the end of the recession, and it did not rebound to pre-recession levels until 1997. (See table 18).

This new pattern of recovery signaled the beginning of the ‘new normal’. Thereafter, recoveries from the two recessions that took place in the early beginning of the new millennium were characterized by fluctuations in unemployment rates which were not settled down at their pre-recessionary levels.

Year	**Unemployment rate**
1989	5.3%
1990	5.6%
1991	6.8%
1992	7.5%
1993	6.9%
1994	6.1%
1995	5.6%
1996	5.4%
1997	4.9%

Table 3.10: Unemployment Rate before and after the recession of 1990-91[73]

President George W.H. Bush insisted on a reduction in the capital-gains tax. In contrast, Democrats insisted on higher taxes on wealthy Americans. Such titanic struggle ended by maintaining the capital-gains tax. The President also favored a free-trade policy. In addition, Bush forced Congress to find an offsetting spending reduction or tax increase every time lawmakers wanted to provide more money for some program or other. By the third quarter of 1991, the recession seemed to come to an end.

[73] Investopedia.com 27/12/2017

The mid and latter 1990s proved to be one of the most robust periods in U.S. economic history. The most unusual feature of the 1990-91 recession may well be that it was both preceded and followed by periods of subpar growth.

3.4 Conclusion

After the Second World War, the United States witnessed minor and major panics. It could recover thanks to monetary and fiscal policies. Still, the Twentieth century marked the beginning of a new trend: the jobless recoveries from contractions.

4.1 Introduction

During the twenty-first century, The United States witnessed but a minor recession in 2001, and a major one in 2007. The present chapter studies briefly the recession of 2001. Second, it studies deliberately the Great Recession, with comparisons to previous recessions notably the Great Depression.

4.2 The 2001 Recession

The economic expansion that started in March 1991 was brought to a close a decade later. The 2001 recession was classified by the arbiter of American business cycles, the NBER, as mild as the recessions of 1969-70 and of 1990-91. In addition, they were all preceded by long expansions. This proves that the United States has been moving progressively towards longer economic expansions, and milder and shorter recessions. The economic disturbances, which were recorded in 2001, were caused by the fallout from the events of September 11, 2001.

Short duration and mildness are two characteristic features that distinguish this recession from the other Post-War economic downturns. Data revealed that real GDP rose

0.2% from the first quarter of 2001 to the fourth quarter of 2001 (from the peak quarter to the trough quarter respectively according to the NBER).

The 2001 recession was the mildest of the post-war era, yet it furnished the stage for the Great Recession.

4.3 The Great Recession 2007-09: a Global Crisis

It is said that "when the United States catches a cold, the rest of the world sneezes" this seemed to be true. By mid 2008, important European countries and Japan went into recession. The crisis was a surprise for academics, policymakers, and investors. Therefore, the severity of the downturn was underestimated. But few economists and professional analysts could predict the course of events, yet the warning signs were there. Countries like the United States and Great Britain experienced large deficits, loose monetary policy, and lax financial regulation. The table below illustrates the depth of the Great Recession in different countries.

Some advanced and developing countries could resort to stimulus packages to inject massive amounts of credit into financial markets, nationalize banks, and increase

Table 4.1: Percentage Change in Real GDP, Financial Crisis, 2007-2009, Selected Countries Source: Eurostat (2010) for EU countries, BEA (2010) for USA and Trading Economics (2010) for Japan. (Adapted from Mazurek & Mielcová 2013 p 192)

Country	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
EU	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Germany	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
France	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Latvia	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
US	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Japan	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

discretionary spending, among many other policies, to avoid the catastrophic outcome of the downturn. Such policies varied depending on the magnitude of the downturn on economies. The latter differed from one country to another in terms of duration, and GDP decline. The table below illustrates best such differences.

Country	Duration	Mean Decline of GDP (%)	Magnitude
Latvia	8	3.56	8.15
USA	4	4.13	7.37
Japan	4	2.26	6.50
Germany	4	1.68	6.07
EU	5	1.10	5.79
France	4	1.00	5.32

Table 4.2: Evaluation of the Financial Crisis 2007-2009, Selected Countries (Mazurek & Mielcová 2013 p 193)

In spite of these differences, the crisis quickly evolved into a global job crisis. The United States was by no means among the countries the hardest hit. While China could start to recover very soon thanks to the stimulus package of $585 billion provided by Chinese authorities, and Indian economy recovered thanks to a smaller package, things were worse for the United States.

4.4 The Great Recession in the United States: Factors and Extent

During the boom years of the 2000s, governments and policymakers seemed to forget easily the low rates of growth that occurred during the 1980s and 1990s, and the great economic damage of the surge in oil and food prices.

4.4.1 Pre-recession Period

In the early beginnings of the twenty-first century, the world entered an era of 'low volatility' referred to as the 'great moderation'. Ben Bernanke, the Chairman of the Federal Reserve during the Bush and the Obama Administrations respectively used the term "great moderation" to refer to the decades before the Great Recession. Bernanke noted that

changes in economic institutions, business practices, technology, led up to the fall in macroeconomic performances. The Great Recession can then be explained either by the great deal of optimism or of a dim view of the past.

It has already been mentioned in this study that in the period between 1929 and 2001, there was hundred of banking crises, debt crises, currency crises, and several price shocks. Global economic downturns were likely to take place every ten years. Studies conducted by many scholars revealed that crises which lasted two years could induce sharp recessions. Even when economies could recover, levels of employment, consumption, investments, and credit flows were devastating. The Great Recession was no exception.

The pre-crisis period (2002-2007) witnessed historical high levels of growth in many developing countries. These countries witnessed an important surge in investments and exports. Upon the whole, the world was overwhelmed by optimism about the future. Investors in developing countries underestimated risks. Likewise, policymakers denied the signs of global economic downturn even when the seeds appeared in the American heartland.

The labor markets recorded great job losses even during the global boom that preceded the2007-09 crisis. Nevertheless, insufficient attention was attributed to the high unemployment rates. In addition, the increase in economic growth could not afford improvements in household incomes. This global boom led also to food and energy price shocks that pushed many countries into poverty.

Verick & Islam 2010 reported that the World Bank estimated that the Great Recession led 64 million people into poverty. Likewise, the food and oil crisis impacted many rich and developing countries more severely. It is noticeable that the Great Recession of late 2007 is preceded by an economic growth of about ten years just like the Great

Depression of 1929. The causes of such unexpected Crisis originated first in the United States.

4.4.2 Causes of the Great Recession 2007-09

The National Commission on the Causes of The Financial and Economic Crisis in the United States concluded in its report delivered in 2011 that the recent crisis was avoidable. The members of the Commission stated that,

> Despite the expressed view of many on Wall Street and Washington that the crisis could not have been foreseen or avoided; there were warning signs. The tragedy was that they were ignored or discounted… and regulators had ample power in many arenas to protect the financial system but they chose not to use it. (p XVIII)

Causes of the Great Recession, which originated from a lack of appropriate financial regulations, the large number of financial institutions, and political bickering, are both systematic and local. Verick & Islam 2010 noted,

> The crisis was largely unexpected and due to its complex roots, it continued to puzzle policymakers, economists and other commentators as it unravelled and sucked in at first banks and companies, and then economies across the globe. The collapse in the real economy has had devastating consequences for households as a result of rising unemployment and surging poverty. At the same time, some countries have been affected more than others due to differences in initial conditions (state of economy, labour market, fiscal space, institutional framework) and exposure to direct and indirect impact of the crisis via credit and trade channels. (p 13)

The above passage explains the causes behind the crisis. Actually, the Great Recession is primarily a financial crisis. Since its beginning in August 2007, losses had accumulated at an increasingly rapid pace. The market valuation of the financial sector was steadily decreasing and the pace has accelerated: the stock market was falling; the capitalization was likewise, at a monthly rate of 150 million dollars at the end of 2007, 250 after the Bear episode Stearns then 650 after Lehman. In total, between August 2007 and the end of 2008, the market capitalization of the financial sector lost $ 5000 billion. Two things hit the spirits in the spring of 2007: the extent of the means implemented to save the financial system, and the brutality of the consequences on the real economy.

During its first phase, the crisis lasted for one year. Faced with the direct consequences of the subprime crisis, the US authorities, in particular the Fed, reacted vigorously and quickly; we could think that they had measured the extent of the problem. The means of precedents, judging by the interventions of the central banks, have responded to situations themselves unprecedented like the rescue of the bank Bear Stearns. The summer of 2008 saw temporarily the return of a semblance of confidence: perhaps eventually, the excesses of the American real estate were in the process of being purged. It is known that America's business is fundamentally optimistic.

In the spring of 2008, for example, the idea of a "decoupling" had emerged, a new term expressing the hope that emerging countries, and perhaps Europe itself, could continue to grow under the effect of their own dynamism and even pull the US economy out of the rut. In support of this scheme, we also noted that the support given by the US economy to net exports during three quarters was boosted by the devaluation of the dollar.

September 2008 revealed the naivety of these hopes and marked the beginning of a second and more dramatic phase of the financial crisis. The bankruptcy of Lehman and the

rescue of AIG unveiled the subprime, and we discovered in forty-eight hours a much more disturbing perspective on the extent of the disaster. The banking sector was instantly cowering, credit was drying up, and confidence was falling from there, American authorities multiplied technical and political errors. The political calendar, too, weighed down and weighed down the financial climate: in the face of the crisis, there was a kind of power vacuum in Washington.

The result was a truly chaotic policy, especially in the autumn of 2008. Accepting the collapse of Lehman Brothers seemed understandable for a moment, but the consequences on the market were simply very badly appreciated; such a mistake is particularly difficult to understand from a reputable Treasury team so aware of the realities of the market!

The role attributed to the FED, which went far beyond its normal competencies, was also improvised and presented risks. Adoption and implementation of the Troubled Asset Relief Program (TARP) which was to buy bad debts from the failing financial institutions in the panic that followed the bankruptcy of Lehman, was not in the limelight either the US Treasury or the Congress: a massive effort, followed by a second plan a few weeks later, did not have the expected psychological effect, far from it.

Designers of the TARP believed that the failure of the 'too big banks to fail' might lead to another Great Depression. A number of parties, like the United Steel Workers, raised concerns about the TARP. The Union blamed the Treasury for its unsatisfactory actions. In a letter about their discontentment about the overvalued purchase of assets, they announced that,

> Your investments do nothing to deal with the causes of the current crisis. Now that even Chairman Greenspan has discovered a "flaw" in his theories,

> wouldn’t it make sense to have some reason to believe that the recipients of this government largesse won’t just take the money and do it all again? Perhaps there is some reason I do not understand that you have seemingly handed this chicken coop back to the very same foxes who have been pillaging it for the last two decades? (Qtd in Hsu 2017 118)

The TARP contained critical flaws. After the crisis began, the TARP failed to address economic problems. It could not know the exact number of banks which held in bad assets. Second, the program did not require financial institutions to stop paying their executives who transferred their funds to the wealthy Americans, and were responsible for the crisis. Upon the whole, the political opposition to the TARP impacted markets negatively.

The winter of 2008 marked the entry into a third phase. It was the real economy which was directly and massively affected. The slowdown was noticeable in the fourth quarter, but the magnitude of the decline made observers shudder. Some indicators summarize the situation at the beginning of 2009 as follows:

Consumer confidence reached its lowest point in twenty-five years; real estate prices fell (nearly 20% over one year at the end of 2008, housing, which reached 1.8 million in 2006, collapsed to 400,000, the rise in retail prices, which was still above last year's 5% year-on-year, dropped to 0, resurrecting the specter of deflation; companies listed in the S&P/500 recorded, for the first time since the 1930s, a cumulative loss of $ 180 billion in the fourth quarter of 2008; the unemployment rate rose by half in a few months, reaching 7.2% in December, and many forecasts suggested that it would exceed 9% by the end of 2009.

Economists and historians stated that the housing bubble was the main cause that ignited the Great Recession. Speculation in the real estate spheres made economists

question the stability of the American financial system. The National Commission on the Causes of the financial and economic crisis in the United States concluded its 11th chapter of its report delivered in May 2011 that “the collapse of the housing bubble began the chain of events that led to the financial crisis.” (p 230)

Gjerstad & Smith (2010) noted that the Great Recession is attributed to the housing bubble that started in 1997, and resulted in an important house price increase between 2003 and 2005. During this period, the net flow of mortgage funds increased so rapidly. However, such positive growth was interrupted when it started frightening investors. In late 2005, house prices began to level off as a result of a decrease of one third in mortgage funds into the market.

Nothing supported house prices as credits were not flowed into the housing market. Figure 4.1 on the next page shows how the housing sector impacted other economic sectors. The crisis began at the bottom of the economic pyramid. Residential construction, investments, and durables were collapsing.

Obama himself noted that positive forecasts of the housing market encouraged financial institutions and homeowners to lend and borrow respectively. In such an atmosphere, risky borrowers took out mortgages. Banks lent money even to those who could not afford. The Federal Reserve could not impose appropriate measures to obstruct home prices since financial institutions were to resolve their problems under the Gramm-Leach-Bliley Act of 1999.

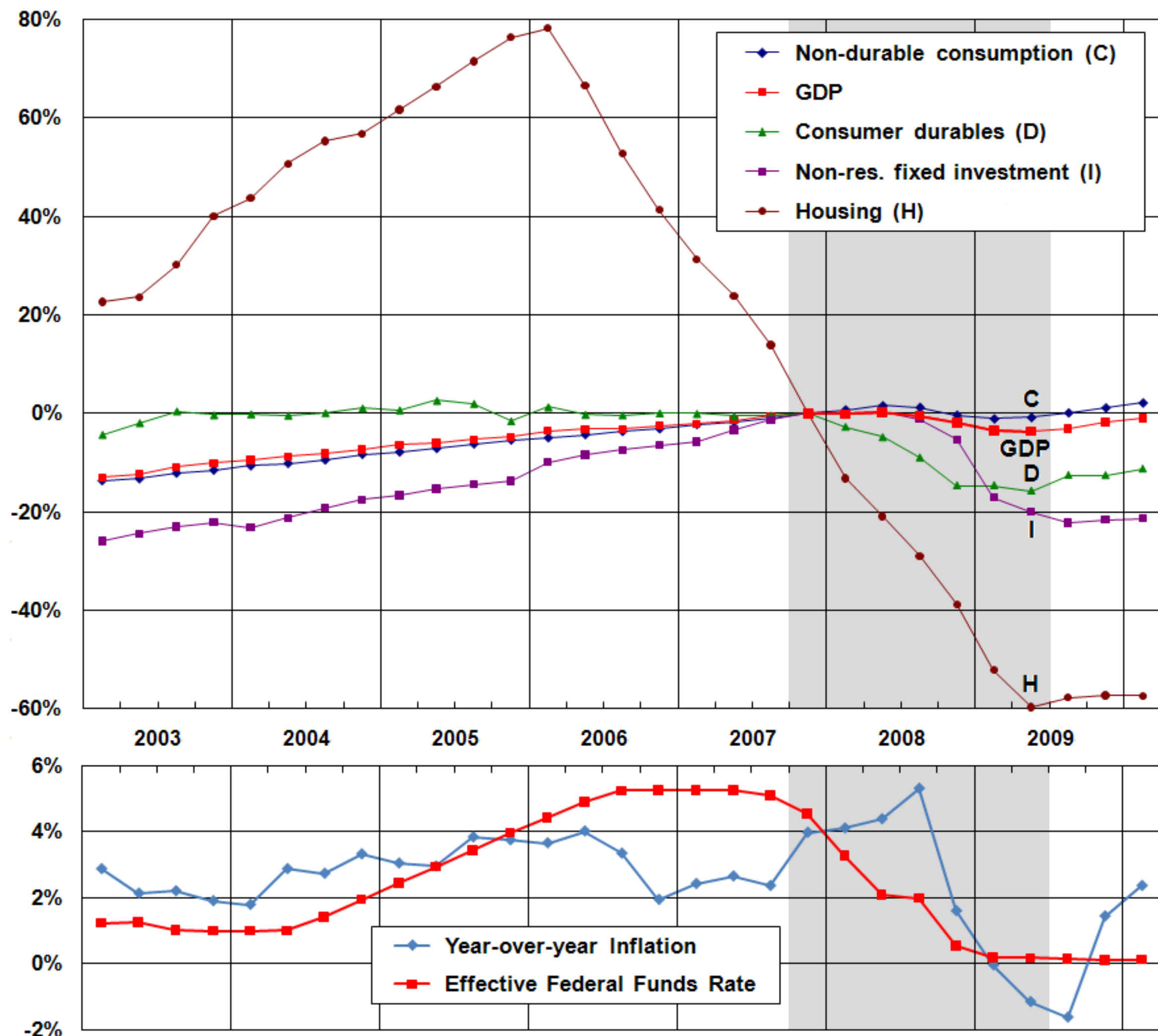

Figure 4.1: Percentage changes to GDP and its major components before, during, and after the Great Recession.[74]

Once the housing bubble burst, the sub-prime mortgage loans were the first to be adversely affected posing a threat to the entire American financial system. [75]The Fed was to be blamed for its failure to regulate housing transactions.

Single families sold their homes. The home price index rose sharply from 2003 to 2005. By 2006, it started plunging. Many homeowners lost their homes. Only few of them could retain their homes during the foreclosure crisis. Housing equity was much lower than

[74] (Gjerstad & Smith 2010, 6)
[75] The crisis spread directly to European banks that owned housing assets. Soon after, those countries experienced sharp increase in unemployment, and a decline in spending in the United States

the pre-recessionary levels. Even after recovery, house prices were still 30% below the peak recorded in 2006. (Danziger 2013)

The mortgage crash led up to the failure of investment banks, for instance, the Bear Stearns was heavily implicated in the subprime mortgage market. The bank used $3 billion to bail out one of its hedges that placed a wager on the sub-prime loans. As a response to a rumor that the Bear had liquidity problems, the bank's stock was driven down by 47%. Despite the several attempts of the Fed and the Treasury to save the Wall Street investment bank, the Bear collapsed as it ran out of $18 billion out of its cash and reserve. Six months later, Fannie Mae and Freddie Mac started faltering. Other major financial institutions like Lehman Brothers, Washington Mutual Inc. and American International Group went bankrupt during the same period. According to the National Commission these firms were affected by the collapse of the housing bubble first because of the decline in collateral asset values and the concern about their subprime exposure.

The announcements of Investment banks' losses, the collapse of German Sachsen Landesbank, and the run on Northern Rock revealed that the trouble was spreading. All that the Bush Administration could do was to nationalize those institutions and fire their managements. The Fed coordinated with important banks to provide billions of dollars to the banks. (Donato 2009)[76]

The global crisis was first triggered by the real estate bubble that started after the dot com crash of 2000 when the Fed lowered interest rates. The Fed kept short-term interest rates low. The National Commission reported that "by 2003, creditworthy home

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[76] This economic meltdown transformed financial markets and politics at the same time. The crisis impacted the political maneuvering of the incumbent president and the two candidates Barack Obama and John McCain alike. While Bush tried to avoid being compared to Herbert Hoover, Obama represented fresh and new presidential opportunities for the desperate Americans, just like F. D. Roosevelt who used the New Deal to give Americans hope.

buyers could get fixed-rate mortgage for 5.2 % 3 percentage points lower than three years earlier" (p 85)

In addition, Goodman & Mance (2011) noted that rising oil prices, which proved to be a contributing factor to previous recessions, strained the economy in 2008. From June 2007 to June 2008, oil prices doubled as demand surpassed production. Subsequently, the rising energy costs impacted personal consumption expenditures. Expenditure on durable goods such as autos and appliances began to shrink by the first quarter of 2008.

Moreover, the automobile manufacturing industry underwent ongoing decline in competitiveness and demand due to the crisis. It was subsequently compelled to resort to government assistance. Important manufacturers like General Motors and Chrysler filed for bankruptcy.

The year 2008 witnessed an excruciating financial drama. Donato (2009) presented the other tragic events of the financial crisis as follows:

10 March 2008: Bears Stearns' liquidity problems start, putting the bank on course to collapse seven days later.

The bank was brought out by JP Morgan Chase in a purchase monitored by the Fed and the Treasury. This frightened both Congressmen and some European leaders.

14 March: Federal Reserve officials find Bear is 'systemically' connected with the wider financial markets, meaning its failure could risk the collapse of the whole financial system. Federal Government rescue efforts begin.

2 April: Federal Reserve Chairman, Ben Bernanke, testifies before Congress, warning that recession in the United States is possible.

10 April: The Senate passes a bipartisan measure aimed at boosting the housing market.

30 April: The Federal Reserve cuts interest rates to the lowest point in nearly four years.

11 July: Indy Mac Bank fails.

12 July: Treasury Secretary, Henry Paulson, successfully seeks power to take over Fannie Mae and Freddie Mac, the two government-sponsored mortgage-lending entities.

30 July: President Bush signs a housing bill, allowing homeowners who cannot afford repayments to refinance access to more affordable government-backed loans.

7 September: The Bush Administration nationalizes Fannie Mae and Freddie Mac.

The members of the financial crisis inquiry commission believed that the risky practices of Fannie Mae to meet Wall Street's expectations for growth, to regain market share, and to ensure generous compensation for its employees, particularly from 2005 on, led to its fall

12 September: Lehman Brothers requests a bailout, but Paulson decides not to bail the firm out, citing moral hazard.

Lehman Brothers went bankrupt when it failed to find a buyer; the Fed and the Treasury proved unable to bail it out. Many economists questioned the government's refusal to bail out Lehman Brothers. Treasury Secretary Paulson claimed that it was impossible to bail the Lehman out due to its real capitalization as opposed to liquidity problems. (Qtd in Hsu 2013) The inconsistency of the Federal Government to rescue this firm added more uncertainty to the financial markets. Lehman declared bankruptcy with over $600 billion in debt. This was the largest bankruptcy ever recorded in the history of the United States. It reflected the cataclysmic proportions that the financial crisis reached.

After the Lehman Brothers bankruptcy, many banks hastened to accumulate liquidity. Subsequently, equity prices fell dramatically worldwide leading up to a worldwide confidence crisis in financial markets. Due to such great losses, the oldest American money market reduced its share value. In response, the Treasury announced that it would support all money market mutual funds.

14 September: Merrill Lynch sells itself to Bank of America and Lehman Brothers files for bankruptcy, after it fails to find a buyer in an increasingly nervous market.

16 September: The Federal Reserve changes course and spends $84 billion to bail out American International Group (AIG), the largest insurance firm in America.

18 September: Paulson proposes a $700 billion plan to buy toxic assets from America's biggest banks.

Hsu (2017) noted that the failed financial institutions were put under government conservatorship and received injections from the Fed and the Treasury under close monitoring. Other investment banks, like Morgan Stanley and Goldman Sachs, converted into traditional commercial banks. Some savings banks such as Washington Mutual and Wachovia Bank were acquired by individual investors. Troubles seemed to have no end.

25 September: Washington Mutual Bank fails.

29 September: Congress rejects Paulson's proposal.

3 October: Congress approves Paulson's revised plan.

28 October: The Federal Reserve cuts its lending rate to 1 per cent.

4 November: Barack Obama is elected President.

14 November: Leaders of 20 major economies gather in Washington, DC, to discuss coordinated emergency action to address the financial crisis.

16 December: The Federal Reserve cuts its interest rates again—to nearly zero.

20 January 2009: Barack Obama is sworn in as the forty-forth President of the United States.

26 January: The Senate confirms Timothy Geithner as Treasury Secretary, succeeding Paulson.

10 February: Geithner outlines a new, sweeping overhaul and expansion of the government's rescue effort.

17 February: Obama signs a $787 billion package to revive the economy.

18 February: Obama announces a $275 billion plan to help financially struggling families to refinance their mortgages.

19 February: Obama orders the nation's 19 largest banks to undergo a 'stress test' to help bolster confidence in the bailout plan.

23 March: Geithner lays out a detailed version of his 10 February rescue plan.

24 March: Obama and the Federal Reserve seek to expand the Federal Government's power to seize control of troubled financial institutions deemed too big to fail. (pp 45-47)

Economists wondered whether it was an economic crisis or a system crisis. Trust in capitalism is widespread in the United States. Communism is the empire of evil and social democrats are called liberals: few think of rebuilding capitalism or simply understand the term. There is nothing in the cultural background of the country that prepares it, in the face of an unforeseen or difficult situation, to question the "system". Or rather if, when things go wrong, really bad, it is that the country has deviated from its founding values; it is undoubtedly that the intervention of the government derailed the market economy.

Without making this detour, it is difficult to understand the political debate in the United States. Surprisingly enough, after twenty-five years of Reaganism and two Bush-Cheney mandates, in the midst of an unprecedented financial meltdown, those on the East Coast on the West Coast spoke of a crisis of the system, denounced a crisis caused by the interventionist state.

Starting from the widespread idea, even in the editorials of the big American newspapers, that for a quarter of a century America has been the country of deregulation, that interventionist policy could have had positive consequences on growth but that is one of the causes of the derailment of the markets. For example, on August 1, 2008, Steaven Pulitzer, a well-known columnist for the *Washington Post*, wrote: "The United States has trusted open, unregulated and low-tax markets in the last 25 years, and there is little doubt that this model has, over time, increased its performance and improved its efficiency. (Qtd in Mistral 75)

But what the Americans began to realize was that this model was less suitable to provide other highly valued ideals: safety, equity, economic security and sustainable development.

Mistral (2009) stated in his article "*Vers un Nouveau New Deal? Les cent premiers jours de Barack Obama"* that John Taylor systematized with talent that the origin of the evil would be an absurd policy of housing that sought to extend real estate ownership to disadvantaged groups, especially ethnic minorities, and the choice to conduct this policy not in the course of fiscal decisions but in manipulating the credit system, using the regulatory power to "force" financial institutions to lower their loan criteria and extend credit beyond that they could have.

Other commentators noted that the origin of the crisis can even be pointed out more precisely in the action of democratic governments. For example, the loosening of lending conditions, which has been one of the blinding manifestations of credit laxity for several years, would have its origins in a directive by the Ministry of Housing in 1994 encouraging the development of 'financing that uses creativity, and private and public sector resources to help homeowners who lack resources to make payments.'

The most talented writings contain very precise developments on the details of certain legislations, the perverse effects of the free "options" offered to borrowers to use their real estate investment as an income resource, the distortions introduced by a tax system that is too favorable to real estate investment, the bias provoked by banking regulations, and finally, disproportionately encouraging the supply of housing loans.

For example, Peter Wallison, American Enterprise Insitute, concludes: "A careful review of the US government's housing, tax and regulatory policies for years has directly linked these policies to the development of the bubble, obviously" (Qtd in Mistral)

The Financial Crisis Inquiry Report delivered by the National Commission on The Causes of the Financial and Economic Crisis in the United States delivered in 2011 revealed that the key cause of the crisis was the failures of corporate governance and risk

management at many important financial institutions. It also revealed that excessive borrowing, risky investments, lack of transparency, the government's ill preparation for the crisis, a systematic breakdown in accountability and ethics, the collapse of mort-gage lending standards and the mort-gage securitization spread the flame of contagion and crisis.

So, the crisis was not only a product of the Fed's policies but also of global imbalances. Hsu S. (2017) noted that the United States was running large current accounts deficits. It purchased consumer goods and other assets in dollars at a lower rate interest. China, its main trading partner, did not allow its currency to be devalued in front of the dollar. This created global imbalances. The latter prevented an increase in world rate interests. The loose monetary policy in the United States worsened the situation.

Verick & Islam (2010) concluded that the crisis was caused by an interrelation of four main factors which were: interest rates, global imbalances, perceptions of risks, and regulations of the financial system. They drew figure 14 (on the next page) to explain the four core factors behind the Great Recession. It would be unwise not to note that Verick & Islam (2010) excluded the interaction between these factors in their representation.

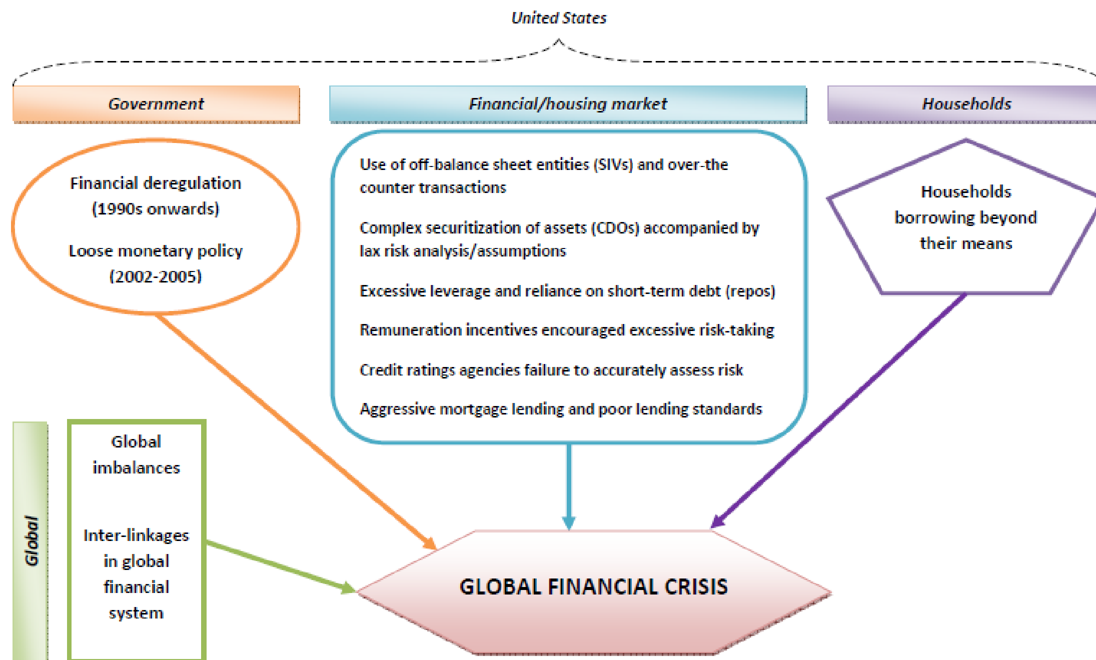

Figure4.2: Factors behind the Great Recession[77]

4.4.3 Extent of the Great Recession

During the boom period that preceded the Great Recession, consumption in the United increased significantly. This led up to a worsening in American deficits which rose from $398.3 billion (3.9% of GDP) in 2001 to $803.6 billion (6.0% of GDP) in 2006. (Verick & Islam 2010)

Macroeconomic data revealed that the decline in aggregate consumption during the Great Recession was the most severe and persistent ever recorded since WWII. All its subcomponents declined deeply. Although the drop was historic, the behaviors of consumption and its subcomponents before the recession were not different from past recessionary periods.

When compared to the 1973-75 recession, the 1980 recession, and the 1990-91 recession, the Great Recession witnessed rather a muted fall in consumption. However, its

[77] Verick & Islam 2010, 14

late fall implied that it had a much longer duration. Moreover, it remained below its pre-recessionary level for a longer period than the previous recessions.

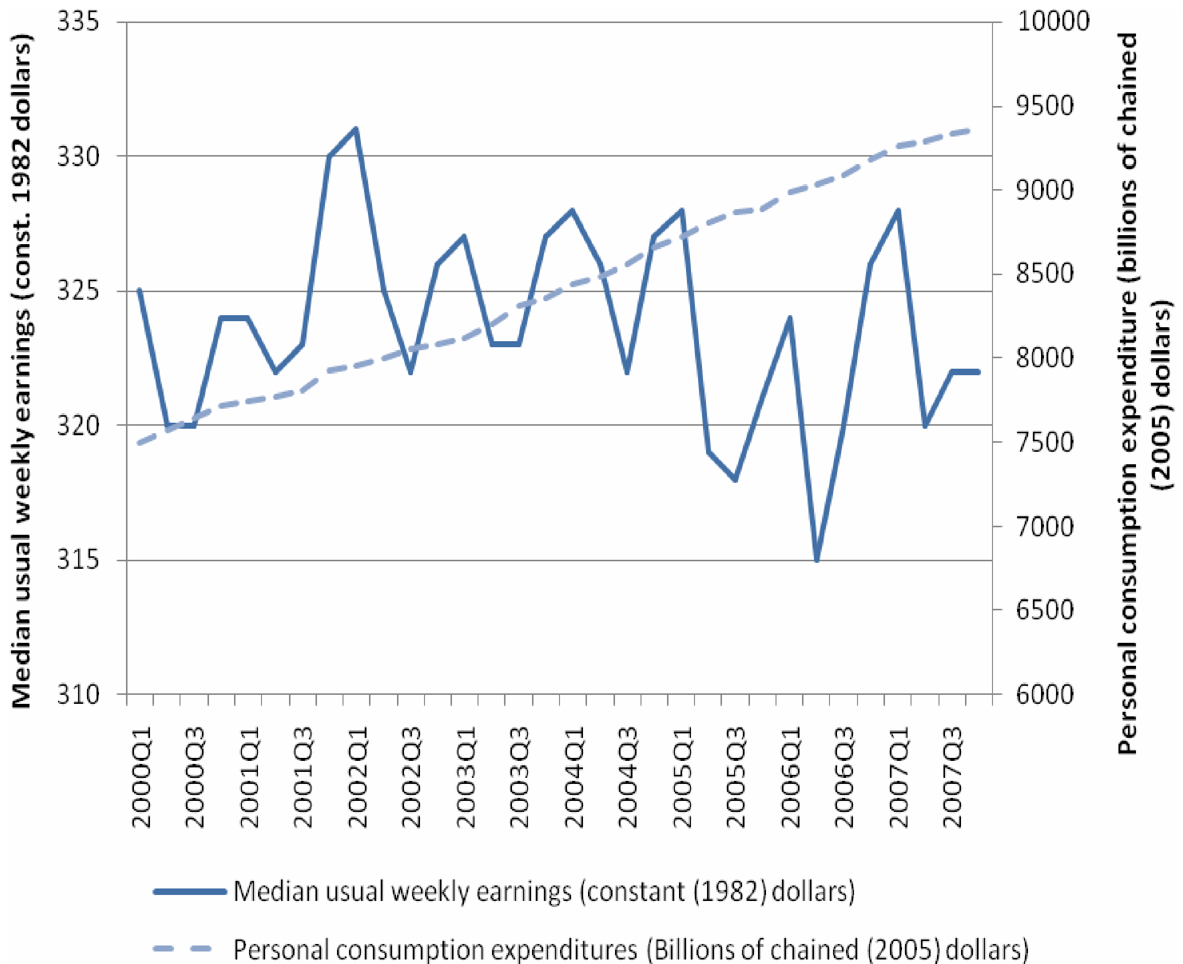

Figure 4.3: Growing Consumption in the US during the Boom Years despite Stagnant Real Wages, 2000-2007[78]

Petev et al. (2012) presented four explanations of the strong decline in consumption during the Great Recession. First, they pointed out the negative response of consumers to the burst of the housing bubble and the collapse of the stock market in 2008. Second, as consumers were uncertain about the state of economy, they reduced spending and accumulated precautionary savings. Third, changes in gasoline prices led to a decrease in the consumption of gasoline and all its complementary products and services. The last

[78] (Verick & Islam 2010 pp 11)

factor behind the decline in consumption was the decrease of purchasing through borrowing.

Overall, the global financial crisis is characterized by a decline in all consumption components. Consumption returned to its pre-recessionary level three years after the beginning of the Recession. (see figure on page 8) Such a weak recovery path is reflected most in the subcomponents of nondurables and especially in services. The growth it witnessed in the second half of 2009 was due to government intervention.

Petev et al. (2012) came to the conclusion that,

> The Great Recession, which was characterized by a large destruction of wealth, was not consumption-driven. The fall in consumption occurred after the financial crisis and the deflation of the housing bubble, not before. Of course, once the consumption decline was in full swing, it contributed to prolong the recession. There is the broader and perhaps deeper issue of whether the ultimate explanation for the financial crisis was an increase in the demand for credit induced by an increase in consumer demand not matched by a concurrent increase in permanent income. (pp 31)

Still, it is noteworthy to point out the fact that the sub-prime crisis resulted from a shift in credit supply rather than a shift in demand.

The Dodd- Frank Wall Street Reform and Consumer Protection Act of 2010 was passed. The Act created the Consumer Financial Protection Bureau, and the Financial Stability Oversight Council to regulate consumer protection, and recommend the Fed to impose regulations on non-bank financial institutions. The creation of such council reflected Obama's Administration will to avoid future crises that might be caused by financial failures.

In addition to consumption, unemployment reflects the diversity and the complexity of the crisis.

During the Great Recession, no economic sector remained unscathed. The labor market, in particular, was hard hit. Job losses, unemployment rate, and unemployment duration recorded high levels. The fall in the financial market impacted employment immediately. Data revealed that the unemployment rate was slightly lower than the post-depression records.

Just like the previous recessions, during the 2007-09 recession, good-producing industries experienced the largest declines in employment. Construction was the hardest hit. It experienced deep employment losses. In the course of the Recession, in residential construction, employment fell 2.2 million. Non residential construction like commercial and industrial projects also recorded great job losses.

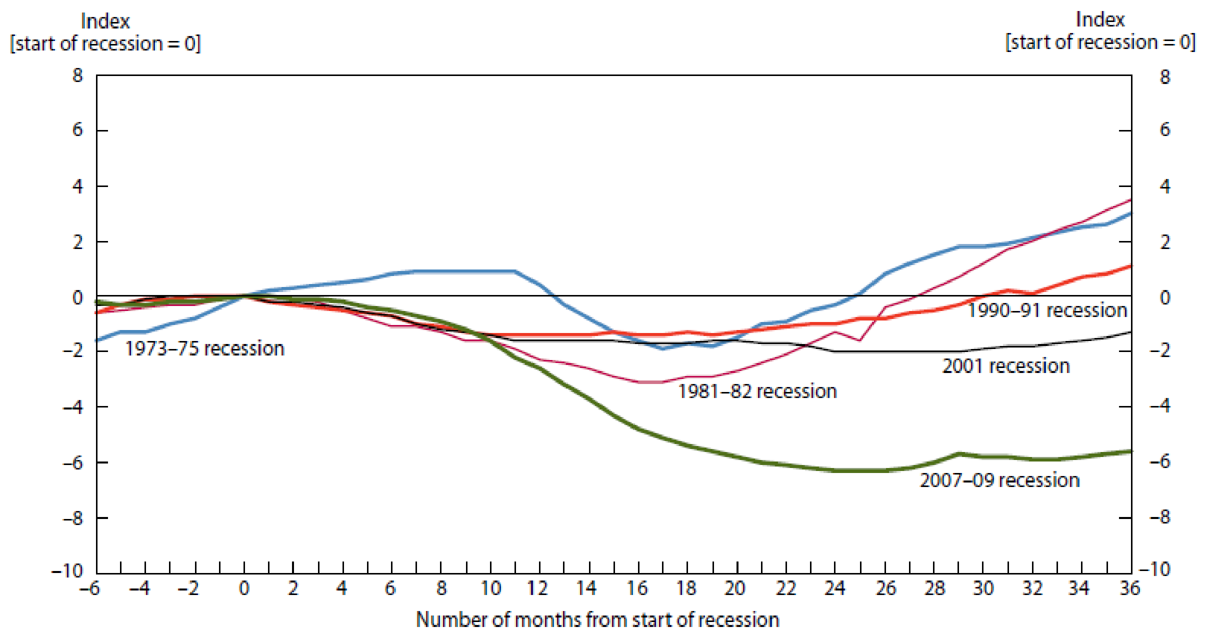

Figure 4.4: Nonfarm Employment in selected recessions[79]

Manufacturing, too, had been losing jobs significantly. Manufacturing employment did fall by 14.6% from December 2007 to June 2009. However, some areas of manufacturing like machinery and aerospace products were adding jobs during the first

[79] (Goodman & Mance 2011, 10)

nine months of the Recession. Yet, the deeper the economic downturn, the less these two industries could withstand.

Private industries like education and health services were not different. These industries, which had recorded high growth even during recession, could not be immune to the latest recession. They had fallen by 4.6 million; this was their lowest point in the history of private-sector industries.

State tax revenues collected from income, sales, and taxes began to fall. Thereafter, states started cutting employment. Local governments, too, reduced employment to cover budget shortfalls. Not only employment had been reduced but also workers' hours had been cut.

Upon the whole, the labor market deteriorated far more than during any recession since the 1930s. The Bureau of Labor Statistics delivered the following data

- Total job loss of 8.5 million, more than 6% of all jobs (previous post -Depression record was 5.2% in 1948-49)
- Loss of 11.4 million full-time jobs, nearly 9.5% of the total (previous record was 4% in 1981-82)
- Decline of 4.5 million service-sector jobs, 4.8% of the total (previous record was 2.5% in 1957-58)
- Aggregate hours worked down 9.7% (previous record was 7% in 1973-75)
- Largest increase in the unemployment rate, 5.7 percentage points (previous record was 4.4 percentage points in 1973-75) (Seyfried 2012)

Although economists agreed upon the severity of the downturn, they expressed surprise regarding these levels. They seemed unable to explain the rise in unemployment rate. Seyfried (2012) explored the relationship between employment and economic growth to explain why unemployment remained high even after the economy recovered. He

assumed that job growth is associated with growth in economy. When economy is growing, companies seek to increase production. For so doing, they hire more workers. However, high risk premium can have a negative effect on job creation.

Economic growth and risk premium do not explain the poor behavior of the labor market. Other factors such as changes in economic growth and the persistence in employment growth contributed to the great job loss recorded during and after the Great Recession. The labor market proved unable to recover from a loss of more than 8 million jobs when the Recession ended. Hsu (2017) noted that: “the extreme fallout from the US portion of the crisis had mainly dissipated by the end of 2009, but the real effects of the crisis continued to be strongly felt. Jobs continued to lag and many citizens in the US remained disgruntled, fueling union protests.” (p 127)

Seyfried (2012) believed that all the aforementioned factors contributed simultaneously to the growth of unemployment during and after the Great Recession. He stated,

> Though credit is affected somewhat during many recessions, the freezing of credit markets during the financial crisis of 2007-2009 appeared to have a powerful effect on the job market…The dramatic rise in the risk premium during late 208 and early 2009 helps explain the huge loss of jobs during the depths of the recession….The rapid increase in the risk premium between the third and fourth quarter of 2008 was responsible for at least a third of the job losses during the fourth quarter of 2008. Though economic growth is an important predictor of employment growth, the risk premium, whether as a measure of credit availability or as a market-based measure of fear on the part of corporations, is critical in understanding the behavior of the labor market during the Great Recession. (pp 6)

4.5 The Great Recession Compared to Previous Recessions:

The history of the United States shows that the country passed through economic crises recurrently. When compared to the previous economic downturns, the recent crisis proved to be the longest and the deepest.

4.5.1 The Great Recession Vs. the Great Depression

Economists and commentators agreed upon the relevance of comparing the Great Recession to the Great Depression. Berger K. (2014) noted that the 2008 crisis is the only crisis comparable to the Great Depression of the 1930s in terms of its impact on employment, production, markets and public finances in developed countries. He wrote : « la crise de 2008 est la seule crise qui soit comparable a la Grande Dépression des années 1930 par son impact sur l'emploi, la production, les marchés et les finances publiques des pays développés » (p 78).

Economists failed to grant the adjective "great" to all episodes of financial disturbances but to the recent crisis. There are many differences between these two "great" downturns. The Great Recession was by no means the worst since the Great Depression, it was rather more reprehensible. During the Great Recession, The global economy contracted for the first time since WWII.

The rate of contraction was much worse than the one recorded during the Great Depression. The rate of production declined in the 2007-09 recession faster than during the 1930s crisis. The recent crisis witnessed a decline in global stock market wealth of 17%, while the decline during the Great Depression was estimated at a mere 3%.

Other studies revealed that although unemployment reached very high rates during 2008 and 2009, it was not as high as in late 1930s. Actually, during the Great Depression, unemployment reached 25%. Comparative evidence also reveals that despite the shared nature of events, economy during the Great Recession, did not witness as many bank runs

as in the Great Depression. Similarly, consumption in the 2007 crisis remained somehow stable, but in the 1930s it declined by 25%. The Dow Jones Industrial lost 90 % of its peak value in 1929, but only 50% in 2008. (See table below)

	Cumulative Change in Output	**Rise in Unemployment Rate**	**Cumulative Change in Prices**
1929-1933	-26.7%	3.2% to 25.2%	-25.5%
2007-Q2: 2009	-4.1%	5.0% to 9.5%	2.5%

Table 4.3: Comparing the Great Depression (First Contraction) to the Great Recession[80]

Just like the crisis of 1929, the recent crisis originated in the excesses that characterized the decades of financial liberation that preceded them: drifts of finance and explosion of income inequality fueled growth driven by debt and the proliferation of financial innovations that led in both cases the world economy to the edge of the abyss.

Berger noted: « Le parallèle peut tout autant être tracé entre les racines de la crise financière : comme la crise de 1929, la crise actuelle a son origine dans les dérives qui ont marqué les décennies de libéralisation financière qui les ont précédées : dérives de la finance et explosion des inégalités de revenus ont alimenté une croissance dopée par l'endettement et la prolifération des innovations financières qui a conduit dans les deux cas l'économie mondiale au bord du gouffre. » (p 79)

[80] (Labonte 2010 8)

Hsu (2017) noted that the beginning of the Great Recession, in terms of the declines recorded, was worse than that of the Great Depression. Only countercyclical monetary and fiscal policies could avoid another *great depression*. She concluded: "Without countercyclical policy approaches, the crisis would have a much worse impact around the world." (p 127)

To recover, economy in the Great Depression needed nearly four years; it recovered only after one year and a half after the recent recession. While the Great Depression was brought to an end thanks to the New Deal, the United States could overcome the Great Recession thanks to the stimulus package imitated by President Barack Hussein Obama (2009-2017).

American voters luckily had the opportunity to vote for new administrations in both episodes. While the Roosevelt Administration introduced important measures incorporated within the New Deal, the Obama Administration introduced the stimulus package.

4.5.2 The Great Recession and the Post-World War II Era Recessions

Comparing historical episodes proved satisfactory to gauge how the recent recession differed from the other recessions recorded during the Post-World War II period in terms of length and depth.

Recessions are not uncommon. In the period between 1945 and 1981, recessions were recorded every 73 months. However, from 1981 to 2001, there were only two recessions; they were less frequent. The 2007-09 recession is the longest as compared to the recessions of 1973 and 1981 which lasted for 16 months; it lasted for 18 months.

In terms of depth, the second phase of the recent recession was deeper. The decline recorded in GDP during the Great Recession was the deepest of the post war period. While the declines recorded in GDP during the recessions of 1973 and 1981 were of 3% and 2.9% respectively, the NBER registered a fall in GDP of 4% during the recession of 2007.

Economists noted that the longest and the deepest recessions of the post war period took place in a context of high inflation. While the Federal Reserve hesitated during the recession of the twentieth century to reduce interest rates, it brought interest rates down to zero with great inclination. Although some economists predicted that once the country would return to full employment because of the Fed's actions, others attributed the low inflation rate and the short deflation to the Federal Reserve.

The recent recessions share some other similarities with other post war recessions. Just like the recessions of 1973 and 1981, the 2007-09 recession was also featured by large spikes in oil prices. Moreover, the recession of 1991 marked the beginning of new a trend: the 'jobless recovery'. The recent recession recovered, yet employment did not.

Economists registered but one unique characteristic of the Great Recession. The latter disrupted the financial markets severely. While the financial markets continued to function during the previous recessions, the financial downturn was too severe during the Great Recession. It started in August 2007 and worsened dramatically in September 2008, leading up to a decline in business investment. Still, the Obama Administration reacted and intervened hastily to stimulate economy. Actually the aggressive and unconventional response to the crisis is a sharp feature that differentiates the Great Recession from all the economic downturns that the country underwent.

It is clear that the lesson about the monetary policy drawn from the Great Depression and the other severe downturns had been successfully learnt. The Fed aggressively avoided deflation through cutting its rates. As far as the fiscal policy is concerned, economists cannot really decide whether or not lessons have been learnt by the Obama Administration.

4.6 The Obama Administration's Response to the Great Recession

On the eve of the presidential election, the picture of the economy was 'darker than dark'. The 2008 Comparative Campaign Analysis Project made a nation-wide survey about the way Americans assessed the economy before the election. About 94% of the surveyed voters found that the economy was performing worsely. (See table below) It is clear that voters were strongly impressed by the dire economic conditions.

	Socio-retro	**Ego-retro**	**Socio-prospect**	**Ego-prospect**
Better	1	10	29	29
Same	5	36	16	36
Worse	94	54	55	35

Table 4.4: Economic Perceptions in the 2008 Presidential Election[81]

4.6.1 Obama's Election

The selection of Barack Hussein Obama as a candidate was very carefully undertaken. As a stepping stone to the presidential elections of 2008, the former Democratic candidate John Kerry chose Barack Obama as the keynote speaker at the Democratic National Convention.

4.6.1.1 Successful Pre-Election Efforts

Obama's associates followed the Clinton election campaign pattern. They began their work in the summer of 2008. Some observers reported that the associates started writing briefing memos before the candidate announced his planning effort. Obama, so

[81] Lewis-Beck & Nadeau 2009 pp 479

early, turned discreetly to Washington to seek advice from the survivors of the Clinton years.

John Podesta, the former chief of staff during the Clinton election campaign, proved to be one of the effective associates that Obama relied on. Podesta and his team were undertaking a very remarkable effort, and they had developed a harmonious and tolerant reputation before and after the Election Day. They even worked for the vetting process with an unprecedented aid of the Federal Bureau of Investigation (FBI) which checked on potential nominees for senior positions. According to Rucker (2008),

> Obama is conducting the vetting process much the way he managed his campaign: methodically, thoroughly and on a prodigious scale. He did not wait until he won the election to vet his favored picks. Soon after he clinched the Democratic nomination, lawyers quietly prepared dossiers of about 150 contenders for senior positions - often without the candidates themselves knowing - said a senior Obama transition adviser who spoke on the condition of anonymity. (Qtd in Bruke 577)

Additionally, Podesta and his team looked at the successes and mistakes of their predecessors. They even planned preliminarily for the Obama's first 100 days. Podesta prepared a 26-page report about the daily activities of the Obama presidency. The team also reviewed executive orders, rules, and regulations enacted and signed during Bush presidency. Baker (2008) stated: "The Obama team has identified executive orders he can sign in the first hours and days of his presidency to demonstrate action, even as the more ambitious promises take more time. Among other things, he can reverse a variety of Bush

policies, like restrictions on abortion counseling and stem-cell research" (Qtd in Bruke 578)

Observers noted that none of the past pre-election efforts had such a director who could easily and directly undertake such planning policy. The Obama presidential agenda included a pressing call for an economic recovery program. The debates between Obama's advisers about the agenda started months before the election. Advisers worked hard in virtual solitude to decide upon the important policy changes that Obama could implement once in office. Lawyers, too, compiled hundreds of regulations and executive orders which the president might need to rescind. This would help the president regulate some vexing issues without waiting for the Congress.

The team was rather unique in undertaking another effort. They sent a series of letters to federal employees in different agencies. They intended to outline the differences between Obama and the Bush Administration with regard to bureaucracy, and other issues related to workers and their safety.

4.6.1.2 Extensive Use of Technology to Win Elections

In addition to his team's efforts, Ford et al. (2009) attributed the victory of Obama to his skilled and effective use of technology. His campaign team was the first to make use of the second generation of Web technology such as blogging, micro blogging, video broadcasting sites, online document storage, public file sharing, and social networking sites. The team spread news, images, and videos to millions of users and viewers to achieve full communication and voter mobilization.

Obama benefited from the use of such technological innovations in several ways. First, journalists who covered the 2008 presidential elections noticed that Obama's extensive use of technology helped him position himself as the 'technology president' unlike his rival John McCain. The latter confessed that he was a 'computer illiterate'. Second, Obama's strategists relied on database management to 'identify, monitor, and communicate with voters.' They uploaded nearly 2.000 videos on YouTube as they knew that many American voters watched political advertisements on the site.

Furthermore, the campaign's team could reach young voters through *Facebook*. Surveys conducted by political scientists revealed that in the course of the campaign, Obama had more than 800,000 *Facebook* friends, as compared to 120,000 for John McCain (Ford et al. 2009) Scott Goodstein, who organized the mobile communication aspect of the campaign, deemed it highly important to use mobile phones to mobilize voters as he knew that about 84% of the American population used mobiles. Obama did not only use text messages to remind voters of their right to vote but also offered ringtone collage of his speeches.

Once in office, the President used technology to move from campaigning to governing. He nominated Aneesh Chorpa as the new chief technology officer to restructure the White House website. They created the Web site (http: //www.change.gov) to provide a list of available jobs in the new administration. They made it easy to find, sort, download, and manipulate information.

Burke (2009), in writing about Obama's pre-election efforts, came to the conclusion that,

> While not perfect, the Obama transition to office did reasonably well in laying the groundwork for his presidency. The pre-election effort is especially notable. It not only put in place the necessary steps for organizing the post-election transition effectively, but also it undertook a robust effort to plan for his presidency. Both before and after Election Day, discipline prevailed; the infighting and media leaks that had plagued earlier transitions were absent. The post-election transition moved quickly in appointing and organizing the White House…By April, the administration appeared to have made up for lost time. (p 601)

In addition to these historic achievements, Obama opened the doors to other minority candidates to use Web technologies in their electoral campaigns. Data revealed that Americans of color were more likely to use internet than White Americans. Many electors subscribed and signed to receive update online political news. However, both Whites and African Americans created their online political contents. Even Republican members caught up. They started twittering and using other Web sites to mobilize voters.

Joe Trippi, a campaign manager, argued that: "the Obama victory ensures that future elections will be won not because the candidate was anointed by a power party, but because he or she was best at using a Web and new media strategy to rally the masses"(Qtd in Ford et al.) Ford (2009) concluded that: "And now, due to the retrospective technological changes, that outsider [Obama] is inside the White House." (p 473)

4.6.1.3 Obama's traits

Renshen (2011) stated that the health care legislation was designed to redress unfairness. Among Obama's important personal, psychological, and political traits was

fairness. His values and ideals, which mirrored his mother's, were embodied in his *fairness and moral leadership* to overcome social injustice. A sense of social and economic justice was encapsulated in the health care legislation. The commentator David Leonhardt noted,

> The bill that President Obama signed on Tuesday is the federal government's biggest attack on economic inequality since inequality began rising more than three decades ago . . . This fact helps explain why Mr. Obama was willing to spend so much political capital on the issue, even though it did not appear to be his top priority as a presidential candidate. Beyond the health reform's effect on the medical system, it is the centerpiece of his deliberate effort to end what historians have called the age of Reagan. (Qtd in Renshen 2011)

Obama wrote that among the ideals and the values that his mother stressed was fairness. In Indonesia, she spent her time working for change and fairness. Her son emulated her strategy to become a community organizer. He was also influenced by his father who aimed for a political position where he could preach for fairness. Although Obama held conflicted feelings about his parents, he could by no means ignore the role his mother, in particular, played in his life. He wrote: "I think sometimes that had I known she would not survive her illness, I would have written a different book - less a meditation on the absent parent, more a celebration of the one who was the single constant in my life ... I know that that she was the kindest, most generous spirit I have ever known, and what is best in me I owe to her" (Qtd in Renshen 2011)

So, fairness and justice were central ideals that anchored his ambition to fight for "economic fairness". It seems clear that Obama intended to become "a moral leader" just like the heroes he admired most. To reach such an end, Obama believed that more and

more individuals had to join the moral fight. He believed in the collective salvation which is a cornerstone in the politics of transformation.

Renshon (2011) stated that Obama's great love for his country aspired him to redeem and transform it. His great goal was to transform the country to reach its national redemption through fairness. On his hundredth day in office at a meeting, he addressed the American people by saying: "So today on my 100th day in office, I've come to report to you, the American people, that we have begun to pick ourselves up and dust ourselves off, and we have begun the work of remaking America. We're working to remake America."(Qtd in Renshon 2011)He was enamored with change. Obama stated that he wanted to scramble and mingle the frameworks endeavored by his heroes like Abraham Lincoln, F. D. Roosevelt, and Martin Luther King.

His first two years in office and his fierce fight against the dire economic conditions proved that he succeeded to redeem his country. He established himself to be a "great president". He did not only change some particular issues; instead he sought to transform the culture. Renshen 2011 believed that it was: "clear that Obama's view of transformation involves the remaking of America's basic culture in the service of his view of presidential greatness." (p1040)

Obama's childhood, which provided him with the opportunity to see extreme disparities of wealth and poverty, helped him be aware of 'fundamental unfairness'. It is on this basis that the President wanted to help this country 'to live up to its ideals as a place of opportunity and fairness'; this was one of his presidential quests.

During the first two years of his presidency, the President demonstrated his willingness to pursue fairness through his ambitions to truly redeem the country from its malaise. Renshen (2011) concluded that,

> Obama emerges as a confirming case for the importance of ambition, conviction, and relatedness in assessing the impact of a president's core psychology on his leadership choices and political consequences. However, it is here that Obama differs with his immediate predecessors. Neither Bill Clinton nor George W. Bush aspired to be transformative leaders. Neither aspired to become the moral center of the American policy universe, and certainly neither began their quest for presidency with the assumption that they were running for office to redeem the country and their family legacies. These latter aspects of Obama presidency are unique. (p 1054)

In addition, Obama's pragmatism helped him undertake important strategies to solve the nation's problems. Of his pragmatism, Obama said;

> Well, I think what it means is that I don't approach problems by asking myself, is this a conservative - is there a conservative approach to this or a liberal approach to this, is there a Democratic or Republican approach to this. I come at it and say, what's the way to solve the problem, what's the way to achieve an outcome where the American people have jobs or their health care quality has improved or our schools are producing well-educated workforce of the 21st century. And I am willing to tinker and borrow and steal ideas from just about anybody if I think they might work. (Qtd in Rensshen)

However, he remains a mystery to many people even to his supporters and some political analysts who covered his presidential campaign. They think his personality is elusive and contradictory. While some people judged the President negatively because of his race, Winter (2011) deemed highly important and effective to undertake a systematic

analysis of his personality. Winter employed a fourfold conception of personality. He focused on Obama's behavior, his principles and values, and long-term goals.

With regard to his social class, Obama could be placed along the borders of lower-middle-class and working class. However, the educational institutions he attended helped him co-opt into the ruling class. As a Black man, Obama succeeded to found a family at a time when such 'traditional' institutions were in a flux. His family provided him with an ultimate source that would shape the rest of his personality.

Obama is mostly referred to by biographers and journalists as 'Mr. Calm'; the nickname 'No Drama Obama' attributed to him during the presidential campaign refers to his legendary calmness and emotional stability. Actually, his emotional stability is an important factor to achieve his calmness. His social context also played an important role in shaping his calmness. Domains of the White world like universities, high schools, and politics helped the Black man to control his anger. This was to avoid giving a negative image about Black Americans.

Other social contexts are relevant to Obama's calmness. Hawaii, where he spent his childhood and adolescence, provided an atmosphere of great tolerance and calmness. Describing it, Obama said: "Hawaii brings together people from all walks of life…….The truth is that there is more cooperation and people getting together despite different religions or different ethnicities than just about any place else in the country. And that spirit, that aloha spirit is something I carry with me." (Qtd in Winter 2011)

In addition to Hawaii, Obama attributed his calmness to Indonesia where he spent four years. Indonesia, where he learnt to be patient, calm, and a good listener, fostered another aspect of calmness. People around him also contributed to his calmness.

His mother afforded ‘a sense of unconditional love’ which sustained him entirely. In addition, his grandparents, with whom Obama spent eight years, had a great role in raising his calmness and confidence.

Beside his calmness, Obama displays great openness to the views of others. This can explain why his team was a ‘team of rivals’. Winter (2011) noted

> Obama displayed this style [openness] well before running for president, as a law student, and later as a law school faculty member. This evidence points clearly to his being high in *openness to experience*. He is careful and plans ahead. This combination of careful planning and rigorous debate suggests a high level of *conscientiousness*, which is also consistent with the emphasis on Obama’s strong organizational skills. (p1064)

As for the cognitive aspects of his personality, analysts measured Obama’s cognitive aspects of his personality through his speeches, interviews, and writings. According to Walker (2011) Obama is pessimistic. Such a pattern might lead to passive withdrawal. However, Obama, the “conciliator”, emphasized the cooperation based on appeals and rewards, rather than on threats.

This emphasized Winter’s view on Obama’s pragmatism. Winter noted that

> As president, Obama has indeed been pragmatic and inclusive, compromising when necessary while continuing to articulate a vision of “working hard and working together” instead of “drawing lines in the sand”. In fact, during the second year of his presidency, many of Obama’s most loyal supporters became upset at his willingness to compromise and adjust his policies in the course of legislative debate, because they felt that the Republican opposition was exploiting Obama’s “inclusive” operational code merely in order to block his programs. (pp 1066)

Such characteristics could mitigate the inevitable frustrations of politics. They do all seem to come together in his decisions.

4.6.2 Obama's Platform of Hope and Change

As the political electorate needed change, Obama set forth essential elements of a new course. He promised to increase taxes on the wealthy Americans, to end the war in Iraq, to achieve energy self- efficiency, to introduce a 'green' economy, to focus on the educational system, to enhance the transportation system, and to make the country a world leader in science and technology.

4.6.2.1 Inaugural Message

Via a language of poets instead of a language of economists and politicians, Obama expressed his ends in his Inaugural message. He said,

> We will build the roads and bridges, the electric grids and digital lines that feed our commerce and bind us together. We will restore science to its rightful place, and wield technology's wonders to raise health care's quality and lower its cost. We will harness the sun and the winds and the soil to fuel our cars and run our factories. And we will transform our schools, and colleges and universities to meet the demands of a new age. All this we can do. (Obama 2009)

The 2008 presidential election provides an example of the impact of the state of the national economy on politics. Over the course of the electoral campaign, economy was going into a freefall. Barack Obama was to convince the electorate worried about the perilous economic conditions. His campaign slogans such as 'Yes We Can!' and 'Change You Can Believe in!' proved highly effective to convince voters that Obama was the

effective president to settle down not only the economic issues but also other vexing problems that the nation was confronting. The prospective vision of his administration to stop the economic downslide and restore credibility to the United States benefited Obama.

His victory resulted from the electors' disapproval of the bad economic conditions. Most voters did not vote for Obama, they voted rather against the Bush Administration seeking change. Lewis-Beck & Nadeau (2009) stated that a voter "may vote with party X regardless of whether it is incumbent, if that party is closer to his or her position on an economic policy."(p 479) They concluded by stating that

> Gloom over the American economy found no precedent in contemporary times. This gloomy view translated itself sharply into a vote against McCain, for many felt the incumbent Republican administration was responsible. Even among those who did not consciously pin the material misery directly on President Bush, many must have undoubtedly responded to the "nature of the times," which was scary.

However, some observers pointed out the fact that Obama maintained Bill Clinton's economic advisors group, which tried to take over the world trade in the 1990s. He made few appointments to the Council of Economic Advisers by nominating Jason Furman and Austan Goolsbee. Even Rahm Emanuel that he appointed to serve as White House chief of staff created controversies. The American media opposed the nomination because Emanuel, as Congressman in 2002, voted for the Iraq war and backed occupation of the West Bank and Gaza and its attack on Lebanon. Though he stated that he symbolized change, Obama's cabinet was not very different from its predecessors Gandásegui Jr. (2011) stated,

> Obama said that he symbolized change, but it seems that there was little content to his discourse. The outcome of Obama's first two years is reflected

> in the November 2010 results. The people of the United States did not back his militaristic policy or his economic policy, which turned its back on "Main Street," they were not convinced by the degree of ethnic diversity he introduced to the White House. His party lost its majority in the House of Representatives almost lost the Senate; it also did badly in terms of governors and mayors. (p 110)

Still, other commentators noted that the White House Chief of staff had strong political credentials as the fourth-ranking Democrat in the House of Representatives. Burke (2009) added that Emanuel had a reputation of a fierce partisan, and he might serve as an effective manager and policy advisor. He along with other staff members like Axelrod, Jarrett, and Rouse would have major impact on Obama presidency.

4.6.2.2 Economic Issues that Helped Obama Win Elections

Nevertheless, the Cooperative Campaign Analysis Project (CCAP) revealed that Obama was positively viewed by the growing number of voters who considered economy as their most important issue. From December 2007 to October 2008, his favorability rating increased from 46% to 60%. However, Obama's favorability was lower in the minds of individual voters to whom economy had not weighed so heavily. (See figure17) Nevertheless, by the end of the campaign, Obama proved himself to 'own' economy which defined his political agenda.

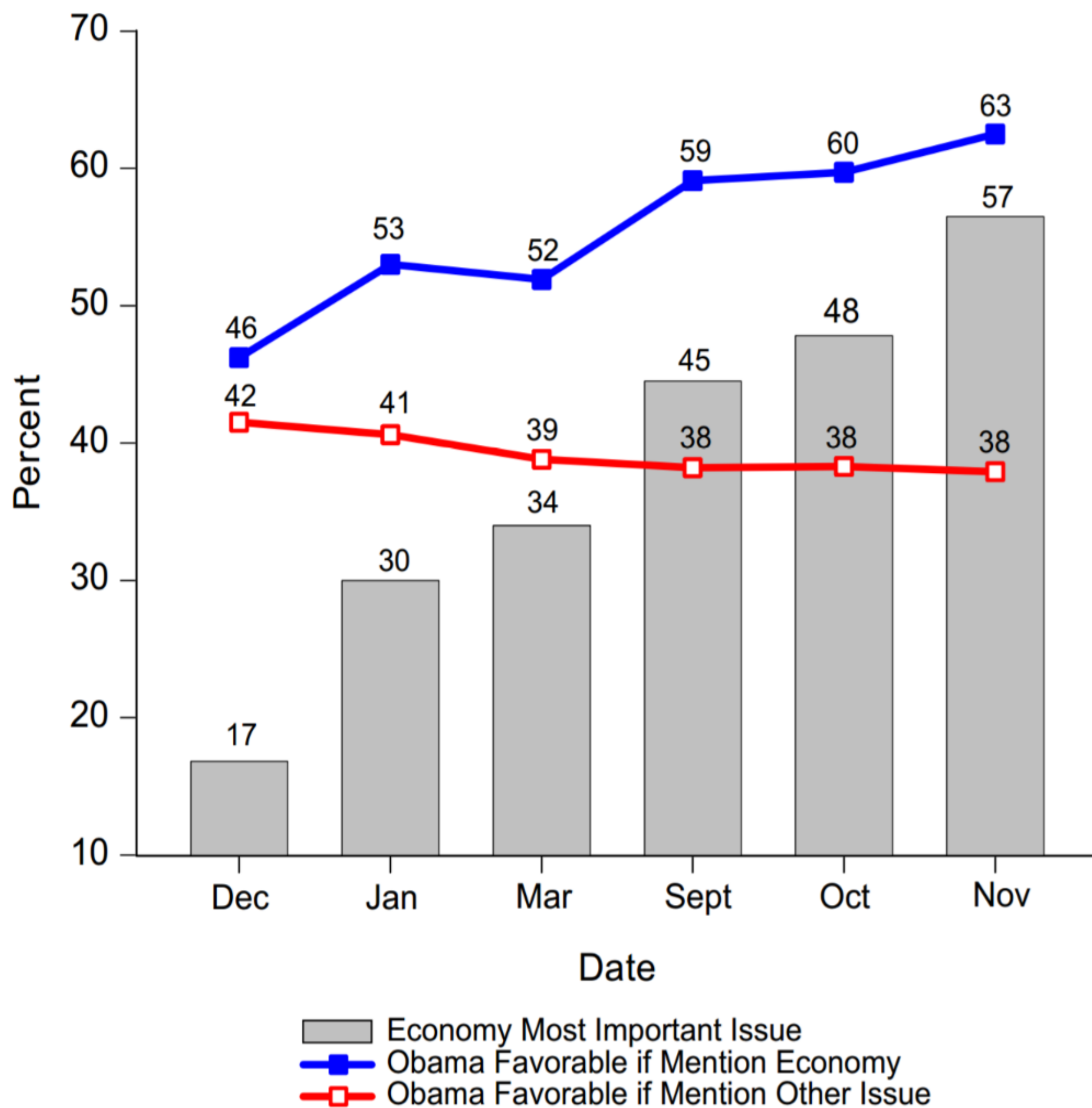

Figure 4.5: Obama's Favorability Ratings, December 2007–November 2008.[82]

Obama believed that the social willingness to change would lead him to victory. The war and the economic recession contributed significantly to this victory. Lewis-Beck & Nadeau (2009) deduced that: "Overall, as the voter's assessment of national economic conditions migrated from "ok" to "much worse', the probability of an Obama vote rose as much as 43%, given a conscious attribution of economic responsibility to the Republican incumbent." (p 482)

[82] Scotto et al .548

Obama's success was also facilitated by his rival John McCain who proclaimed that he knew little about economics. He stated: "The issue of economics is not something I've understood as well as I should…...I've got Greenspan's book." (Qtd in Scotto et al.545) Obama highlighted sharp contrasts between himself and the Republican candidate McCain and President Bush. He portrayed himself as having the required traits to be a successful president able to rule the country in a time of national crisis, as he knew that voters were highly influenced by leader images while trying to make sensible decisions in a political world of high stakes and considerable uncertainty. This led to a sharp rise in the polls in his favor.

4.6.2.3 Obama and Racial Issues

> Obama's racial background is actually complex; as a child of a White woman and a Black father, he is technically of a mixed race; moreover, his father was an African from Kenya, imbued with the legacy of British colonialism rather than American slavery and discrimination. In the American context, however, these complexities are overlooked, and people with any African ancestry are usually coded and treated as "African American" or "Black". (Qtd in Winter 2011)

Obama, a member of an American social construct named 'a minority', expressed a strong appeal to minority groups which contributed to his political party's electoral coalition. Groups like African Americans, Hispanics, blue-collar workers, women and young people all demonstrated their enthusiasm for him at the polls. His election promoted a significant cultural change and a lasting impact not only on the African American population but also on Africans in Kenya.

Bemmel (2013) noted that millions of Kenyans expressed their happiness when Obama was elected president of the United States 2008. After his inauguration, parties were held in Kenyan cities like Kogelo and Kisumu where Obama's father was raised. 'Brain beats color' Africans there shouted. Obama, who was considered as 'being made in Kenya' gave them hope for a better life. Bemmel (2013) reported that one of Kenyan boys told him that he, too, would become a president of America and of the world one day just like [Obama] his brother. In addition, many Kenyan citizens were heard sharing their dreams about 'change'.

The "Obama village" witnessed significant changes and developments. For the first time, Kogelo was connected to electricity. The government of the '51st state of America' also supplied the village with water, established a police station to improve security, and made around his grandmother's house a big steel fence.

Kenyans believed that OBAMA was but a shortened form of "Originally Born African Managing America". Obama himself expressed his sense of belonging to Kenya by saying,

> There's your ordinary house in Nairobi. And then there's your house in the country, where your people come from; your ancestral home. Even the biggest minister or businessman thinks this way. He may have a mansion in Nairobi and build only a small hut on his land in the country. But if you ask him where he is from, he will tell you that that hut is his home. (Qtd in Bemmel 2013, 79)

Kenyans who lost faith in their political institutions saw Obama as an example of democratic reforms in their country. He was seen as a source of inspiration for citizens and politicians alike. Kenyans believed that they could be superpower like America. They sent a message of hope to their leaders. They shouted: "Stop corruption and build Africa. Arise,

Africa. Say Yes We Can. We can stop tribalism. We can fight terrorism. We can fight this poverty, diseases, and illiteracy. Africa, unite. Africa, we can avoid bad leadership and get Obama in Kenya." (Qtd in Bemmel 2013, 81) Obama taught them that democracy could surpass race, religion, and even political interests.

This young charismatic African American politician would be making decisions on the behalf of the world hyper power, changing the life of African Americans which had been featured by slavery, repression, and injustice. The election of the first African American president in the history of the United States embodied the dream of Martin Luther King Jr., and millions of his fellow citizens.

So, the election of Obama changed Africans' self-esteem inside and outside the United States. He provided them with "possibilities for personal identification, causing feelings of pride and stimulating reflection on cultural identity and social condition." (Bemmel 2013)[83]

In his Inaugural message, Obama admitted the presence of many diverse groups in the United States. He said,

> For we know that our patchwork heritage is strength, not a weakness. We are a nation of Christians and Muslims, Jews and Hindus, and nonbelievers. We are shaped by every language and culture, drawn from every end of this Earth. And because we have tasted the bitter swill of civil war and segregation and emerged from that dark chapter stronger and more united, we cannot help but believe that the old hatreds shall someday pass; that the lines of tribe shall soon dissolve; that as the world grows smaller, our common humanity shall reveal itself; and that America must play its role in ushering in a new era of peace. To the Muslim world, we seek a new way

[83] Nevertheless, such excitement and enthusiasm about Obama's second election were not as immense as about his first election.

> forward, based on mutual interest and mutual respect. To those leaders around the globe who seek to sow conflict or blame their society's ills on the West, know that your people will judge you on what you can build, not what you destroy. (Obama 2009)

To these groups he promised change, equality, freedom, and a chance to pursue happiness, expressing a shift from traditional views of the American society to a more diverse one. He stated,

> We remain a young nation, but in the words of Scripture, the time has come to set aside childish things. The time has come to reaffirm our enduring spirit; to choose our better history; to carry forward that precious gift that the noble idea, passed from generation to generation: the God-given promise that all are equal, all are free, and all deserve a chance to pursue their full measure of happiness. (Obama 2009)

It is worth mentioning that although Obama promised change for all Americans, he relied more on African Americans' consciousness to mobilize Black voters. He endeavored to increase Black registration, voting, and mobilization. African Americans' registration was the highest since 1984. This strategy proved effective to galvanize his campaign and afford him important victories in Southern states with high African American populations. In addition, data revealed that African Americans' contribution to the campaign through time or money reached unprecedented levels. This support remained constant and consistent during his first eight months in office.

During this period, the president could neither cure the stagnant economy nor decrease the high rate of unemployment, yet he was overwhelmingly supported by Black

voters. While 92% of African Americans approved his overall performance, only 4% of them disapproved. 62% of all Americans, and 53% of Whites approved his performance.

The country, which has been for centuries weakened by racial divisiveness, considered Obama as the only person who would represent the interests of all segments of society. He could build a coalition_ rather a fragile one_ of White voters through pioneering a race-neutral campaign. Obama maximized his appeal to White voters. He could compromise groups of different political partnerships. Henceforth, African Americans enjoyed more possibilities of participating in the political scene and privileges which have been for a long time closed to Black candidates. They moved from protest to politics. Obama's victory paved the way for generations of African American politicians. He even provided them with the appropriate strategic approaches to reach victory. They would appeal and mobilize multiracial constituencies.

Furthermore, his victory discredited the dehumanizing bigotry which characterized the United States during the Jim Crow period. Insensitive statements, nooses, and confederate flags that expressed racism were politically corrected. Yet, structural racism and racial disparities could not be removed once and for all. Although some observers argued that the Obama's victory could promote equal redistributions of services, wealth, and employment, they pointed out that Blacks were affected by the economic crisis than Whites. The National Urban League reported that: "even as an African American man holds the highest office [in] the country, African Americans remain twice as likely to be unemployed, three times more likely to live in poverty and six times more likely to be incarcerated." (Qtd in Frod et al. 2009)

In addition, some Whites expressed fear of Black leadership. They thought such leadership would have negative consequences on their communities so far as the distribution of wealth, integration, and forwarding resources to the Black community were concerned. (Ford et al 2009).

Obama's connection to the Black community helped him gain more Black votes, yet he was also dependent on the votes and financial supports of wealthy White liberals. Obama did strike a precarious balance between Blacks and Whites. His hopeful promise of changing social and economic contexts along with his race-neutral campaign contributed to his victory. However, Obama could not win the votes of the dominant class in the United States. During his campaign, Obama promised to establish a 'green economy' in order to put an end to the hydrocarbon-dependence economy.

The capitalist class wanted to defeat the project, which was introduced by Obama who was associated with the subjected and enslaved, to extend its dominance. Although Obama represented hope and change, his administration was dominated by 'ice-blooded' politicians and economists. He could not, then, introduce a New Deal without social struggle between the electorate and the political and economic elites.

In addition, Obama had never introduced a program for the working class. This was clearly seen during the campaign. He met great difficulties in connecting with White-working class voters as compared to Hillary Clinton. Workers had undergone a decline which started decades ago. Even with regard to labor unions, Obama was evasive. He was to meet and answer to their needs. Instead, he privileged the large manufacturing and financial sectors. As far as the mining activity was concerned, Obama allied himself with big mining interests and refused to sign a bill that would impose taxes on mining activities

to finance cleanup programs. It is easy then to deduce that although historians draw a parallel between Obama and Roosevelt, the former could not have a political alliance with the working class and the labor unions which helped the latter overcome the economic crisis.

4.6.3 Obama, the Economic Crisis, and the Promise of Recovery

During the electoral campaign Obama described the realities of American economy by stating that: 'Our economy is badly weakened, a consequence of greed and irresponsibility,' He entered office in an uncertain environment. Just like Richard M. Nixon, Obama took office in wartime. Likewise, Obama just like F. D. Roosevelt was to face the gravest of economic difficulties. Economic conditions were particularly notable in the cloud they ominously cast on his presidency: banking and auto industries on the verge of collapse, a stock market in its most significant retreat since the 1930s, skyrocketing federal deficits, and an economy in the midst of what is likely to be the deepest recession in the post- World War II period.

The forty-fourth president of the United States has read Anthony Badger's book, entitled "*FDR, The First Hundred Days",* and carefully thought about how to achieve "his first hundred days." The day after his installation, highly symbolic decisions were made; the page was turned with the Bush Administration. In economic matters, he sought to find the right balance: to stress the seriousness of the problems, to make feel the urgency to act, to adopt the recovery plan, and to put the economy back on track for sustainable growth; not to give in, however, to an excessive pessimism that could destabilize a little more a fragile situation, to dissipate prematurely the capital that represent the energy, the hope, the feeling of national unity which were the marks of the campaign in Denver , the victory in

Chicago, and finally, the inauguration on January 20 in Washington. Barak Obama said: "It will take time, what we want to do is not only revive the economy but start the solution to some of the structural problems we have in this economy" (P.73).

Obama was hounded by the high unemployment rate, the failure of businesses, the housing crisis, and the decline of Wall Street. He was a firm believer that all these culminated from the capitalist system's three decades of overproduction. The slowdown that American and international economies could no longer be ignored. It was high time to state that the economic downturn was not solely caused by individual who failed to afford houses they purchased. Obama also blamed Republican and Democratic governments that ruled two decades before his presidency.

Donato (2009) noted,

> In his first key speech on the economy and executive pay, delivered on 4 February 2009, Obama took a type-3 stance, describing the situation as 'an economic crisis unlike any other we have faced in our lifetime…a crisis of falling confidence and rising debt'. Before becoming president, Obama had strongly focused blame for the meltdown and its persistence on the Bush Administration's fiscal and regulatory policies, which he had promised to change. (p 50)

Obama believed those governments opened up the doors to China and established factories there that benefited from the country's cheap labor. Economists stated that while the United States was suffering from a large trade deficit, China created sovereign investment funds thanks to its important reserves. China was willing to lend money to the United States provided that the latter would continue to buy its goods. This would help

China buy American corporations at bargain prices. China's success is attributed to its clear economic strategy, while the United States' failure is attributed to its strategy which culminated from the pressure of Wall Street and lobbies. Gandásegui Jr. (2011) stated,

> Obama criticized Bush and Republican policy for favoring Wall Street and sidelining "Main Street," but he has failed to implement any real changes. His statements regarding U.S. trade policy were critical of it, arguing that trade agreements had to be accompanied by environmental and labor rights awareness, but the facts speak otherwise. His discourse reflects the interests of U.S. capital, which has failed to stop the decline in profits in spite of having found a very cheap labor force in China. Obama is now repeating the Republican argument (wielded earlier by Bill Clinton) that Chinese products are invading the U.S. market and the United States cannot allow another nation to manipulate the export market. (p 117)

He concluded by saying that in spite of his discourse of hope and change: "Above all, Obama Administration is in charge of protecting the prevailing interests; no real change is taking place either in the foundations of the economy or in its relations power."

However, the facts say otherwise. Once in office, the president promised to change the remuneration regime which triggered the crisis. One aspect of his policy was to reform executive remuneration regimes. Reactions to such a statement were mixed.

Most of the media supported the president's claims. Statistics revealed that the president's rating had spiked to 67% after the announcement of his policy. Actually, he was elected on the basis of the three areas of energy, education, and health care.

Nevertheless, commentators noted that after other speeches that Obama addressed to Congress, his rating approval had changed.

4.6.4 Obama's New New Deal: the Stimulus Package

Upon taking office, President Obama moved to pass a stimulus bill. While he took some steps in the fields of health, climate energy independence, Obama's political priority was the implementation of an economic recovery program. The appointments he made on November 24 were also important.

4.6.4.1 The President's Appointments

He named Timothy F. Geithner, with whom he shared a 'certain low-key wonkish quality', the president of the Federal Reserve Bank of New York, as treasury secretary. Unlike his predecessor Henry Paulson, Geithner referred to the crisis under study as "the worst economic crisis in generations". According to Geithner, the economic crisis culminated from an accumulation of several causes and policies. Among many, he named 'policies that caused a huge global boom in credit; imprudent lending and borrowing; excessive executive remuneration; and poor regulation and oversight.'

Although Geithner did not mention the failure of the Bush Administration and its responsibility in causing the crisis, he implicitly focused the blame on its slow reactions, the application of misguided policies, and its failure to regulate financial markets properly. Just like Obama, Geithner made use of historical analogies to support the Economic Recovery Act, also referred to as the Financial Stability Plan, whose targets were to restart the flow of credits and to impose regulations in the financial market to achieve transparency and accountability. He referred to the Great Depression to explain why the

government failed, and he claimed that what the Obama Administration intended to do was different. (Donato 2009)

Although his speeches focused more on the way the Obama Administration would implement the president's agenda to overcome the crisis, they failed to convince the public. According to the journalist A Kessler, Geithner failed to save the banking system. He noted,

> One of the cool things about being Treasury Secretary is that you get your signature on dollar bills, giving them authority, defending their honor. Timothy Geithner's plan to save the struggling banking system probably does the opposite, throwing good money after bad to a banking system struggling under the weight of its own mistakes. The markets don't like it. The Dow dropped 382 points while bonds rallied as a port in a continuing storm. (Qtd in Donato 2009)

Public opinion was divided over him. While 42% approved the way he explained the causes of the crisis and the way he was doing his job, 40% of the American people disapproved. Kessler added,

> The Treasury Secretary seems stuck on keeping the banks we have in place. But we don't need zombie banks overstuffed with nonperforming loans—ask the Japanese. Mr Geithner wants to 'stress test' banks to see which are worth saving. The market already has. Despite over a trillion in assets, Citigroup is worth a meager $18 billion, Bank of America only $28 billion. The market has already figured out that the banks and their accountants haven't fessed up to bad loans and that their shareholders are toast.

In addition to Geithner, Obama named Lawrence Summers whom he classified as a brilliant economists, former Clinton treasury secretary and former president of Harvard, as director of the White House National Economic Council (NEC); and the economist Christina D. Romer as chair of the White House Council of Economic Advisers. Ties among those appointees were important. For instance, the relationship between Geithner and Summers was very interesting: they were good friends and tennis partners; their relationship did not have any friction (Burke 2009). Later, the president-elect named Peter R. Orszag, director of the Congressional Budget Office, as director of the Office of Management and Budget, with Rob Nabors as his deputy.

At the head of the Federal Reserve, Obama maintained Ben Bernanke, Bush’s appointee. Bernanke attributed the high rates of foreclosures to the deterioration of the housing market which had its origins in advances in technology and the credit system of previous administrations. After the collapse of many major banks, Bernanke admitted that the country was in a period of financial turbulence. He was among the few of all Bush-era officials who believed that the American financial system was so weak. As a response to the crisis Bernanke suggested offsetting the Fed’s efforts on credit conditions.

After the presidential election, Bernanke stated that the American financial sector failed to ensure the inrush of capital. This precipitated a downturn in the global economy. He pointed out the failure of governments to decrease the inflow of capital. He acknowledged the consistency within Obama’s and Geithner’s attempts.

On November 26, President Obama announced the appointment of a new President's Economic Recovery Advisory Board to be chaired by former Federal Reserve chairman Paul Volcker. Finally, the president named his longtime economic adviser, Austan Goolsbee, as a member in the Council of Economic Advisers and a staff director of

the new advisory board. Such appointments reflected the president’s emphasis on economy, and appointees would “keep out fresh voices and new ways of thinking.”

Obama did not only name great economists to important economic departments and agencies, but also created new offices to coordinate energy, health care reform, and urban policy initiatives. So, unlike Gandásegui Jr. (2011) and other observers who maintained that the Obama Administration did not promote hope and change, Bruke (2009) reported that Obama’s appointments indicated that “White House staff that will not only drive but likely define the early Obama policy agenda.” The president could build “a cabinet of prominent and strong willed players ... he is putting together a governing structure that will concentrate more decision making over his top domestic priorities in the White House.”

4.6.4.2 Obama’s Announcements about the Stimulus Package

During Obama’s second news conference, the president announced that he and his economic team would start immediate work to decide upon a stimulus package whereby they could dislodge economy from the ‘vicious cycle’. Actually, reports indicated that the president and his team were working with Democratic congressional leaders ‘behind the scenes’ on a plan that included benefits for the unemployed Americans, financial aid to states and cities, promoting infrastructure projects, and food stamps. Obama did also organize meetings with Republican leaders and asked for proposals for an economic recovery plan.

4.6.4.3 The Stimulus Package Ideology

According to Hook & Parsons (2008), “Obama has consulted with Republican lawmakers about his economic plans. Members of Congress and their staffs say that the Obama team has been engaged in fact-gathering on the Hill as much as seeking support for its own agenda. That stands in “marked contrast to the approach of Obama's Democratic

predecessors". The president invited even Americans to brainstorm about how to cure the economy and report back to him.

Obama's economic advisors held different views about the way to deal with the dire economic context and the rising budget deficits. While some of them favored Roosevelt's approach, some others drew lessons from the failure of the Clinton's health care initiatives. In the course of time, there were signs that the Administration planned for the implementation of new policy initiatives. The stimulus package proved to be the earliest outcome of such policy.

Verick & Islam (2010) noted that countries which were hit by the global crisis responded through pump-primping. They stated,

> As the global financial crisis unravelled, governments across the globe increasingly recognized the severity of the downturn and the urgency to intervene in order to avoid a catastrophic collapse of the financial markets and real economy. The response has consisted of three main interventions: 1) bailouts and injections of money into the financial system to keep credit flowing; 2) cutting interest rates to stimulate borrowing and investment; and 3) extra fiscal spending to shore up aggregate demand. These measures have sought to prevent further economic deterioration and ultimately keep workers in jobs where possible and help create new jobs to provide opportunities for the unemployed. Overall, this response has helped avoid a far more severe downturn. (p 35)

So, many important countries resorted to unprecedented expansionary monetary policy which included both aggressive reductions in policy rates and quantitative easing, and

massive support to banking systems. Still, financial stimulus packages were highly recommended by policymakers of the contracted countries.

4.6.4.4 The Stimulus Package Applied

At the outset, the size of Obama's stimulus package was $825 billion dollar to be spent during the period between 2009 and 2011. The American House of Representatives approved an initial stimulus package of $819 billion through a 244-188 vote, after protracted negotiations. In the course of time, a bill of only $787 billion could be approved in both Chambers with a narrow support of Republicans. Nevertheless, within his first 25 days, he passed the $789 billion stimulus package, and implemented other policies to cure industries like housing and automobile.

Regulations for banks and Wall Street were also introduced. Obama tried actively to steer the economy. Instead of resorting to programs that provided direct relief to impoverished citizens, the President resorted to programs that increased health care and access to education through tax structure. He sought to link economic issues with domestic policy as he believed that his policy had to be ambitious instead of being confined to the economic situation.

Obama used historical analogies to explain his policy to Americans. He stated,

> History reminds us that, at every moment of economic upheaval and transformation, this nation has responded with bold action and big ideas…In the midst of civil war, we laid railroad tracks from one coast to the other that spurred commerce and industry…From the turmoil of the Industrial Revolution came a system of public high schools that prepared our citizens for a new age…In the wake of war and depression, the GI Bill sent a

generation to college and created the largest middle-class in history. (Qtd Donato 2009)

4.6.4.5 The Stimulus Package's Controversies

Components of the stimulus raised many controversies. Observers noted that the jobs it created could not be largely in place until 2010, since the Congressional Budget Office announced that $185 billion would be used in the fiscal year 2009, and $399 billion in the fiscal year 2010. Michael Grabell (2012) who spent three years reporting on the stimulus came to the conclusion that "Government can create jobs-it just does not often do it well."(*The New York Times*)

He admitted along with other economists that the plan did a lot of good though it could not promote a sustainable recovery. Preliminary assessment of the ARRA revealed that the plan was expected to create about 3.5 million jobs by the end of 2010. It could create only 1.5 million jobs by the end of 2009. The labor market lost more than 8 million jobs from the end of 2007 to 2009; the ARRA proved to have a modest outcome on employment. It could not restore pre-crisis employment rate although it could probably avoid a depression.

A recent assessment of the stimulus package conducted by Sheldon Danziger published in 2013 reveals that the unemployment rate was 7.4% below its peak rate of10.0 % recorded in October 2009. According to the report delivered by Congressional Budget Office in February 2013, the year 2014 would witness unemployment rate exceeding 7.5% of the labor force. Such rate would record the longest period of unemployment in the history of the country since the WWII.

Many views have been elaborated to explain the ARRA's modest outcome. First, the forecasts about the depth and the duration of the crisis were optimistic. This influenced

and limited the ambitions of the package. Some economists suggested rather a package that would to be three times larger than the ARRA to compensate for employment and general output gaps.

It has also been clear that the allocation of monies was too slow. (Verick & Islam) The Obama Administration spent money on worthwhile long-term projects rather than on the "shovel-ready" projects which could put people back to work immediately. Gabrell (2012) pointed out to the number of workers who had been hired in the summer of 2009 when the nuclear cleanup received $1.6 billion in stimulus recovery. Henceforth, the unemployment rate declined in a matter of months albeit slowly.

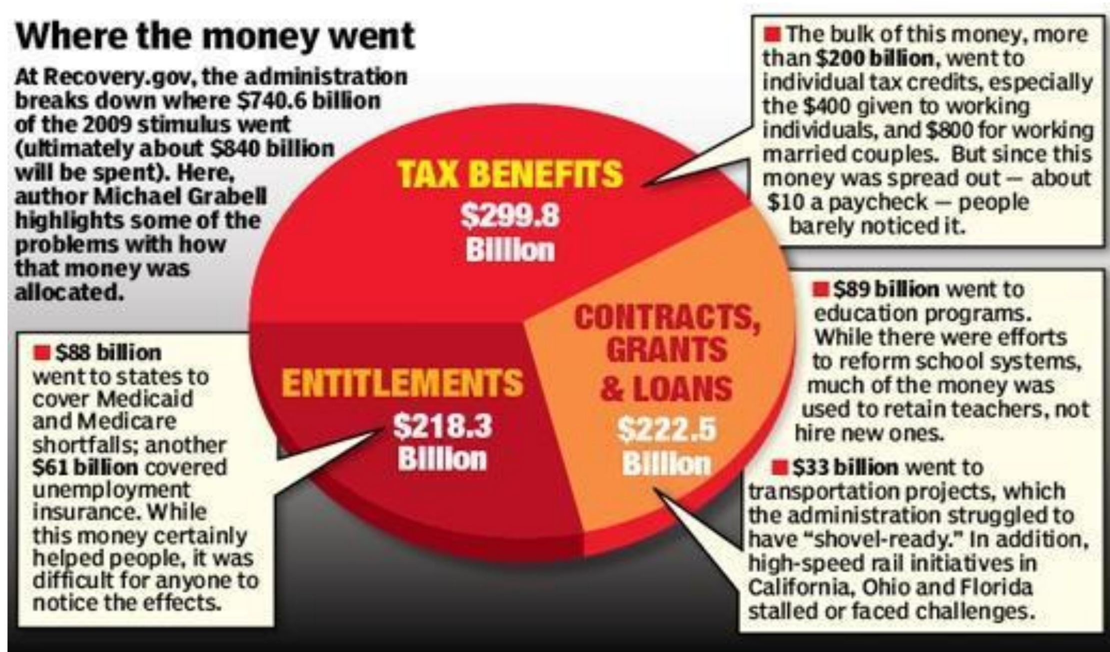

Figure 4.6: Disbursement of the Allocated Monies (*New York Post* January 29, 2012)

The government could immediately send money to contractors who had already established their plans for projects. The Obama Administration promised to finance such projects within 90 days. Yet, this often took more than six months. Grabell, too, noted that

the stimulus did not provide money directly because of a tortured bureaucracy. Furthermore, he favored “pumping” money to other industries.

He stated: “The stimulus effort should have contained more programs like Cash for Clunkers, which pulled car sales forward, emptied dealership lots and prompted auto plants to bring back thousands of employees.” It is necessary then to assess the effectiveness of the Obama Administration policy to cope with the global recession.

The Obama Administration was also recommended to provide temporary jobs program, just like the Works Progress Administration which could employ millions of people during the Great Depression.

Actually, some states could create temporary jobs via a $5 billion emergency welfare fund. Yet, only few states could enjoy real results. Thousands of workers were out back to their jobs, and thousands of teachers were saved from layoffs.

4.6.4.6 The New New Deal’s Achievements

It would be rather unwise to deny the stimulus’ achievements. The stimulus was officially referred to as the American Recovery and Reinvestment Act of 2009 (ARRA). It is reported that the stimulus was five times more expensive than the Works Progress Administration. In recent assessments, economists noted that the ARRA created more than two million jobs, generated clean energy, and thousands of miles of roads were improved.

Local leaders were to bring about strategies whereby to combine several modes of transportation. Rail lines were straightened in Chicago, streetcars and rapid buses were financed in Dallas and Washington, respectively. Miles network of bike and walking traits were built in Philadelphia, to name only these.

Other investments in solar and wind energy also saw the light under the stimulus package. Still, their impact remained uncertain. Grabell (2012) stated,

> The fluctuations in America's energy policy, the absence of a trust fund for high-speed rail as there is for highways and aviation, and the clear lack of a plan to tackle the deficit hinder the recovery instead of helping it…….In short, there are areas where the government should get out of the away, by clearing bureaucratic hurdles. But it's equally important for politics to get out of the way of smart government policies that can help the private sector create jobs. (*The New York Times)*

4.6.5 The Bank Bailout Plan

The second major initiative that Obama introduced along with the stimulus package was the administration's bank bailout plan. At the outset, the plan seemed vague. During the day it was unveiled, the Dow Jones Industrial Average dropped to 4.6%. This implied bankers and investors' uncertainty vis-à-vis the plan. It was not until March 23rd that Geithner, the Secretary of the Treasury, unveiled a fleshed-out plan. Thereafter, there was a positive response; the Dow Jones rose to 6.8% (Burke 2009).

It is important to betoken that only the stock market indices recovered all their losses recorded during the Great Recession.

The funding bill of the remainder of the fiscal year 2009 was the third initiative that Obama introduced. It included thousands of earmarked projects. The bill, which drew criticism, impacted the federal deficits greatly. Data revealed that in fiscal year 2007, the deficit was $162 billion; in the fiscal year 2008, $458 billion; and in fiscal year 2009, $1.75 trillion.

In a televised address on February 26, the President presented his own budget proposal for the fiscal year 2010, as his final initiative. The plan provided $150 billion to new energy projects. Another $634 billion was devoted to extend health care coverage. Similarly, expansions of grants for college students were included therein. The plan also suggested a tax increase, and a termination of the Bush tax cuts. After great resistance in the White House, the bill was finally passed in both Chambers without the Republicans' vote. Upon the whole, Obama's agenda forced his Administration to rely on narrow partisan majorities.

The President's intention to break from the Bush administration had been made clear through such proposals. David Broder, the American journalist, who spent more than 40 years writing for the *Washington Post* and reporting on presidential campaigns, was classified by Obama as the "most respected and incisive political commentator of his generation". Broder noted that "For the first time the extent of [Obama's] ambitions became clear - not just stopping and reversing the steep slide in the economy but launching highly controversial efforts in health care, energy and education." (Qtd in Burke 2009)

The President, too, wanted to lessen Americans' expectations for a quick recovery from the Great Recession. Obama noted in his Inaugural message: "the challenges we face are real and they will not be met easily or in a short span of time."

This reconciliation bill of $3.4 trillion raised concerns even among some Democrats. Among many Senators, the Chair of the Finance Committee, Max Baucus, worried about the decline of tax deductible provided for charities. Likewise, Senator Kent Conrad, the Chair of the Budget Committee, expressed his worries about proposed cuts in subsidies to large agribusiness. Some moderate Senators, too, were troubled by some

provisions of the bill. Senator Ben Nelson; for instance, expressed his concerns about the changes in loan program for students.

Still, the economic crisis worked to the administration's advantage. As demands for responses were pressing, the President could press Congress to pass important initiatives that might be difficult to be achieved later on. This benefited Obama; he did great things from this "opportunity". He scored well with the public inauguration.

4.6.6 Assessing Obama's Overall Endeavour

Ultimately, the ARRA proved unsatisfactory to bring about a sustainable recovery. At the outset, the stimulus was supposed to raise consumer spending through tax cuts, food stamp, and unemployment checks. In addition, education and health-care money would stop the intensive deficits of states' budgets. Then, "shovel-ready" projects were to create more jobs. After that, new investments in different industries were to lead the country out of the recession.

Verick & Islam (2010) noted that,

> Governments enacting fiscal stimulus packages should concentrate on spending measures rather than tax cuts. Furthermore, within the category of spending measures, governments should focus on capital expenditure, such as investments in employment-intensive infrastructure. This will yield higher dividends in terms of the impact on output and jobs for any given size of fiscal expansion. (pp 39-40)

The United States, like many other countries which were hit by the global crisis, opted for tax cuts instead of adopting spending measures. Actually, the share of tax cuts in the package was estimated at 33%. Unlike the Roosevelt Administration, the Obama Administration could not resort to infrastructure programs such as building roads and bridges,

and investing in housing and other social buildings. Such programs, though they might be beneficial, required time to be designed and delivered. It was then ideal for the United States to rely on tax cuts.

Economists failed to forecast the recession; thus, the plan failed to promote a sustainable recovery. Gabrell (2012) attributed the failure of the ARRA to the poor design and presentation. He stated: "What I found is that the stimulus failed to live up to its promise not because it was too small (as those on the left argue) or because Keynesian economics is obsolete (as those on the right argue), but because it was poorly designed. Even advocators for a bigger stimulus need to acknowledge that their argument is really one about design and presentation."

A comprehensive view on the recovery reveals that The United States, which could by the end of 2009 restore somehow pre-recessionary levels of DGP, private consumption, government expenditures, and exportation, failed to promote full employment. [84]

The beginning of 2010 experienced an infant recovery since the labor market was not yet improved. In responding to the economic crisis, the government was not only required to cure the Wall Street. The "Main Street" was to be revived through job creation.

4.6.6.1 Opposition and Misconceptions

Just like the New Deal, the constitutionality of the *New New Deal* was reviewed in the Supreme Court through a number of cases.

However, unlike some provisions of the New Deal which were nullified by the Supreme Court, provisions of the *New New Deal* could survive.

4.6.6.2 Obama's Second Term

[84] It is worth mentioning that many other countries like Great Britain, Japan, Turkey, Spain, France, and Canada, to name only these, could not return to positive growth in employment.

Observers of voting behaviors paid considerable attention to the low rate of the white vote recorded during the 2012 presidential election. From 2008 to 2012, the white vote dropped by 6.1 million. Weisberg (2015) conducted a research to explain such decline. First, he claimed that racial attitudes did not affect the voting behavior greatly neither in 2008 nor in 2012. Then, Weisberg proclaimed that Obama's vote decline was due to economic issues. He came to the conclusion that

> Obama's vote decrease among whites seems to be most due to the economy: he did not get as large a boost as he did four years earlier when the public was very upset with President Bush's handling of the economy. While scholarly attention focused mainly on the impact of racial attitudes on Obama's election
>
> as president in 2008, he also benefited considerably from the financial crisis occurring under the Republicans' watch. He no longer had that advantage in 2012 and the economy had not improved enough for him to gain credit for a recovery, so his vote sagged among whites. (Weisberg 457)

Likewise, Bemmel (2013) noted that, "the Global Attitudes Project of the Pew Research Center (2012) established among most respondents a sense that Obama had not lived up to the expectations invested in him when he first took office, though people continued to express confidence in his leadership."

4.6.6.3 Obama's Impact on People's Mind about Economy

In the 2008 presidential election of Barack Obama, Black voters constituted the highest participation of Black voters ever recorded in the history of the United States. Furthermore, Obama could easily accumulate the highest percentage of Black support during a presidential election at 95% surpassing the one amassed by President Lyndon Johnson in 1964. In addition to these political and historic achievements, the election of

Obama had a tremendous influence on how some people assessed the economy. R. Seltzer & J.W. Hutto (2016) found out that during the two last years of the Bush Administration 18% of Whites and 35% of Blacks said the economy was poor. This increased to 56% and 68%, respectively by September of 2008. However, this was reversed during Obama's presidency. Although Whites held a negative opinion about economy, just like Blacks, they were less likely to say the economy was behaving poorly.

R. Seltzer & J.W. Hutto (2016) concluded by stating that;

> The election of Barack Obama had a tremendous effect on how some groups perceived the economy. Blacks demonstrated group consciousness by rating the current state of the economy as good, which was in direct contradiction to what was taking place in the society….the Obama effect colored Black responses to objective survey questions (355)

However, it may be unwise not to consider statistics which revealed that after Obama's victory, low-income Whites were more likely than high-income Whites to believe that the national economy was behaving better. This fascinating datum challenges scholars who confine the good sentiment about economy to the Black community. Actually, the Obama slogan about Hope was true for poor Whites as well as Blacks.

4.7 Recommendations to Avoid Future Crises

Governments are recommended to adopt work-sharing schemes to keep workers in their jobs in order to combat crises and reach a full-fledged recovery. They need also to encourage employers to hire new employees through utilizing the job/wage subsidies along with tax credits. Finally, 'the employability of the employed' proved sufficient under the New Deal as it assisted and trained the unemployed to encourage them to seek long-term jobs despite structural changes in the labor market.

Actually reviewing most of all the economic disturbances, be they minor or major, that the United States experienced from 1819 to 2007 enables us to set forth a list of recommendations for countries to avoid future economic downturns inasmuch as the idea that a financially liberalized country would enter a crisis was unthinkable until the experience of the world's hyper- power with the Great Recession.

1. On the behalf of free markets and free trade, economies furnished arsenals for financial crises. So, economic stability is likely to be reached if global economic regimes are improved and coordinated. Some economists and observers urged the establishment of a "second" Bretton Wood System to enhance the international financial architecture. Others asked for reforming the IMF, created under the Bretton Woods.

More comprehensive prevention policies must be implemented at the domestic and the global levels alike.

2. Negative shocks and confusion ignite crises; a slow response aggravates them. Therefore, implementing a policy of 'containment' before the crisis worsens is to be accounted for.
3. Since it is difficult in a time of crisis to recognize the solvent banks which may ensure liquidity and absorb losses, a short 'banking holiday' is recommended to examine financial institutions for solvency.
4. Resolving a banking crisis requires transferring non-performing assets to government ownership and/or selling financial institutions' assets under government leadership, and imposing controls on capital inflows if deemed necessary.
5. To improve banks' performances, management, and transparency; and enhance consumer protection, prudential regulations are to be implemented and improved.

Even with the aforementioned solutions, one may wonder whether or not crises are inevitable. Karl Marx noted that crises are endemic to capitalism. The system is by nature

unstable. Other economists like Keyness and Paul Sweezy believed that overinvestment, overproduction, under-consumption, and excessive speculation were, are, and will be the culprit of leading up to crises. They start due to uncertainty and random shocks. Crises can be prevented by scarifying growth over stability.

Hsu (2017) concluded,

> Capitalism has created instability and unanticipated crises. Deregulation of the financial sector and breakdown of the global monetary and economic cooperation of Bretton Woods has led to more pronounced and rapidly developing crises. At present, we need not only financial and economic regulation but some economic restructuring to reduce the role of finance in the global economy and increase the role of real economic activity. After all, real economic gains are based on real production, and we must re- orient our focus to this aim. (146)

Some economists argued that the Obama Administration created a 'consumption-driven bubble' which might lead to a 'double-dip' recession, basically because the country's budget deficit was estimated by IMF to reach 84.5% of GDP in the period between 2010 and 2015. The impact of the ARRA on American economy will require a number of years to come to be clearer for economists, policymakers, and historians. They will eventually be able to deal with the enigma of the 'uncertain future'.

4.8 Conclusion

The Great Depression and many intervening crises taught us much about how policy makers should respond during the Great Recession, but again we face new challenges. The US component of the financial crisis clearly warranted more attention than was given to the Great Depression in the short run. Governments around the world should

be lauded for implementing fiscal stimulus packages and loose monetary policy to halt the crisis in its tracks, although the crisis was so severe around the globe that it will take some time for economic conditions to improve.

Obama, just like Roosevelt and Reagan, was to fight against the worst recession ever recorded since the Great Depression. Obama did not plan to implement any revolutionary changes in U.S. policy, and there was little he could do internationally even as the rest of the world cheered him on. The election of an African-American was in itself a significant cultural change and will have a lasting impact, but his supporters had very high expectations—that he would establish some kind of New Deal that would guarantee health coverage for all U.S. families, fiscal restructuring, job creation, and secure pensions.

The New Deal, in spite of its weaknesses, proved to be much more satisfactory than Obama's New New Deal.

General Conclusion

The present thesis concludes that the financial system of the United States of America is prone to collapse every once and while. During the nineteenth century, the country passed through minor and major economic downturns. The twentieth century rather witnessed economic collapses every ten years. This implies that the country moved toward long expansions in motion. The twenty-first century witnessed but one severe recession.

In the course of time, the United States could compensate for its economic and financial mistakes that triggered crises. First, the country seemed to learn from the mistakes of the monetary policy that led up to contraction in 1929 and transformed it into a depression. The stock market crash was caused by the tightening policy that leaders adopted to fight speculation and high prices. The Fed raised interest rates sharply to save the gold standard and stabilize the dollar. Moreover, Congress pressured the Federal Reserve to reverse its policy to eliminate the abundance recorded during the *Roaring Twenties*. History proved that problems of inflation and deflation could be eventually hindered when Roosevelt suspended the gold standard and lowered interest rates.

As far as the Great Recession is concerned, mistakes were less and the monetary policy was different. The Fed's monetary policy was swift and effective. It could avoid deflation. In the course of the crisis, the Federal Reserve increased liquidity provisions to financial institutions, purchase of government bonds, and support the big financial companies. In addition, the American government entered the Great Depression with a debt service of 15% of revenues, while debt service during the Great Recession accounted only for10 % of revenues.

In addition to different monetary policies of the two crises under study, there were different fiscal policies. Some economists and historians believed that the Great Depression was brought to an end thanks to the New Deal. Roosevelt adopted a clear new direction of government policy. He promptly opened the banks after their closure and took the country off the gold standard.

Roosevelt's reforms promoted nearly fifty years free of serious economic unrest. Banking became a safe industry, and most Americans invested in the stock market. Measures like the Federal Deposit Insurance Corporation (FDIC) which could successfully 'resurrect' people's faith in the safety of banks, the Glass-Steagall Act which separated commercial banks from investment banks, and the Securities and Exchange Commission (SEC) which regulated financial investments.

Other economists believed that such fiscal policy proved unsatisfactory to promote recovery since the stimulus was smaller than the size of the problem. The fast economic growth registered during Roosevelt's first term was likely to lead to inflation. Both the Fed and the Roosevelt Administration reversed their fiscal and monetary policies. This led up to the recession within the depression, and delayed the return to full employment. Recovery was fully achieved by the beginning of the Second World War.

Once the Glass-Steagall Act was repealed, the patterns of a new financial crisis developed. Economists and economic advisors realized that a crisis was about to start. Still, they could brake its transformation into a depression through standing by some of the failed banks. Bernanke blamed the Federal Reserve for not saving all the banks which failed. This might avoid a large scale of bank failures inasmuch as the important banks held 40% of the total assets of the industry.

The Federal Deposit Insurance system incorporated within the New Deal contributed in the restoration of Americans' confidence in the banking system, and thus to the recovery. Roosevelt's New Deal, or as economists prefer to call it the *Stimulus Package*, is equal to present time $800 billion.

The Obama Administration adopted a *New New Deal* to recover from the Great Recession. The American Recovery and Reinvestment Act, signed by President Obama, is deemed as big and bold as the New Deal. However, it might be unwise not to denote the differences between them.

The stimulus' primary objective was to save and create jobs as immediately as possible. Second, it aimed at providing temporary relief programs to those severely impacted by the crisis, and investing in infrastructure, education, health, and green energy. However, The New Deal's primary objective was to provide relief for the poor, the unemployed, and farmers since Roosevelt believed that unemployment and the drop in industrial production had to be remedied before any other effective actions.

Nevertheless, it is pretty apparent that the lessons drawn from the Great Depression have been successfully learnt: bank failures as well as inflation have been avoided, and the importance of restoring public confidence and certainty to ensure investment.

Above all, policy coordination among local leaders and across borders is highly important in a time of globalization and the ease capital mobility among nations to avoid any negative shocks. In the United States of American, the lack of coordination led to both crises under study.

Actually, my work presents a broad analysis of all the economic downturns witnessed by the United States; it is neither the first nor will it be the last attempt to identify similarities and differences between the Great Depression and the Great

Recession; and the New Deal and the New New Deal. From what has been learnt about crises, one may suggest that we might expect other financial disturbances. My work endeavors to expose facts of different panics, with reflections on the Great Depression and the Great Recession, in an attempt to help avoid future crises through a journey of revelations.

Other researchers may find a wealth of information beyond what I presented here that can be studied for years to come; and comprehensive records of the financial crises in the United States continue to be written and reviewed to explore how the world's strongest financial system came to the brink of collapse.

The study of past behaviors of economies may help economists forecast future panics, depressions, and/or recessions. Yet, neither macroeconomic nor microeconomic analyses can predict future economic behaviors inasmuch as factors like human psychology, confidence, and certainty about the solvency of economic systems; and people's expectations may trigger crises.

History repeats itself, yet differently. We have to learn from history, so that we will recover from future panics. Crises will happen again if we accept the notion that no one could have seen it coming and that nothing could have been done.

A

- **Aggregate demand:** the sum of money paid for goods, services, investments, and non-exports within an economy.
- **Antitrust law**: legislative acts such as the Sherman Act whereby competition is promoted and monopoly is controlled.
- **Asset**: economic items owned by individuals or corporations which could be converted into cash.

B

- **Balance–of-payments deficit**: the difference between the equilibrium price of a currency and its exchange value.
- **Balanced budget:** when government expenditures equal tax revenues.
- **Balance sheet**: a summary of assets; liabilities, and net worth owned by a company in a given period of time.
- **Bank run:** this happens when depositors rush to withdraw their money from an insolvent bank.
- **Budget:** government expenditures and tax revenues that governments state for every fiscal year.
- **Budget deficit:** the amount by which tax revenues fall short government expenditures
- **Budget surplus**: the amount by which tax revenues exceed government expenditures
- **Business cycle:** the cyclical behavior of productions over time.

C

- **Capital resources:** buildings, equipments; raw materials, and inventories that are intended to produce other goods and services within an economy.
- **Capital investment:** cash money invested in businesses intended to make income over several years.
- **Capitalism:** an economic system under which equipments of production, resources, competition, and the free market are owned and controlled by private enterprises.
- **Central bank:** a financial agency, like the Federal Reserve in the United States, established by governments to supply commercial banks with money in case of insolvency.
- **Commercial banks:** financial institutions that hold cash or other deposits, and lend money to firms and individuals.
- **Consumer:** an individual who uses or consumes goods and/or services.
- **Consumer durables:** goods that can be used during more than three years.
- **Consumer goods:** products such as clothes and food that consumers purchase.
- **Consumer Price Index:** an index, calculated by the American Bureau of Statistics, to measure changes in durables and goods' prices.
- **Consumption**: the use of goods and services by consumers or producers alike.
- **Corporate Profits:** income taxes and other earnings received by stockholders and corporations.
- **Corporation:** a group of companies, acting as a fictitious company, ruled by a board elected by and from the stockholders.

- **Cost of Living Adjustments (COLA):** the Consumer Price Index measures the required adjustments in wages to balance losses in the purchasing power**.**
- **Council of Economic Advisers:** a group of economists who help the president assess the economic policies of government. It was established in 1946 by the Employment Act.
- **Current Prices:** the value based on prices during the nominal year.
- **Cyclical Unemployment:** unemployment caused by cyclical fluctuations.

D

- **Deficit:** when government spending is greater than its revenues.
- **Deflating:** converting values in current dollars to values in constant dollars to compensate for changes in prices.
- **Deflation:** a general decline in prices of goods and services.
- **Demand deposits:** bank deposits paid back to their holders on their demand.
- **Deposit contraction**: reduction in deposits due to a drain of currency that banks may witness.
- **Deposit Insurance:** depositors are provided a protection from a government agency against banks and depository institutions**.**
- **Depression:** a severe recession when national output is diminished, trade and commerce, consumption and investments, and credit decrease for two or more years.
- **Devaluation of currency**: a decrease in the value of a currency because of an increase in the price of gold.
- **Direct regulation:** government interference to regulate the conduct of firms.
- **Discount rate**: charges for loans that commercial banks pay to the Federal Reserve.

E

- **Economic activity**: manufacturing, distributing, selling and buying, and consuming goods and services.
- **Economic growth:** a positive increase in the production of durables, goods, and services of an economy over a period of time.
- **Economic profits**: The revenue a firm receives which exceeds costs and expenses.
- **Exchange rate:** the amount of a currency that can be converted to another currency.
- **Expansion:** a period during the business cycle when national output increases.
- **Exports**: goods produced in one country and sold to another one.

F

- **Federal Reserve Board**: a group of seven governors appointed by the president to assess, supervise, and sustain the U. S. banking system.
- **Firm:** a company which makes profits in return of its goods and services.
- **Fiscal dividends:** an increase in federal revenues that follows tax reduction.
- **Fiscal policy:** government policies to regulate and stabilize economy through managing taxation and expenditures.
- **Fixed exchange rate:** the rate of the conversion of a country's currency is determined by government.
- **Flexible exchange rate:** the rate of the conversion of a country's currency is determined by free market.
- **Full employment:** when a high level of employment is achieved in an economy without high inflation.

G

- **Gold exchange standard:** currencies were converted into gold at a fixed exchange rate.
- **Government purchases:** government expenditures to obtain final goods and services.
- **Gross domestic product (GDP**): the total amount of final goods and services produced by an economy during a period of time.
- **Gross national product (GNP):** the value of all goods and services produced and imported in an economy, excluding the exported goods and services.

H

- **Holding companies:** a business corporation which buys and owns shares of other companies. It then can control and influence them.

I

- **Imports:** goods and services that a country buys from another country.
- **Income tax:** a tax imposed on personal incomes and corporate profits.
- **Income policy:** A policy that controls inflation through setting forth guidelines for firms and industries in making wages and price decisions.
- **Industrial union:** a labor union that gathers workers of a particular industry.
- **Inflation:** a persistent increase in prices and a decrease in the currency exchange rate.
- **Inflation expectations:** rate of inflation that business and investors predict.

- **Input:** resources or information put in projects and production.
- **Interest:** the money paid to depositors and suppliers of money.
- **Interest rate:** the amount of money that borrowers or saving banks must pay to depositors every year for the use of their money.

K

- **Keynesians:** Economists who are firm believers in the body of ideas set forth by John Maynard Keynes. This economic school describes the way economies should behave, and how monetary and fiscal policies affect aggregate demand.

L

- **Labor:** physical and mental efforts of workers used in the production process of goods and services.
- **Labor force:** is the number of the employed persons and the unemployed who are looking for jobs.
- **Labor productivity:** the hourly goods and services produced during a period of time by every worker.
- **Loans:** money or any material goods provided by individuals or financial institutions to other individuals or organization in exchange for future repayment of the loan plus interests.
- **Lender of last resort:** The financial institution which acts a s a central bank providing the ultimate source of credits to smaller banks in case of crisis.
- **Liabilities:** debts or financial obligations of a company.

M

- **Market:** a structure or a place wherein buyers and sellers make their transactions.
- **Market failure:** a situation in which resources are not allocated efficiently; it is often attributed to government intervention in economy.
- **Medicaid:** a federal program, financed by federal, state, and local incomes, designed to afford medical aid to poor Americans of all ages.
- **Medicare:** a system whereby aged persons can receive free medical treatment.
- **Monetarists**: economists who believe that limiting a country's money supply helps control its economy.
- **Monetary policy:** the control exercised central banks over the money supply and the level of interest rates to promote economic growth**.**
- **Money:** coins and banknotes used in transactions and as a means of exchanging goods and services. It also refers to the sum that depositors have in bank accounts.
- **Money income: income measured in money.**
- **Money supply:** the total amount of money like currencies, printed money and assets that circulate in an economy during a given period of time.

N

- **National debt:** financial obligations of government.
- **Net exports:** is the difference between a country's imports and exports.
- **New Keynesians:** a contemporary economic school that emerges as a reaction against criticism of Keynesian economy to reinforce the belief that wages and prices tend to be rigid in the short run.

O

- **Open market operations (OMO):** the buying and selling of government securities on open markets to control the available money in the banking system. Such operations can adjust the federal funds rate.
- **Overvaluation of currency:** an increase in the value of a currency that goes beyond the expected rate.

P

- **Parity:** when farm prices are equal to prices of goods and services.
- **Peak:** a specified time in the business cycle when national output reaches its highest level.
- **Personal consumption expenditures:** the money individuals spend on goods and services. It is a measure of consumer spending.
- **Potential gross domestic product:** the total value of national output that economies can produce at full capacity and full employment.
- **Price index:** the ratio that shows how a price changes as compared to a standard price.
- **Private cost:** the amount of money that individuals pay to use goods and services.
- **Prohibitive tariff:** a tariff that a country imposes on imported goods which it wishes to keep out. Such tariff renders importation prohibitively expensive.
- **Property tax:** a tax imposed directly on properties. Owners pay this tax annually.
- **Public debt:** It refers to national debt. The total of all financial obligations that all governmental institutions of a country owe to foreign governments.
- **Public goods:** commodities and services provided by governments to individuals who do not pay for them.
- **Purchasing power**: the financial ability of an individual to use goods and services.

R

- **Real income:** an income that an individual can earn. It measures the purchasing power.
- **Real estate:** lands and buildings that individuals own.
- **Recession:** a specified period of time in the business cycle when national output falls drastically.
- **Recessionary gap:** macroeconomists refer to the situation when an economy operates below the level of its GDP by recessionary gap or contractionary gap.
- **Regressive tax:** unlike the progressive tax, the regressive tax requires low-income earners to pay a tax higher than the one paid by high-income earners.
- **Regulations:** governmental laws and rules to control economy.
- **Resources:** means, staffs, materials, and money used to produce goods and services.
- **Runaway inflation:** a rapid inflation which cannot be controlled easily.

S

- **Sales tax:** a tax imposed on sales.
- **Saving:** money or a resource that are saved after spending in banks or any other financial institutions to be used in the future.
- **Short run:** during a period of time, at least one of a firm's inputs is fixed and others are variable.
- **Social security**: A federal program whereby retired persons, the disabled, the unemployed, and the poor can receive health insurance.

- **Structural deficit:** an imbalance between government expenditures and revenues may result in a structural deficit which is a budget deficit.
- **Structural unemployment:** joblessness caused by fundamental changes in economy and technology.
- **Supply shock:** a sudden shift in the supply of products and commodities which changes prices unexpectedly.

T

- **Tariff:** a tax or a financial obligation imposed by government on imported goods.
- **Tax:** compulsory fess imposed by governments on products, incomes, and financial activities for public purposes.
- **Tax avoidance:** a legal method undertaken by taxpayers to lower tax liability.
- **Tight monetary policy:** a policy adopted by a central bank to tighten economic growth and control inflation through raising interest rates.
- **Trough:** as opposed to peak, trough refers to the period in the business cycle when national output is lowest relative to its potential level. It signals the end of the decline in the business behavior.
- **Trusts:** mutual trust and agreement between companies to control competition and prices.

U

- **Uncertainty:** prediction of negative economic events leads to economic uncertainty.
- **Undervaluation of currency:** the rate of exchanging a currency is below its potential price.

- **Unemployment:** the number of eligible workers who are jobless.
- **Unemployment rate:** the percentage that expresses the number of the unemployed people who are active in the labor force.

V

- **Variable input:** a resource, used in production, whose quantity is not fixed.

W

- **Wage and price control:** ceiling on wages and prices determined by governments.
- **Wage rate:** the amount of money paid to workers per unit of time.

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