Did the New Deal save Democracy and Capitalism?
Implications for the 21st Century

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Written for the conference *Lessons from the 1930s*, organized by Nick Crafts and Peter Fearon in April 2010. This is a very preliminary draft and I apologize for the rough spots.

The paper is too long, well beyond the 9,000 word limit suggested by the Oxford Review of Economic Policy. I apologize for that as well. A good bit of the current paper is laying out ideas and sources that can be trimmed in a tighter draft. Some of it may go altogether, I look forward to your reactions.

"The sharp difference between transitional and modern countries demonstrates graphically the thesis that modernity means stability and modernization instability." Samuel Huntington, *Political Order in Changing Societies.*

I. Introduction

When Huntington published that sentence in 1968, his intention was to contrast the "modern" countries of western Europe, Canada, the United States, Australia, New Zealand, and Japan from the "transitional" countries of Africa, Asia, and Central and South America that were struggling to modernize by establishing political stability and sustained economic growth. It is striking, that only 30 years before his publication date the modern world was undergoing the worst global economic depression in recorded history (far surpassing the current economic crisis) and that only 25 years earlier the modern world was in the process of tearing itself apart in World War II. There is little doubt that the origins of both the Great Depression and WWII lie in the instability of the modern world of western Europe and the United States.[1] How had the modern world come to change so much in such a short time that Huntington's analysis was not significantly challenged but met with wide acclaim? How did the modern western world become a source of stability?

Important elements of the answer lie in the lessons of the 1930s. But rather than asking how the modern world became more stable, perhaps we should ask: how did the modern world became less unstable? Decreasing instability in the modern world was the result of reducing the number and moderating the negative effects of the crises that inevitably arise. The moderation of crises was not due to an underlying increase in the rate of growth or technological change, but

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[1]In Huntington's first book, *The Soldier and the State*, he included the Soviet Union in the modern societies, on the basis of the government's relationship with the military. I need to be sure where he placed it in the later book.

a change in the political economy of national states, including the United States, that enabled them to coordinate in crisis more effectively, whether the crises were domestic or international. The coordination was often not far sighted or, perhaps, even particularly effective in promoting recovery from the crisis. The primary effect of better coordination has been to prevent things from getting worse, not necessarily to ensure that things get better. The primary lesson to learn from the 1930s is to see how the modern world has moderated the effect of crises.

The effects of the post-war modern regime are relatively easy to see if we think in terms of economic growth. Rich countries are not rich because they grow faster when they grow, but because they have fewer episodes of negative growth and shrink more slowly in times of crisis. The first seven rows of Table 1 presents information from the Penn World Tables on income from 1950 to 2004 sorted by income categories, and the right side columns divide the data into years with positive and negative growth in real per capita income. The 27 countries with income higher than $20,000 grow in 84 percent of the years at an average annual rate of 3.88% and shrink in only 16 percent of the years at a rate of -2.33%. In contrast, countries with lower than $20,000 income grow in only 66 percent of the years, but at an average rate of 5.35%, while they shrink in 34 percent of the years at an rate of -4.88%. The table shows the strong correlation between per capita income and the rate of negative growth in negative growth years: poorer countries shrink more rapidly in crisis years. The very poorest countries grow in only 56 percent of the years and shrink at almost exactly the same rate as they grow. Poor countries are poor in large part because of their inability to avoid crises and cope with them when they arise.

In the terms of the answer to Huntington's question, modern societies are not more stable because they are better at growing when they are stable, but because they are better at mitigating and defusing crisis through their ability to implement better coordination within and between societies. For comparison, the last two rows of the table present information on the United States from 1840 to 1949, and from 1950 to 2009. In the earlier period the U.S. had positive growth in 65 percent of years in which it grew at an annual rate of 4.65% and shrank in 35 percent of years at an average rate of -3.86%. After 1950, the U.S. grew in 83 percent of the years at an annual growth rate of 2.82% and shrank in 17 percent of years at a rate of -1.84%.[2] The post-war period in the U.S. has seen slower positive growth, a reduction in the number of years with negative growth, and a reduction in the severity of economic crises.

The paper's organizing question – did the New Deal save Democracy and Capitalism? – is about more than growth rates. The global experience in the first four decades of the 20th century strongly suggest that democracy and capitalism are vulnerable to crises.   If the experience of the New Deal led the world to avoid another Great Depression and/or world war, that is a lesson we need to understand. The central idea of the answer is that crises occur and are made worse when rational decisions by individuals (or by nations) to protect their interests lead to collective outcome that magnify and deepen the crisis. If individuals can coordinate their response to the crisis, and that coordination is credible, then while crises may not be avoided their negative effects can be mitigated.

Historically, we can approach the question through an historical narrative with a simple structure. The first World War and the economic crises of the decades that followed were caused

[2] If you are concerned about the difference in the size of the time windows, we were to compare the 1890 to 1949 period, per capita GDP grew in only 63 percent of the years, while positive growth averaged 5.66% and negative growth averaged -5.38%. The comparison to the post-1950 world is even more striking if we use the 1890 to 1949 period as the benchmark, rather than 1840 to 1949.

by an inability of nations to coordinate, exacerbated by the unwillingness of the United States to participate actively in international agreements. During the 1930s, the U.S. responded to the depression by developing social welfare and other government programs, the New Deal, that changed how Americans thought about the capacity of their national government to act. In the lead up to the second World War, the U.S. played the central role in organizing the Allied response to Germany and implemented a number of New Deal policies to coordinate Allied relationships: the UN, IMF, and World Bank among them. The United States continued to hold to its commitments to multilateral coordination into at least the 1970s. The increasing coordination between and within countries reduced the magnitude of crisis in the post-war period.

The sequence of events, beginning with the onset of World War I in 1914 and concluding with the recovery of Europe up to 1950, can be thought as the last great crisis of the modern world.[3] After the inability of western European powers to coordinate their responses to each other's military build up in the events leading up to World War I, the post-war settlement produced a fragile set of international arrangements for security and finance that could only work with the active and ongoing coordination of Britain, France, Germany, and the United States. Such coordination was not forthcoming. The United States, reluctant to enter the war in the first place, refused to ratify the League of Nations treaty and, as it had since the 1780s, remained suspicious and wary of entering deeper into European political and financial arrangements. A decade of economic recession in Europe in the 1920s was followed by a decade of world wide

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[3]The introduction to Kennedy's *Freedom From Fear* (1999) lays out nicely why we must think of this entire period as interconnected, particularly if we are to understand the events of the 1930s and 1940s.

depression in the 1930s. The depression resulted in radical political change in Germany, Spain, Italy and other parts of Europe and ultimately led to war. Again, the modern world failed to coordinate responses to economic crises that could have slowed the depression's onset or eased recovery. Democracy and capitalism were in retreat in the 1930s and 1940s in Europe.

The depression produced a different political response in the United States than in Europe. The new Democratic majority, led by Franklin Roosevelt, dramatically expanded social welfare programs (relief), public infrastructure investment, financial regulation, and industrial cooperation. Not all of these policies were successful or politically viable, but from 1935 to 1939 a workable set of arrangements between the national and state governments were put in place that resulted in a permanently larger public sector and a much more active national government. When war began in Europe, despite vigorous isolationist resistance in the United States, a program of support and coordination led to a much larger American presence in war planning and the war effort.

Without the domestic political transformation of the New Deal, it is unlikely that the national government would have been in a position to dramatically expand its international role. The United States had not been willing to undertake large international commitments before 1939, yet the outlines of the post-war international settlement were laid out in 1941, before the United States entered the war, and followed the outlines of the American New Deal: a general commitment to economic policies to maintain incomes and eliminate poverty, self-determination, and open markets.[4] After the war, the United States played a critical role in

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[4]Many may question whether the New Deal had a commitment to open markets, given its role in price supports in agriculture, cartels under the National Recovery Administration, and minimum, but in general, the New Deal stood behind private ownership and free markets.

guaranteeing peace in Europe, supporting a coordinated western European recovery effort, and a new political order for Europe. The origins of the institutional solutions that enabled the United States to confidently, if reluctantly, transform itself into a world power, lay in the institutional solutions devised during the New Deal to constrain and coordinate a much larger national government.

The larger American role was not sufficient to cause change in the modern world order by itself. The change was, after all a European process. But the American role was critical. As Feinstein, Temin, and Toniolo suggest:

> In a broad historical perspective, it is possible to see that the world had changed since 1919. The United States emerged from the Second World War as the undisputed leader of the western world and this time was ready to accept the responsibility. The lesson of Versailles had been absorbed: a sufficient degree of international coordination and cooperation had to be established if stability and prosperity were to be achieved. The United States could provide the relevant preconditions for a new international order based upon mutual rust and collaboration, but it could not impose this; Western Europe and Japan were encouraged and put in a position to play their parts. (Feinstein, Temin, and Toniolo, 2008, p. 180)

The narrative approach hinges on three historical features: the demonstrated inability of Europe to coordinate between 1915 and 1945; the change in American domestic political arrangements, the New Deal, that made a broader American role possible in 1941 and after 1945; and the importance of American participation in Europe as a determinant of a successful return to democracy and capitalism in the face of a communist alternative. While a persuasive narrative can be woven from this string of historical contingencies, it doesn’t get us very far in answering our question about Huntington, what made the post-war modern world so stable? Why had the world changed since 1919?

II.Impersonality

An alternative way to answer the Huntington question is conceptual. The modern world improved its ability to deal with crisis that, in the past, caused serious disruption with more negative consequences. This is one of the primary lessons policy makers learned from the 1930s and applied in the current crisis (2008 +?), which is perhaps why we are experiencing a great recession rather than a great depression (at least to date in the spring of 2010). The task is to identify why the modern world is less unstable.[5]

Fortunately, economics and economic history have thought a lot about the question of social coordination, even if not in the context of reducing instability. The crux of the issue is the difference between the actions individuals see in a crisis as being in their best interests as individuals, in contrast to the actions that may be in the best interests of individuals as members of the larger community. For example, when the current economic crisis erupted in the fall of 2008, it was individually rational for people to retrench, reduce consumption, and increase savings. But rational individual behavior might have been collectively damaging, as falling consumption leads to higher unemployment and economic contraction that make all individuals worse off. The invisible hand does not necessarily work to produce the best social outcomes in times when uncoordinated, but rational, individual behavior lies at the root of the crisis. Collective response to increase demand through deficit spending and monetary expansion *may* be a way to collectively coordinate.

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[5]Ben Bernanke was quoted in the Washington Post on April 9, 2010: ‘"In the current episode, in contrast to the 1930s, policymakers around the world worked assiduously to stabilize the financial system," he said. "As a result, although the economic consequences of the financial crisis have been painfully severe, the world was spared an even worse cataclysm that could have rivaled or surpassed the Great Depression."’ Article by Neil Irwin.

Coordinating individual behavior, particularly in a crisis, is difficult when individuals perceive that if they act cooperatively they put themselves at risk of incurring even greater losses if their partners do not reciprocally coordinate.[6] The narrative history of 1914 to 1950 is full of situations where coordination was possible, but not realized. European powers who began mobilizing in 1913 and 1914 understood that their actions would lead to predictable responses by other nations, but nonetheless they proceeded to pursue national agendas in the full realization of the potentially disastrous collective outcome (Keegan, 2000). After the war, the Allies were unable to coordinate on a policy that did not leave Germany prostrated, unable to recover, and incapable of meeting the international obligations imposed by the Allies. Despite efforts to ensure coordination, failure to coordinate on monetary and international currency and payments arrangements brought the system into crisis throughout the 1920s and into depression after 1929.[7] At the personal level, falling confidence in the liquidity of banks led depositors to panic and rush to withdraw their funds, leading to a liquidity crisis for all banks and the inability of many depositors to withdraw any funds. This was a primary cause of the waves of banking panics between 1930 and 1933 in the United States (Friedman and Schwartz, 1971).

Economists have spent a great deal of time understanding failures to coordinate over the last fifty years. Coordination problems are the primary preoccupation of game theory.[8] Mancur

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[6]The nub of the coordination/cooperation problem is the prisoner's dilemma game, but this context we are considering here is much richer, given the possibilities of repeated interaction and institutional mechanisms.

[7] Eichengreen, 1990, particularly pp. 113-153; 1992; Feinstein, Temin, and Toniolo, 2008, particularly pp. 48-51, 135-40, and 173-183.

[8]See Eichengreen, 1990, for an application of game theory to the problem of international financial coordination in the 1920s.

Olson (1965) studied the provision of public goods through voluntary associations. He left it to the coercive power of government to ensure the provision of public goods where private coordination could not suffice. But, as Olson and many others recognize, using coercion to enforce coordination entails many other dangers, including the kind of dangers that appeared between 1914 and 1945, when coercion alone was clearly not enough to ensure coordination.

Individuals and societies are justifiably concerned about turning to governments with coercive powers to solve coordination problems. One of the biggest obstacles to public support for government action is the rational fear that the government will use its powers to benefit some and harm others. In times of crisis, the ability of governments to coordinate individual behavior can be hampered by fears of unequal treatment. The process of expanding a government's ability to solve (or mitigate) coordination problems must involve ways to ensure that government treatment of individuals and subordinate governments that mitigates the fear of selective treatment that favors some groups, regions, industries, or interests over others. Governments must become capable of administering what we can call "impersonal" government policies. Essentially, impersonal policies treat everyone the same, although the concept is richer than that. One of the key elements in the New Deal was the ability to put the system of social welfare on an impersonal footing

The Olsonian fear of interests groups capturing government, amplified by the notion of rent seeking as a socially destructive activity, relies on treating different groups differently. Politicians and political groups in all societies, including constitutional democratic republics, inherently seek to treat people differently from one another, for differential treatment creates economic and social interests that can be used by political actors to secure coordination and bind coalitions together. There is nothing inherent in democratic politics that ensures impersonality. If the kind of social coordination that needs to occur to stem banking panics, for example, requires that individuals believe that they will be treated impersonally, then democratic politics will not naturally or inevitably supply the requisite impersonal policies and, as result, cannot supply coordination. Let me clear about this point: creating deposit insurance, for example, may provide the social coordination necessary to limit banking panics, but deposit insurance will not be feasible in a political economy sense unless people believe that the government administering the deposit insurance is capable of carrying out the policy impersonally. If some banks are "to big too fail" and the criteria for what is too big is not publicly transparent, then a democracy is unlikely to support such a policy *ex ante*. In fact, one of the serious problems with any deposit insurance scheme will be that it will not be impersonally designed or administered.

We can see this brilliantly illustrated in the current crisis. The public anxiety that a "too big to fail" criteria enabled the government to pick and choose who benefitted from emergency measures in the fall of 2008 and winter of 2009 (two different administrations, so pick your political party to blame) may seriously erode the government's ability to respond in a similar way in the future.[9] The real challenge for ongoing political decision making about economic policies is not whether they work or not, but whether they are perceived to have been politically biased, i.e. personal, in their administration.

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[9]Johnson and Kwak's forthcoming book, *13 Bankers*, is (apparently) based on the hypothesis that Wall Street financial firms have captured the government. The review quotation from Nouriel Roubini on Amazon.com is: "Essential reading for anyone who wants to understand what comes next for the world economy. Dangerous and reckless elements of our financial sector have become too powerful and must be reined in. If this problem is not addressed there is serious trouble in all our futures." *The Economist* review, March 18, 2010, pans the book.

Implementation of impersonal policies requires rules that are enforced in an unbiased manner. Some of these rules get embedded in what are essentially insurance programs. Social Security (the old age insurance part of the Social Security Act) and deposit insurance through the FDIC are the two most prominent programs that began in the 1930s in the United States. The main point of section IV is to show that Americans were doubtful that the national government could administer an impersonal relief/social welfare program, and they were right. The early national relief programs were not impersonal and were continuously subjected to claims that Roosevelt and the Democrats were "playing politics with relief." The Social Security Act moved relief onto an impersonal basis, and interestingly it was Congress, not the Roosevelt administration who did that.

Impersonal rules, both as general principles and specific laws, also frame impersonal policies. Here history really matters. The mere existence of domestic rules and laws or international agreements and organizations that mandate impersonal policies is not evidence that the actual political and economic dynamics have changed. Nonetheless, in the absence of those rules, laws, institutions, and organizations it is unlikely, even in democratic societies, that individuals will be willing to engage in the kind of social coordination necessary to lessen the negative outcomes that are produced in a crisis when individually rational behavior produces collective disasters.

The remaining sections of the paper tie the conceptual ideas about impersonality with the historical narrative. Section III presents some basic fiscal data about the United States in the 1930s and 1940s. Section IV examines the political process by which the United States came to adopt an impersonal social welfare system, and the way in which it is impersonal. Section V looks at the decisions made to involve the United States in the growing European conflict after 1939, but before the active military participation of the United States after Pearl Harbor and Hitler's declaration of war on the United States. Section VI returns to Europe after the war and America's decision to honor its domestic and international commitments. Throughout these sections an explicit counterfactual presented: what if the New Deal had never happened? The natural basis for such a counterfactual is American behavior in the 1910s, both before and after the first World War. The counterfactual is developed as the evidence is presented.

The final section sums up the argument, evidence, and makes the case that the New Deal played a prominent role in saving democracy and capitalism. If the major transformation of modern societies in the second half of the 20th century involved reducing the number and mitigating the effect of economic and political crises; and if the major institutional changes that accomplished that effect depended on a combination of insurance-like arrangements and formal rules and organizations that coordinate rather than coerce individuals and governments; and if the continued political viability of democratic republics that support free market economies was endangered by severe crisis like those seen in the early 20th century; then the New Deal played a central role in saving democracy and capitalism. The line of argument also suggests that we are likely to find that the "cost" of these arrangements was significant but unlikely to come up with a good measure of their benefits. Like a health insurance schemes, where a typical policy holder pays for a lifetime of premiums and then dies peacefully in bed, the benefits from the insurance are only apparent in a statistical sense. In the case of institutions that support greater social coordination, most of the benefits come in the form of costs avoided, and are intrinsically difficult to measure. Any attempt to draw lessons from the 1930s for the current economic crisis must keep this caveat in mind.

III. A statistical overview

The New Deal represents a change in the constitutional change in the fundamental allocation of responsibilities for different functions that governments can perform between the levels of government. One of the clearest ways to see the changing role of the national government is to look at fiscal data on expenditures. This is not the only way to appreciate what the national government was doing, but it gives a reliable overall picture. Until 1933, or fiscal 1934, national government expenditures rarely exceeded 4 percent of GDP in any years except war years and their immediate aftermath. Figure 1 shows total national government outlays as a share of GDP from 1900 to 1999, as well as detail for military expenditures and for social welfare.[10] The annual numbers on total outlays, military spending, and social welfare spending as a share of GDP are given in Table 2, as well as military and welfare spending as a share of total outlays.

The figure illustrates several important phenomenon. First, the impact of World War I and II are immediately apparent in the two spikes. Second, the peacetime size of the national government grew significantly from the early 1930s to the early 1950s. Third, since the early 1950s, national government outlays have fluctuated within a fairly narrow range between 18 and 22 percent of GDP (with a few years of 16 and 17 percent in the 1950s). There was no trend

[10] National social welfare expenditures at zero until 1933, then taken as annual expenditures for cooperatively administered relief programs from Wallis (1983) until 1939, and then taken as the OMB category of "human resources" which includes Social Security, Medicare, and Medicade as well as other welfare programs.

upward in national expenditures as a share of GDP from 1953 to 2008! Fourth, the composition of expenditures has changed gradually and persistently. In the 1950s, military expenditures were roughly 10 percent of GPD and welfare expenditures were roughly 5 percent, when together they accounted for about 80 percent of national outlays, column (5). The military share of expenditures has drifted downward, by the 1990s it was in the neighborhood of 4 percent of GDP, and the social welfare share has drifted upward, to between 11 and 12 percent of GDP in the 1990s. The two functions, however, account for between 75 and 80 percent of national outlays for the remainder of the century (and still did in 2008).[11]

It is not just that national government commitments to social welfare programs and military spending were very small prior to the 1930s and very large after the 1950s, but that there is very little else to explain in terms of the increased fiscal size of the national government. But there is a catch. Social welfare expenditures do not rise steadily from 1933 and defense spending (accounting for war time increases) does not rise steadily from 1945. Commitments were made to perform both these government functions at a much higher level, but plenty of time transpired between when the commitments were made and when the national government faced with the cost of honoring them.

The other important element is the changing relative size of the three levels of government. Figure 2 reports expenditure shares by level of government for the 20th century. The shares exclude military and interest payments by the national government. This is the

[11]The lowest the combined share of the two functions in total outlays since 1960 was 73 percent in fiscal 1991. In fiscal 2008 national defense and human resources account for 17.4 percent of GDP, out of total national government outlays of 20.7 percent of GDP (OMB numbers).

“domestic” side of government. Expenditures from grant programs are attributed to the receiving government, so national government grants to state and local governments are treated as a state and local, not a national, expenditures. The figure shows the sharp increase in the national government in the 1930s matched with a comparable decline in the share of local governments. The figure also shows a steadily increasing share of state government expenditures. The decline of local and rise of state expenditures suggests that more than a simple expansion of the national government took place in the 1930s.

IV. The New Deal, 1933 to 1939

When Franklin Roosevelt took office on March 1933, unemployment stood at 25 percent of the labor force. Over the previous three years, real income and the price level both dropped 25 percent, nominal income by almost 50 percent. The banking and financial system had ground to halt and stood on the edge of a complete collapse. Roosevelt immediately called an emergency session of Congress. In his first hundred Roosevelt and the new Democratic majority in Congress passed significant legislation affecting banking and finance, securities markets, relief (social welfare), business regulation, public utilities, and infrastructure investment. Many of these New Deal programs appear in other papers at the conference. In sheer fiscal terms and it direct impact on families and individuals, no program was more important than relief.

The history of the New Deal relief programs falls into two eras: from May 1933 to the summer of 1935, and after the summer of 1935. The periods are distinguished by the amount of administrative discretion exercised by the national government and the discretion remaining in the hands of state and local officials.[12] In the May 1933 the Federal Emergency Relief Act (FERAct) created the Federal Emergency Relief Administration (FERA), the largest and most important relief program up to 1935. Roosevelt chose Harry Hopkins as the FERA Administrator. The original act appropriated $500 million to be allocated among the states, half on a matching basis and half at the discretion of the administrator. It soon became apparent that the relief effort required a great deal more funding. Congress appropriated roughly $2 billion a year to be allocated between the states at Hopkin's discretion through a series of emergency acts. Once funds were granted, however, FERA funds legally became the property of the states. Hopkins attempted to raise the standards of relief administration, but his ability to do so was limited by the relative independence of state relief administrations. Hopkins could, and did, threaten to withhold federal grants for relief to states with corrupt, politically manipulative, or inefficient relief administrations. Withholding funds, however, was a blunt policy tool that worked to the direct disadvantage of the unemployed in the state, in contradiction to FERA's mandate.

In 1935, Roosevelt submitted an "economic security act" to Congress. As passed, the act provided a permanent, nationally administered program of old age insurance, what is called Social Security today. The act also provided for a national payroll tax for unemployment insurance programs run by the individual states; 90 percent of the payroll taxes paid in each state were held in trust for that state. Finally, the act provided relief for three categories of persons: old age assistance, aid to the blind, and aid to dependent children. The categorical programs

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[12] Table 3 provides a list of the major New Deal relief programs. Table 4 lists the average monthly number of cases receiving relief for the nation as a whole and for each of the major relief programs. I am not sure that these tables need to be in the final version of the paper.

were financed from general revenues and allocated among the state by strict matching grants. National grants to states were determined solely by state expenditures. It was the states, and not the national government, who controlled spending on the categorical programs. As a result, the welfare programs were distinctly "federal" programs, involving all three levels of government.

The second element of the 1935 reforms was the creation of an "emergency" relief program, funded by a series of ongoing emergency relief appropriation acts. Under the act of 1935, Roosevelt created the Works Progress Administration (WPA), and a number of smaller relief programs: the National Youth Administration (NYA), the Rural Electrification Administration (REA), the Farm Security Administration (FSA), and others. The WPA, also headed by Hopkins, was structured so that Roosevelt could make discretionary allocations between the states and, importantly, WPA officials retained the right to approve individual projects within states. The WPA became the largest public works agency, so infrastructure investment became part of the relief program through "work relief." The WPA also financed a number of nationally administered programs in the arts, theater, literature, and history that did not have state or local sponsors. After the summer of 1935, the WPA was the largest single relief program.

In fiscal terms, the relief programs were enormous. In fiscal 1934, just the national portion of relief expenditures were $2.1 billion at a time when GDP was $60 billion ($56 billion in 1933, $66 billion in 1934). Table 5 gives national government revenues and expenditures from 1929 to 1940, as well as expenditures on "cooperatively administered" programs and relief programs from 1934 to 1940. If we take Hoover's fiscal 1933 expenditures as a base line, nominal New Deal expenditures increased by $21 billion between 1934 and 1940, and relief programs alone account for $16 billion of the increase. In cooperatively administered programs the national government provided the funds but state and local governments actually administered the programs, including relief, public works and infrastructure, highways, and agricultural support programs. Cooperative programs account for $27 billion, more than the entire increase of New Deal expenditures over the level under Hoover.

It is hard to over state the effect this had on the American political system. The national government, who had previously played a major fiscal role only in times of war, was passing out $4 billion a year for relief, highways, bridges, other infrastructure, and farmers and almost all of the money went through state and local governments. There were no rules in 1933 for how the money would be spent, for there was no precedent for doing this. The relevant question for our question is whether New Deal funds were passed out in an impersonal manner? Did states need to worry that their tax dollars would end up in other states?

In the summer of 1933, it seemed pretty clear that states did need to worry. FERA's goal was getting the maximum amount of relief to the largest number of people, quickly, and with a minimum of administrative costs. The state and local share of relief expenditures varied from a high of 62 percent in Rhode Island to a low of 5.4 percent in Alabama. There was constant friction between FERA and state governments over the administration and financing of relief. Hopkins threatened to withhold FERA grants to several states that refused to increase state contributions. The disputes were significant in 12 states. He made good on his threat to withhold funds in Colorado and Missouri. Dissatisfaction with the way relief was administered led Hopkins to take over, or "federalize" the administration of relief in six states.[13] In North Dakota, Governor Langer was indicted and convicted for extorting kickbacks from federal government employees, although he wiggled out of serving jail time. In Ohio, Governor Davey had a feud with Hopkins over the administration of relief.

As the Social Security bill, put before Congress in January of 1935, moved forward, states and their representatives in the House and Senate acted to protect their interests against the national government's. They key provision that enabled Hopkins to manipulate the states under FERA was his discretionary control over the allocation of grants to the states. By the time the Social Security bill emerged from committee in the House, the discretionary power of the national administrator had been removed. All of the categorical welfare programs were funded by strict, closed end matching grants, and unemployment insurance trust funds were segregated by state. Congress imposed these restrictions on the Roosevelt administration. In addition, the Social Security Board, created by the act, was explicitly prohibited from interfering with personnel policies of the state administration or withholding matching funds because of

[13]The six states were Oklahoma, North Dakota, Massachusetts, Ohio, Georgia, and Louisiana. Federal officials federalized relief in Oklahoma on 2/23/34 when the governor announced that he would not apply for relief unless he had control over the distribution; in North Dakota on 3/1/34 as the result of charges that employees of the state relief administration were being assessed for political contributions; for work relief in Massachusetts on 3/7/34 because the state had a statute that all grants from the state had to be distributed on a population basis not on a need basis; in Ohio on 3/16/35 in a dispute over whether Ohio had supplied a fair share of relief funds; and in Louisiana (4/8/35) and Georgia (4/19/35) due to long-running disputes between the governors and federal administrators over the use of the funds. Hopkins withheld funds from Colorado in December 1933 and from Missouri in April 1935 until the state legislatures produced funds to help pay for relief. Threats to withhold funds went out to Alabama and Kentucky in 1933 and to Illinois in 1934. See E.A. Williams (193968, 170-8, 203-5).

personnel policies. Control over patronage in unemployment insurance and categorical relief programs was firmly located at the state and local level.[14]

In other areas national prerogatives held. There was a determined attempt to modify the old age insurance program from a nationally administered program in which every participant received benefits based on their contributions, no matter where they lived in the country when they worked or when they retired, to a publicly subsidized privately administered program. The administration was able to thwart attempts to decentralize the administration of old age insurance by judicious use of the $4.8 billion in relief funds placed at Roosevelt's discretion in the ERAA of 1935 in March. Roosevelt was intimately involved in the allocation of the ERAA funds. Every week Hopkins, Harold Ickes (the head of the Public Works Adminstration), and Roosevelt met to allocate funds between projects, in states and congressional districts throughout the country. The week after the Social Security Act passed, the remaining funds were allocated and the group stopped meeting (Wallis 1981 and 1991).

The Social Security Act was a compromise between the executive and legislative branches of government, but more importantly it implemented a new constitutional arrangement between the states and the national government that guaranteed two features of the new social welfare system. Old age insurance became a national program, administered in a completely impersonal way. Individuals and employers made monthly contributions and beneficiaries received the same benefits no matter where they lived or worked. In contrast, relief between 1933 and 1935 had been administered by local and state governments and typically based on an

[14]For detailed consideration the Social Security Act and its adoption, see Wallis (1981, 1991).

assessment of need. As a result, every relief case received a monthly benefit that was subject to change. Old age insurance would be completely impersonal.

The administration of the remainder of the relief/welfare programs – unemployment insurance, aid to the blind, old age assistance, and aid to dependent children – not only remained with the state governments, but were administered under a set of financial arrangements that prevented the national government from exerting fiscal pressure on the states. Welfare administration was also "impersonal," only it was the states that were treated impersonally not the individual recipients. States were free to set their own welfare administration and standards, subject to oversight by the Social Security Board.[15] The result was a wide variety of benefits and programs across the country, and an ongoing debate for the remainder of the 20th century over the nature of welfare in the states.

There was nothing inevitable about these administrative arrangements, they could have been significantly different. When the Roosevelt administration began spending $2 billion a year on relief the political benefits of doing so were immediately apparent, but how the political benefits were to be distributed within the political system wasn't clear. A nationally funded system with very little discretion for national administrators to use for political purposes eventually emerged. Democrats in Congress managed to have their cake and eat it too. They designed a permanent social welfare system controlled by the states and a old age insurance system with impersonal benefits, at the same time that they gave their party leader, Roosevelt, control over a $4.8 billion war chest to influence current politics. It was a neat solution to a

[15]For the importance of patronage in the administration of relief, particularly in the south, see Alston and Ferrie (1999).

difficult problem.

Few people in the 1930s thought that politics had been taken out of the administration of social welfare, indeed the solution that emerged in the Social Security Act was deeply political, but the system did remove the day to day manipulation of public funds for political purposes. Economic historians have devoted a great deal of attention to answering this question of whether Roosevelt played politics with national grants to the states. The literature began with Arrington (1969, 1970, 1983) and Reading's (1973) investigations, and was redirected by Wright's 1974 paper that explicitly introduced measures of "political productivity." Many others had followed, including myself.[16] Most of this work focuses on the statistical effect of political variables versus the effect of economic variables on the allocation of national grants between the states between 1933 and 1940, or the allocation of national grants between counties for the entire decade. Interest in these kinds of questions endure because of the possibility of showing that Roosevelt and the Democrats were disingenuous when they professed to desire "relief, recovery, and reform" when in fact they were simply motivated by getting re-elected. This literature does not result in an explanation for the New Deal, but only an inference about the motivations behind New Deal allocations.[17]

The problem with testing for "political" effects by examining the statistical effect of

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[16]For a sampling see Anderson and Tollison (1991), Wallis (1984, 1987, 1991, 1998A, 2001), Wallis, Fishback, and Kantor (2006),Fishback, Kantor, and Wallis (2003), Fishback, Horrace, and Kantor (2005, 2006), Fleck (1999A, 1999B, 2001A, 2001B, and 2008), Bateman and , Shughart, etc. [needs to be filled in].

[17]The work of Fishback and Kantor, along with several co-authors cited in the previous footnote, is asking much more substantial questions about the effect of New Deal programs on the economy and society in the 1930s. Fleck (2008) is the only serious attempt to say that the New Deal resulted from the pattern of political benefits at issue in this literature.

“political” variables is that even if politics had played no role in the allocation of New Deal spending between the states, th does not imply that the administration and structure of relief, public works, and agriculture did not have significant political effects. In the early days of the New Deal, the federal relief administrator, Harry Hopkins, was disbursing $2 billion a year to state governments. Roughly one-fifth of American families received a cash payment from the government every month. Congressmen, governors, and politicians at every level wanted to get their hands on some of that money. There was no apolitical alternative, no way of passing out relief funds or public works funds that had a neutral impact on politics. An allocation formula based on the number of unemployed, the number of relief cases in the previous quarter, per capita income, wages, or any other economic variable still had political ramifications.

The fundamental accomplishment of the New Deal political economy, was to accommodate these political forces within an institutional structure that balanced competing interests at the state and national level, administered old age insurance in a way that was truly impersonal (although Congress returned again and again to the level and structure of social security benefits and taxes), and a relief administration that was widely regarded as not corrupt.[18] Unlike the early days of the New Deal, when Hopkins possessed the discretionary power to coerce states, under the Social Security Act the national relief administration possessed the power to coordinate the states. The United States had moved from being a laggard in the provision of social welfare services when compared to European countries to more active (if still limited) government involvement. By doing so, for the first time in American history, the perception that the national government could not provide a wider range of public services in a

[18]For the last point see Wallis, Fishback, and Kantor (2006).

legitimate way began to change.

In a counterfactual world without the New Deal, the national government does not get involved in social welfare programs. The Social Security Act is not passed. FERA and WPA do not some into existence, so the national government budget grows slightly, but not nearly to the extent it did. Public works investment continues, but on a smaller scale than actually accomplished in the 1930s.

V. The Impending Crisis, 1939 to 1941

In 1937 the New Deal reform efforts slowed. The scope of the relief and public works program was reduced, national government expenditures declined by $1 billion from fiscal 1937 to fiscal 1938, relief expenditures declined by $350 million (Table 5). Rather than bounding ahead, the economy reacted to the fiscal contraction and tightening of monetary policy with the Roosevelt recession of 1938: GDP fell from $91.9 billion in 1937 to $86.1 billion in 1938. Faced with the realization that the New Deal had not brought economic recovery, expenditures on relief and other cooperative programs reached their highest level of the decade in fiscal 1939.

By 1939, however, the growing crisis in Europe captivated the attention of Americans, both those who dreaded the possibility of another American involvement in a European war and those who feared that a free and democratic Europe would fall without American involvement. Until Pearl Harbor and Hitler's declaration of war on the United States, the extent of American involvement in the Allied war effort hung in the balance, constantly debated, and continuously an issue between internationalists and isolationists who appeared to be represented equally in Congress. Given the reluctance of the United States to be drawn into World War I and its withdrawal from international coordination efforts after the war, it was not a sure thing that America would be drawn into the European conflict. Whether the New Deal increased or decreased the probability that the United States would go to war is not the question here. Rather we have to ask whether the New Deal affected *how* the United States went to war. The counter factual question is how would the United States have approached the conflict in Europe and the requests from British and Russians for assistance had the New Deal not occurred? The answer depends on how we interpret the events leading up to December of 1941, for it was in that period that commitments were made that shaped both the conduct of the war and the post-war international order.

Roosevelt played a key role in shaping American policy, so much so that a great deal of what has been written about the coming of the war focuses primarily on the personality and ideas of Roosevelt (and Churchill and Stalin). Roosevelt, however, was constrained not only by the opposition of isolationists, but by a long history of popular suspicion of "the insidious wiles of foreign influence" (George Washington), "entangling alliances" (Thomas Jefferson), down to a view that the first World War had been fought "not to make a world safe for democracy but to make it safe for Wall Street bankers and grasping arms manufacturers. The American public had been duped by British propaganda, and Woodrow Wilson had been trapped by his stubborn Presbyterian moralism and slavish, unrealistic devotion to the principle of "neutral rights." The only winners [in WWI] were the "merchants of death" – the financiers and munitions-makers who harvested obscene profits from the war. Ordinary Americans had no appreciable interests at stake in 1917, so the argument ran, and the country should have stayed out of the fray. The indictment was grossly overdrawn, but it fell on receptive ears, especially in the antibusiness atmosphere of the Great Depression." (Kennedy, 1999, pp. 386-7) There was a widely shared fear that international coordination and cooperation was a game for dupes and easy marks, and the interests that profited from an American entry into the European conflict were not all international. Just as relief policy was not shaped by Roosevelt and Hopkins alone, America's approach to the war was the result of the entire nation's concern that international coordination posed serious dangers to the country

In both the 1932 presidential campaign and the years leading up to 1935, Roosevelt had disavowed his internationalist roots and his support for the League of Nations. He sided with the isolationist position articulated, for example, by the Senate's Special Committee Investigating the Munitions Industry chaired by Senator Gerald Nye. As war in Europe spread, Roosevelt needed to redefine his public image in a consistent way with the shared concerns of many Americans about foreign entanglements. The New Deal offered a way to do that.

The idea that the New Deal provided a language and a framework for envisioning a new world order has been explored by the historian Elizabeth Borgwardt (2005). Borgwardt's goals are much loftier and philosophical than this essay, to show how the New Deal contributed to the notion of human rights for everyone, but she draws on two elements connected directly to the picture of the New Deal laid out in the previous section. One is the language of the New Deal. From Roosevelt's proclamation that we have "nothing to fear but fear itself," to the commitment to "relief, recovery, and reform," to the close association of economic security and political rights, and to the four freedoms Roosevelt articulated in January of 1941"freedom of speech and expression, freedom of religion, freedom from want, and freedom from fear" the New Deal created a vocabulary that tied individual and social welfare and security to larger issues of political and social organization. Borgwardt calls this the "New Deal Idiom."[19] The New Deal forged a rhetorical as well as a substantive link between social welfare and security that was available for Roosevelt to use in 1939 and later.[20]

The connection was substantive because the New Deal delivered on social welfare between 1933 and 1939. "The New Deal shaped American perceptions of the capacity of the central government to tackle seemingly intractable problems with large-scale institutional solutions. America's participation in the war also consolidated a national identity as a problem-solving, 'professional,' a pragmatic player on the world stage." (Borgwardt, p. 77) We have already seen the New Deal's ability to structure new institutional solutions to difficult problems. The New Deal innovations were the result of flexibility and ingenuity in structuring relationships within institutions, in particular with respect to the nature of administrative rules and administrative discretion. Both Congressional and the public were wary that too much discretion raised the danger of political motivations intruding into public policies.

Undoubtedly Congress appreciated the subtleties of rules and discretion to a much finer degree than the public, as when they transferred discretionary power over the funding of categorical relief programs to the states in the Social Security act by instituting rules requiring

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[19]One of the great collections of basic information on New Deal relief programs in the 1930s was published by the National Resources Planning Board (1943) and is entitled "Security, Work, and Relief Policies."

[20]"For policy makers, the lessons of the New Deal response to the Great Depression were twofold: first, that there was connection between individual security and the stability and security of the wider polity; and second, that government had "an affirmative responsibility" to help individuals achieve that security. After World War II broke out in Europe in 1939, these lessons were readily extrapolated to the international level by aides in the executive branch as well as by State, War, and Treasury Department planners, many of whom had served as New Deal administrators themselves." Borgwardt, p. 78.

strict national government matching. Congress, isolationist and otherwise, wanted to use a mix of rules and discretion to constrain Roosevelt's foreign policy options. In 1933, the Johnson Act prohibited the national government from making loans to foreign governments that were in default on their existing obligations to the U.S. Treasury. The Johnson Act severely constrained Roosevelt's efforts to get American aid to Hitler's enemies later in the decade. The series of Neutrality Acts passed in 1935, 1936, 1937, and 1939 also contained a mix of rules and discretion that attempted to limit Roosevelt's option when dealing with allies and enemies. The details of the Neutrality Acts were important, since different rules created different outcomes. The Johnson Act prohibition on loans to defaulters struck at France, Britain, and Germany. "Cash and Carry" provisions, on the other hand, favored France and Britain (while they had cash), but unfortunately cash and carry also favored Japan over China.

Roosevelt had a keen interest in maintaining the Neutrality Acts, for they were visible assurance that he and his administration were not rushing headlong into another global war. At the same time he continued to work with, and sometimes against, Congressional interests to obtain the rules and discretion that enabled him to forward American support for the Allied cause. The nature of public opinion required, indeed forced, Roosevelt to craft a nuanced public position. The war effort couldn't be based simply on the idea that Americans were against Germany, Hitler, and Japan. As with social welfare policy, the national government had to formulate a policy that represented the war effort as an effort to change the world, an effort which enabled social coordination by assuaging doubts that cooperators would be fleeced by non-coordinating partners. This was a real domestic constraint on the international options the American people would support, and what they were willing to support had been conditioned by their experience in during the New Deal.

I do not wish the belabor the point, but I want to make it clear. The New Deal did institute a larger role for the national government in the provision of social welfare. But not just any social welfare program could have succeeded. The system in place under FERA in 1933 and 1934 was unsustainable outside of emergency conditions, so probably was the administration of the WPA. The impersonal guarantees embedded in the Social Security Act, both for individuals and states, were critical elements of the acceptance by Congress, the states, and the public. In exactly the same way, not just any call for American involvement between 1939 and 1941 would have garnered public support. Can we see a similar set of institutions at work between 1939 and 1941?

Roosevelt and the Americans weren't offering Churchill and the British a set of matching grant formulas in 1941. But it wasn't the British, or the Russians or Chinese, that needed to be convinced about the viability of new international institutional arrangements, it was Congress and the American public needed to convinced. For Churchill and Stalin, American participation in the war effort was a matter of national survival, ideology and promises for the long term were easily negotiable. For Roosevelt, American participation was not a matter of national survival because the American people did not feel that it was.[21] How then could the American people

[21]Hans Morgenthau makes the point about Roosevelt, Churchill, and Stalin this way: "In other words, for Churchill and Stalin the Second World War was the instrument of a foreign policy whose objectives had existed before the outbreak of hostilities, and were bound to continue to exist when the war had come to an end. For Roosevelt, as has been pointed out in another context, the war was an end in itself, its purpose exhausted with total victory and unconditional surrender. Churchill and Stalin knew that they were fighting for the perennial interests of their respective countries, for which Pitt and Castlereagh, Peter the Great and Alexander I had fought. For Roosevelt, as for Wilson before him, the war was being fought for universal humanitarian ideals, this time formulated in the Four Freedoms and the Atlantic

trust any arrangements made by Roosevelt with Churchill, much less Stalin?

Two elements were central. In 1933, when state and local governments were in deep financial distress the national government was, temporarily, in a position where it could set the agenda. In 1940 and 1941, the United States was in the same position vis a vis Britain, Russia, and the other Allies. The Allies made such large demands on the material resource of the United States that Roosevelt could reasonably ask for concessions on ordering the post-war world. The first formal statement of their plans came as a joint communication issued by Roosevelt and Churchill after their meeting in August of 1941. The "Atlantic Charter" (appendix I), was in form a "New Deal for the world." The Charter read like a New Deal document: "Fifth, they [the UK and US] desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement and social security; and Sixth..., they hope to see established a peace which will afford to all nations the means of dwelling in safety within their own boundaries, and which will afford assurance that all the men in all the lands may live out their lives in freedom from fear and want."

During the New Deal language such as this had produced real, concrete, national government institutions that for the first time in American history tried to guarantee freedom from fear and want. Conditions like 1941 would not persist forever. Americans could not believe that their Allies would always hold firm to their promises, but could they believe that their own national government could honor these promises? Could Americans believe that their

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Charter, yet, as before, unrelated to the concrete distribution of power which the United States had a vital interest in creating after the end of hostilities." (1952, p. 97) You can see in the passage the personalization of Roosevelt's foreign policy, but the need for Roosevelt to package his war plans in a manner acceptable to the public motivated the call to universal ideals.

government would use its position in international affairs to push for the formation of concrete institutions that would create the possibility for coordination of international behavior with respect to economic, political, social, and human rights problems?

The American experience under the New Deal, therefore, was the second important element in 1941. The critical counterfactual question is not whether the Americans would have entered the war at the end of 1941 after Pearl Harbor and Hitler's declaration of war, lets assume they would have. The question is whether Americans would have believed that their government would conduct war and post-war policy in a way that created institutions that enabled a greater degree of credible coordination in the post-war world, had it not been for the New Deal. Would Americans were willing to follow up those commitments with real institutions and rules, even at substantial costs to themselves? We'll consider some of the costs in the next section, but there was real concrete progress immediately, even before Pearl Harbor.

Roosevelt articulated the four freedoms in the state of the union address in January of 1941; the Atlantic Charter was issued in August of 1941; and then Pearl Harbor forced the U.S. into the active war. Almost immediately, in January of 1942, the Allies issued the "Declaration of United Nations Proclamation" (appendix II), signed by Russia and China as well as the U.S. and U.K., that committed the allies to "a common program of purposes and principles embodied in the Joint Declaration [the Atlantic Charter]." As war preparations and execution moved forward, so did planning for a set of international institutions, culminating in the Bretton Woods conference in July 1944 that led to the creation of the IMF and IBRD (World Bank), and the Dumbarton Oaks conference in August to October 1944 that led to the creation of the United Nations. There was nothing inevitable about any of these developments, similar efforts at establishing multilateral institutions after the first World War were mortally weakened by the unwillingness of the United States to participate.

The New Deal changed that willingness. Not only was the United States, reluctantly, participating in international coordination, the United States had a plan and a vision for how the coordination should be structured. “... the domestic origins of the specific contours of the postwar international order lie in the historical experience of one liberal state: the United States during the New Deal. By 1941, having finally accepted that the United States could not effectively isolate itself from the world, U.S. policymakers determined instead to remake the world in the American image.” (Burley, 1993, p. 129)[22] The image the U.S. sought to impose on the world after 1941 was the American world that emerged after 1933. The New Deal was more than the image for the new world, it was the rationale for the new world.

VI. Post-War Coordination and Commitments, 1945 to 1953

The New Deal altered the constitutional structure of American government by changing the relationship between national, state, and local governments, even though the written national constitution was not amended. The New Deal was designed to create a new form of federal government, in which national, state, and local governments would have redefined roles. Social welfare and public infrastructure (with the exception of old age insurance) were explicitly

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[22]“In a unique moment of history after World War II, the United States found itself with an unprecedented power to create rules and organizations- international regimes-that laid down a global framework for international relations while protecting American economic and security interests. Largely because of U.S. enthusiasm, such international regimes as the United Nations, the International Monetary Fund (IMF), the World Bank, and the General Agreement on Tariffs and Trade (GATT) were born. Amid this burst of institutional creativity, publicists spoke of entering "the American Century." Keohane and Nye, 1985, p. 148.

federal programs. Old age insurance, financial regulation, and the expanded role for the military were national programs. Rather than consolidation of government at the national level, the New Deal worked towards closer integration and coordination of the parts of government. Americans feared consolidated national government and had, since the Articles of Confederation, attempted to structure inter-governmental arrangements in order to capture the benefits of coordination without knuckling under to a powerful central government.

Much the same problem faced the international community on the eve of both World Wars. In 1914 and 1919, attempts to coordinate failed. In 1941 and the war years, a group of multilateral international institutions were created with substantial bureaucracies, but little in the way of discretionary ability to coerce their members. It may be argued that an institution like the IMF possess the power to coerce small countries in need to follow its policies, but countries always have the option of not taking IMF aid (or World Bank aid, etc). One of the key constitutional ideas underlying the New Deal was the ability of the national government could offer grants to the state conditional on state behavior, like matching state funds. States, in turn, were free to turn the conditional grants down if they wished, but the requirement that the national government offer the same terms to every state was the administrative twist that cemented the political economy of the New Deal programs. [23] The ability to exert fiscal coercion

[23]The key constitutional interpretation was the Supreme Court decision Massachusetts v. Mellon, in 1923, which found that a matching grant from the national governments to the states to support maternal health programs, did not usurp the sovereign powers of the state of Massachusetts because the state was free to turn down the money: "
First. The state of Massachusetts in its own behalf, in effect, complains that the act in question invades the local concerns of the state, and is a usurpation of power, viz. the power of local self-government, reserved to the states. Probably it would be sufficient to point out that the powers of the state are not invaded, since the statute imposes no obligation but simply extends an option which the state is free to accept or reject." (Justice Sutherland, 262 US 447 (1923)). For an

was the difference between FERA in 1933 and the Social Security Act in 1935. The same kinds of administrative structures, conditional coordination rather than coercion, became an integral part of the international organizations that arose in the early 1940s (even if they were often incapable of treating every nation exactly the same).

Simply making promises and forming organizations was not enough to change the world. Would the United States honor its promises, both foreign and domestic? We can evaluate the answer on two dimensions, policy and fiscal.

The physical production capacity of Europe after the war occurred much more rapidly than the recovery of the economic and political systems. Exactly how nations in Europe would choose to organize themselves and the extent to which they would cooperate with each other was very much an open question. "The future of the price system, the financial system, the trading system, and even the private property rights system was now fundamentally in doubt. As the Oxford don Thomas Balogh sweepingly put it, the war had 'smashed the delicate balance of the nineteenth-century world economy and undermined the fundamental basis of Western European existence.'"[24] Europe was teetering, part went communist and socialist, another part remained democratic and capitalist. It depended on how economic, political, and social arrangements worked themselves out.

Eichengreen suggests that Europe faced four difficult problems after 1945. First,

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interesting discussion of how the interaction of state and national coordination played out in the Sheppard-Towner act, which was the policy at issue in Massachusetts v. Mellon, see Moehling and Thomasson (2009).

[24]The quotation is from Eichengreen (2007, p. 53) and the interior quotation from Balogh (1949, p. 1).

financing the importation of capital equipment needed to replace industrial capacity and bring American technology into Europe. Second, to dismantle the network of wage and price controls that were retained from wartime and were being used to "direct labor and raw materials as a way of maintaining the production of key commodities." Third, to resolve fundamental uncertainty over the direction of policy. Communists occupied positions in the French and Italian governments, the British Labor government contained a number of radical individuals, and the German Social Democratic Party advocated the nationalization of industry and the retention of price controls. Which way would European governments move? Finally, there were pressing questions about whether coordination within Europe, both domestically and internationally, could be used to ease these problems.[25] As in the discussion of the United States, the appropriate word was not consolidation, but integration

These were problems that Europe had to solve for itself. The United States could not impose a new order, but it could help coordinate one. The Marshall Plan, involving $13 billion in assistance to European governments between 1948 and 1951, was evidence of the United States willingness to fulfill its war time commitments. Marshall plan funds were not enormous, a bit more than 1 percent of U.S. GDP from 1948 to 1951, and perhaps not a much higher share of GDP in the receiving countries. What Marshall Plan funds enabled was a greater degree of coordination within and between European countries.

Again, as Eichengreen suggests, the Marshall Plan helped Europe address each of the four major problems. First, it eased the external constraint. Europe's trade deficit from 1948

[25]Eichengreen (2007), particularly the material in chapter 3, pp. 52-85. The quotation about price controls is from page 61.

through 1950 was $11.5 billion, roughly matched by Marshall Plan grants of $10 billion in those years. The grants enabled Europe to import materials and machinery that otherwise would have required substantial international monetary adjustments. Second, the Marshall Plan enabled European governments to reduce fiscal pressures and reduce inflationary pressures, which enabled them to phase out price controls. Third, the Marshall Plan “tipped the balance of political power towards centrist parties. U.S. officials such as Dean Acheson..., made clear their reluctance to favor Socialist governments with aid.” This was not a formal conditions of the grant, but the Plan strengthened the position of political moderates. “A final effect of the Marshall Plan was to encourage European integration. American aid was contingent on agreement by the recipients on a collective strategy for using U.S. funds. The Marshall Planners saw their initiative as encouraging the formation of a ‘United States of Europe’ whose close economic and political relationships would make war unthinkable and would constitute a united front against the Soviet Union.”[26]

The American role in post-war Europe was not to take on the entire burden of financing recovery. It was, as the agreements reached in 1941 presaged, to play an active role in the formation of institutions that enabled greater coordination and cooperation within Europe. Should anyone doubt the use of the New Deal template in Europe, simply remember the alphabet soup of New Deal agencies and compare it with the even richer broth brewed in Europe in the late 1940s and early 1950s. Whether any of the new international or intra-European organizations actually made the economy of Europe and the western world grow faster is certainly a wide open and unanswered question. What seems clear, however, is that the

[26]Eichengreen (2007), pp. 65-69, quotes from p. 67 and 69.

organizations were designed to permit integrated coordination of government policies in order to respond to potential and actual crises in ways that did not make the situation worse.

How committed were Americans to these arrangements? Table 2 provides some important and interesting evidence on the share of GDP devoted to military and to social welfare programs by year. By fiscal 1948, the size of the national government expenditures had fallen back to the level of the late New Deal, 11 percent of GDP, 3 percent on military and 4 percent on social welfare. But then the commitments came home to roost. Military expenditures (including Marshall Plan funds) increased from 3 to 5 percent, and then jumped to 7 and 13 percent in 1951 and 1952 with the Korean war and did not fall much below 10 percent into the 1970s. Social welfare expenditures (including veterans benefits) fluctuated between 3 and 4 percent of GDP until the late 1950s when they began to rise as the commitments made in 1935 to provide old age and disability insurance came on line and began to expand. In the 1960s military expenditures would remain high, and social welfare expenditures would continue to grow (Figure 1). America's New Deal commitments were honored, and the world changed.

VI. Lessons

Did the New Deal save democracy and capitalism? The argument presented here follows the answer to Huntington's question about why the modern world has become more stable and entails two assumptions. First, is the assumption that the stability of the modern developed world is a function of moderating the negative effects of crises, rather than bolstering the economic and political performance of societies in normal years. The threats to democracy and capitalism that shook the modern Western world to its foundations in the 1920s and 1930s had their roots in the inability of polities and economies to adequately coordinate their responses to crises. The second assumption is that the ability to coordinate, both within and across nations, is predicated on the credible belief that individuals or nations who act in a coordinated way will not be taken advantage of. This requires the existence of demonstrably effective institutions capable of coordinating political actions and policies that are, to a large extent, impersonal. This paper has not attempted to validate those assumptions, but use them to understand why the modern world has looked so much different in the 60 years since 1950 than it did in the sixty years following 1890.

The economic and political history of the world from 1914 to 1941 is filled with incidents in which failures to coordinate led to war and economic crises, and continued to make crises both deeper and longer lasting. The evocative phrase "beggar thy neighbor" captures the individual and national rationality that led to decisions that produced collectively disastrous outcomes. We can, with Feinstein, Temin, and Toniolo agree that "The lesson of Versailles had been absorbed: a sufficient degree of international coordination and cooperation had to be established if stability and prosperity were to be achieved," but that leaves us short of an explanation of how the lesson was implemented. How were arrangements devised within and between countries to alter the incentives of individuals and nations to coordinate in a crisis?

American political history is dominated by the ingrained fear that the democratic process does not automatically produce cooperative behavior that is reciprocated. This is not just true in international affairs, but within the boundaries of the United States and, even, within the boundaries of individual states, counties, and cities. What is often unappreciated, is that this is not simply a fear about the size of government, about big government, or about the national government, but these are really fears about the coordination process. As Guy Callender explained over a century ago (1902), when Americans believe that the coordination problems have been solved, they are more than willing to use their governments (although he uses a different vocabulary to state the proposition). In the simplest terms if those who benefit pay, and those who lose are compensated, Americans are willing to use their governments to tackle problems. FDR famously captured the essence of the phenomenon when he was asked about the economics of Social Security payroll taxes in 1941:

> In the course of this discussion I raised the question of the ultimate abandonment the pay roll taxes in connection with old age security and unemployment relief in the event of another period of depression. I suggested that it had been a mistake to levy these taxes in the 1930's when the social security program was originally adopted. FDR said, "I guess you're right on the economics. They are politics all the way through. We put those pay roll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program. Those taxes aren't a matter of economics, they're straight politics."[27]

When Roosevelt and the Democrats came to power in March of 1933 and decided to experiment with the provision of social welfare services on a wide scale, there was no experience in American history that would suggest that they would do so fairly and impartially. In fact, the first two years of relief under FERA and Hopkins were plagued by the politics of relief, although perhaps not the way modern scholars see politics in the allocation of grants between the states.[28] Since the national government had discretionary control over the allocation of grants to states,

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[27]The quotation is attributed to Luther Gullick, who was working on a study of federal, state, and local fiscal relationships when he talked to FDR in 1941. See DeWitt (2005).

[28]The evidence seems to be fairly clear that relief spending was the least politicized of all the New Deal grant programs, and adhered most closely to the goal a relieving the unemployed, Wallis, Fishback, and Kantor (2006).

the relief administrator possessed the ability to coerce states to cooperate. These problems were solved by an institutional design that worked through allocating discretion and rules in a way that created a more integrated government structure. The Social Security institutions were ones in which the center coordinated the state through positive incentives rather than fiscal coercion, and the states had credible guarantees of independence because they controlled the purse strings.

This solution had two implications:

1) The United States found, for the first time in its history, a confidence that the national government could undertake large projects and produce a set of roughly impersonal outcomes.

2) The institutional pattern of coordination rather than coercion, as a way to institutionally address the problem of security, both personal and social, led to an agreement within the U.S. in the 1930s, and between the U.S. and its Allies, first Britain, then the Soviet Union, and then much of the rest of the world in the 1940s, to adopt similar kinds of institutional arrangements both in and after the war.

Point 1) seems hard to believe in 2010, when the American national government is the largest and most powerful government in the world. But the numbers don't lie. It was not until 1933 that the American public and their elected representatives in Congress and the Presidency were willing to let the non-military part of the national government spend anything approaching 1 percent of GDP.[29]

Point 2) seems obvious in retrospect. If you cannot get sovereign powers to coordinate through mutual interest, then you are stuck with the threat of coercion to create coordination.

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[29]See Wallis and Weingast (2005) for a detailed discussion of why the national government was unable, despite constant attempts, to invest in transportation before the Civil War.

Bilateral coordination, coercive or not, is fraught with all kinds of problems. The rise of multilateralism in the post-war world is associated with the active engagement of the United States in the international community. As John Ruggie suggests, there was something important about America: "looking more closely at the post-World War II situation, for example, it was less the fact of American *hegemony* that accounts for the explosion of multilateral arrangements than of *American* hegemony." (1993, p. 8, emphasis in the original). Multilateralism requires a willingness to participate in a social relationship in which not every pair of partners gains from their specific relationship.[30] Support for these kinds of relationships was precisely what the Social Security Act solution achieved for state governments: they all had enough discretion to ensure that, as individual states, they benefitted from participating in the social welfare system, without worrying about whether they were getting a better or worse deal from some other state or, vitally important, whether their cooperation was being abused by other states or the national government.

Extension of that New Deal model to the wider world has not produced a perfect world, any more than the social welfare system in the United States is perfect. It has costs, and perhaps over any short period of time the costs may not generate any apparent benefits. But if the primary gain from cooperation comes from avoiding crises, then perhaps we shouldn't be surprised if such programs are continuously under attack for being inefficient, while the societies that employ them are growing more steadily than any societies in human history.

[30]Keohane (1986) calls this "diffuse reciprocity."

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Figure 1

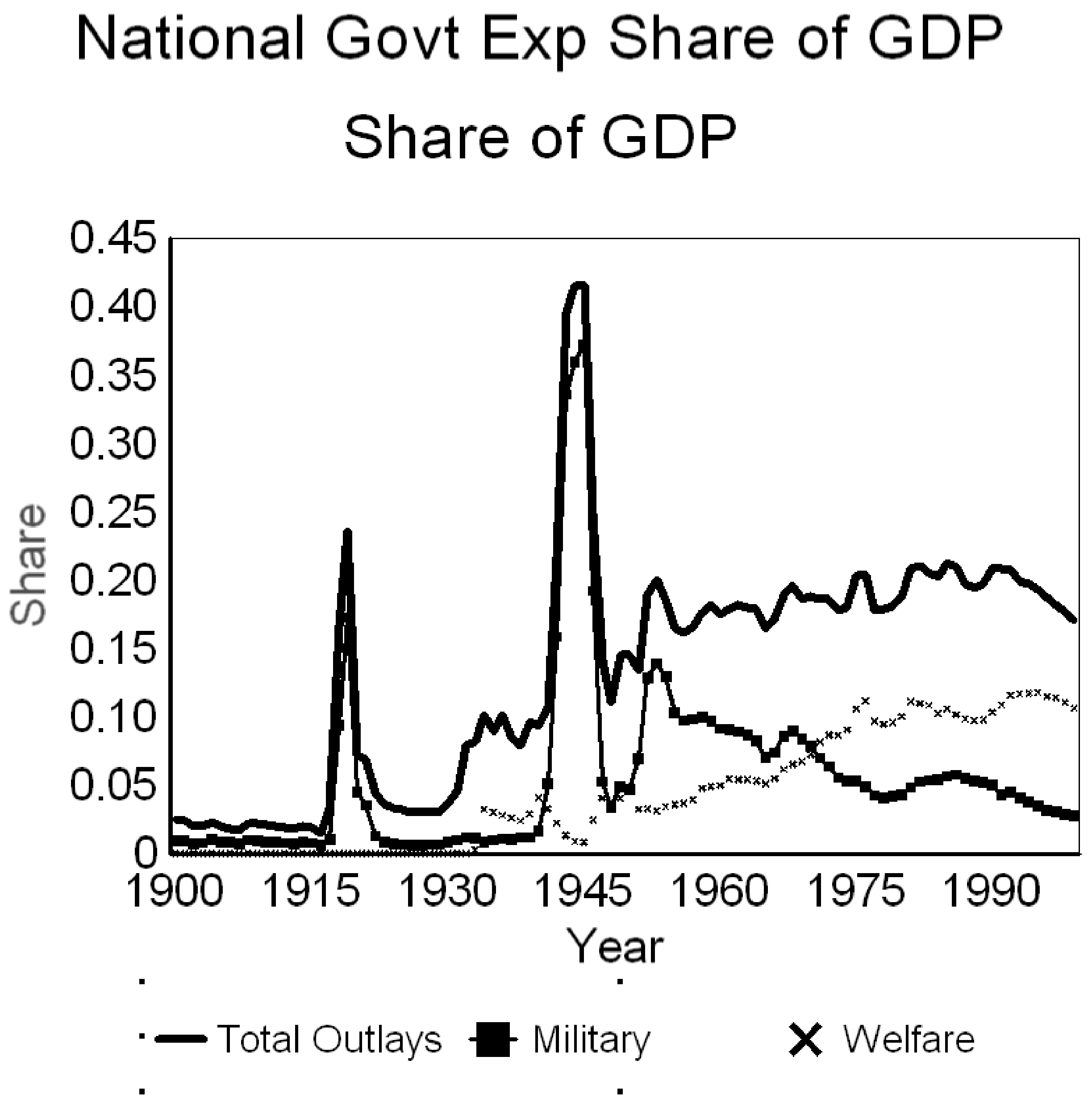
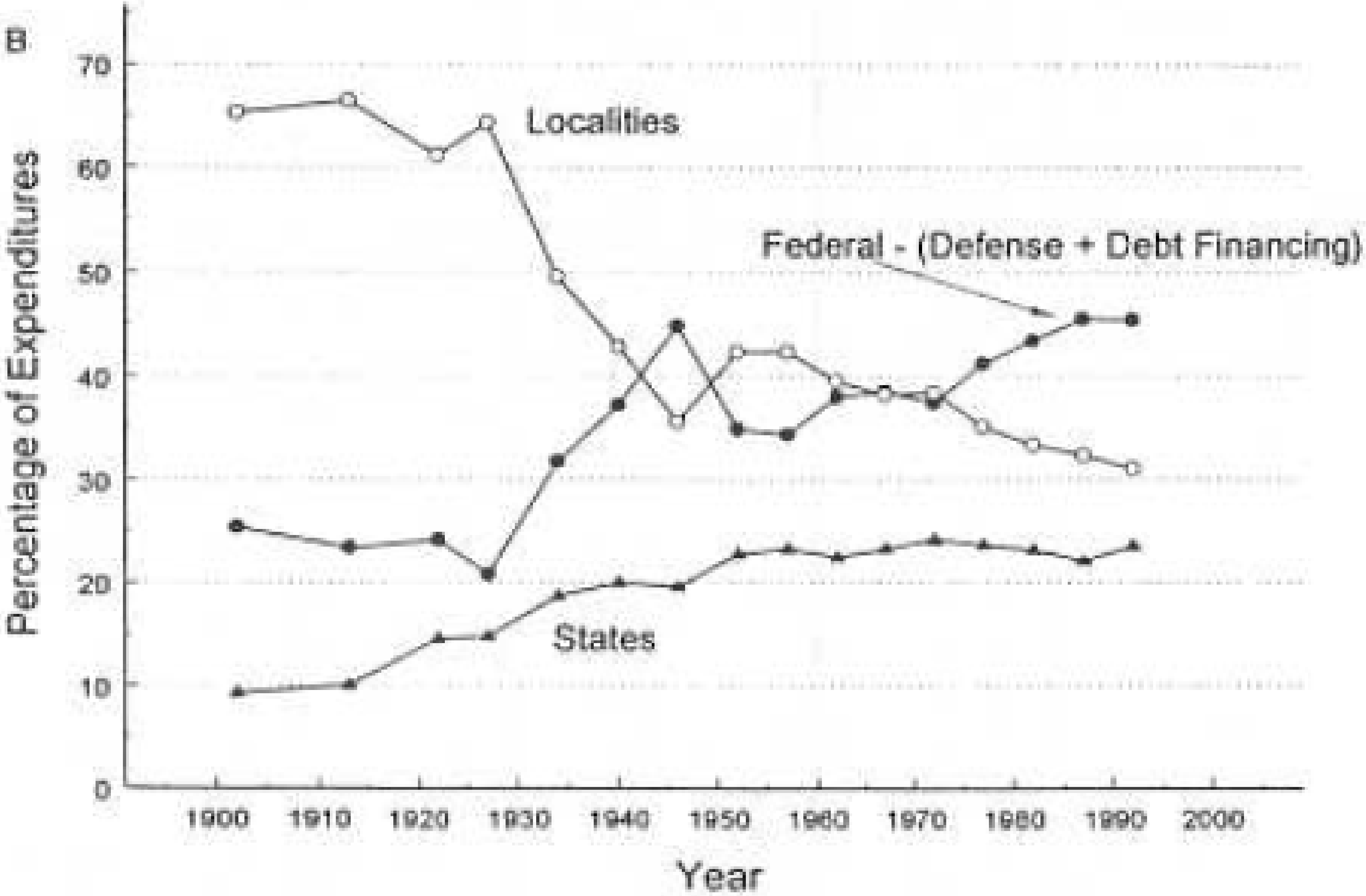


Figure 2



From Wallis and Oates, 1998.

Table 1
Growth Rates in Good and Bad Years
By Per Capita Income in 2000

	Per Capita Income in 2000	Number of Countries	Percentage Of World Population	Number of Years Observed	Percent Positive Years	Average Positive Growth Rate	Average Negative Growth Rate
(1)	Over $20,000	27	13%	1,336	84%	3.88%	-2.33%
(2)	Under $20,000	153	87%	5,678	66%	5.35%	-4.88%
(3)	$15,000 to $20,000	12	2%	491	76%	5.59%	-4.25%
(4)	$10,000 to $15,000	14	2%	528	71%	5.27%	-4.07%
(5)	$5,000 to $10,000	37	16%	1,245	73%	5.25%	-4.59%
(6)	$2,000 to $5,000	46	53%	1,708	66%	5.39%	-4.75%
(7)	$300 to $2,000	44	14%	1,706	56%	5.37%	-5.38%
(8)	US 1840-1949			110	65%	4.65%	-3.86%
(9)	US 1950-2009			60	83%	2.82%	-1.84%

Source: Rows (1) - (7) Heston, Summers and Aten, September 2006. The "Real GDP per capita (Constant Prices: Chain series) and their calculated annual growth rates for that series "growth rate of Real GDP per capita (Constant Prices: Chain series) were used to construct the table. Countries were first sorted into income categories based on their income in 2000, measured in 2000 dollars. Average annual positive and negative growth rates are the simple arithmetic average for all of the years and all of the countries in the income category (zero growth is treated as a positive growth rates) without any weighting. The Penn World Tables include information on 188 countries, but only growth rates on 184 countries. The sample runs from 1950 to 2004, although information is not available for every country in every year. The over $20,000 income category excludes Qatar, United Arab Emirates, Kuwait, and Brunei because their income is so variable. For a similar table including the oil countries see North, Wallis, and Weingast, 2009. Rows (8) & (9) Johnstone and Williamson, 2008.

Table 2
National Government Outlays:
Total, Military, and Welfare
As Percentage of GDP and Percentage of Total Outlays

	National Outlays % of GDP (1)	Military Expenditures % of GDP (2)	Welfare Expenditures % of GDP (3)	Combined % of GDP (4)	Combined % of Outlays (5)
1923	4%	0.8%	0%	1%	22%
1924	3%	0.7%	0%	1%	22%
1925	3%	0.7%	0%	1%	21%
1926	3%	0.6%	0%	1%	20%
1927	3%	0.6%	0%	1%	20%
1928	3%	0.7%	0%	1%	22%
1929	3%	0.7%	0%	1%	22%
1930	4%	0.8%	0%	1%	22%
1931	5%	1.0%	0%	1%	20%
1932	8%	1.2%	0%	1%	15%
1933	8%	1.1%	0%	1%	17%
1934	10%	0.8%	3%	4%	40%
1935	9%	1.0%	3%	4%	45%
1936	10%	1.1%	3%	4%	38%
1937	8%	1.0%	3%	4%	43%
1938	8%	1.2%	2%	4%	45%
1939	10%	1.2%	3%	4%	42%
1940	9%	2%	4%	6%	61%
1941	11%	5%	3%	8%	78%
1942	22%	16%	2%	18%	83%
1943	40%	34%	1%	35%	88%
1944	42%	36%	1%	37%	89%
1945	42%	37%	1%	38%	91%
1946	25%	19%	2%	22%	87%
1947	14%	5%	4%	9%	66%
1948	11%	3%	4%	7%	64%
1949	15%	5%	4%	9%	62%
1950	14%	5%	5%	10%	66%
1951	13%	7%	3%	10%	76%
1952	19%	13%	3%	16%	85%
1953	20%	14%	3%	17%	85%
1954	19%	13%	3%	16%	88%
1955	17%	10%	4%	14%	84%
1956	16%	10%	4%	13%	83%
1957	17%	10%	4%	14%	83%
1958	18%	10%	5%	15%	84%
1959	18%	10%	5%	15%	80%
1960	18%	9%	5%	14%	81%

Source: *Historical Statistics*, Outlays and Expenditures: Series EA644 & EA704 (Total Outlays), EA645 & EA 705 (Military) and EA711 (Welfare/Human Resources), and Wallis, 1983 (Relief exp. 1933-1939). GDP from Johnstone and Williamson, 2008.

Table 3
Major Relief Programs, Dates, and Administrative Character

Started	Ended	Agency	Administration
May 1933	Fall 1935[1]	Federal Emergency Relief Administration (FERA)	Federal
April 1933	July 1942	Civilian Conservation Corp (CCC)	National
November 1933	March 1934	Civil Works Administration (CWA)	National
Spring 1935	1942	Works Progress/Projects Administration (WPA)	National/Federal
1935	1994[2]	Rural Electrification Administration (REA)	National
1937	1946[3]	Farm Security Administration (FSA)	National
Summer 1935	Present	Old Age and Survivors Insurance (OASI)	National
Summer 1935	Present	Unemployment Insurance	Federal
Summer 1935	1974[4]	Old Age Assistance (OAA)[3]	Federal
Summer 1935	1974[4]	Aid to the Blind[3]	Federal
Summer 1935	1996[5]	Aid to Dependent Children (ADC)[4]	Federal

Notes. Federal administration refers to joint administration by the state and national governments. National administration refers to programs administered by the National government. General relief was provided by local governments throughout the period.

Sources: National Resources Planning Board (1942, pp. 26-97); Fishback and Thomasson (forthcoming); Alston and Ferrie (1999, pp. 91-98); Columbia University Press, 2005.

[1]Some FERA projects were phased out over a period lasting through March 1937.
[2]The Rural Electrification Administration in 1949 was authorized to make loans for telephone improvements and in 1988 was permitted to give interest-free loans for job creation and rural electric systems. Its duties were assumed by the Rural Utilities Service when it was abolished in 1994.
[3]The Farm Security Administration took over the role played by the Resettlement Administration begun in 1935. Some of its programs were eventually taken over by the Farmers Home Administration in 1947.
[4]Old-age assistance and aid to the blind were almost entirely superceded by the Supplemental Security Income Program in 1974.
[5]Aid to Dependent Children was renamed Aid to Families with Dependent Children in 1962 and the program was replaced by Temporary Aid for Needy Families in 1996.

Table 4
Average Monthly Case Loads by Major Programs (000s of cases)

	Total	Federal Emergency Relief Admin.	Civil Works Admin.	Works Progress Admin.	Old-Age Assistance	Local Relief	Unemp. Insurance
Months Reported	1/33-6/40	6/33-12/35	11/33-4/34	8/35-6/40	1/33-6/40	1/33-5/33, 1/36-6/40	1/38-6/40
1933	5022	3836	2565		109	1990	
1934	6593	4474	2970		142		
1935	6320	4655		1156	303		
1936	5758			2544	737	1667	
1937	5202			1793	1369	1445	
1938	5995			2611	1559	1543	698
1939	6285			2407	1852	1661	718
1940	5943			2102	1941	1547	1065

Source: Social Security Administration (1941, Table 9, pp. 68-70).

Notes: All figures are the average of monthly case loads for the months reported in each year in the original source. For example, the FERA listing in 1933 is the average monthly case load for the months June through December of that year. The UI listing in 1940 is the average monthly case load for the months January through June of 1940. The CWA listing in 1934 includes a peak of 4.311 million cases in January 1934 down to 1.1 million cases in April after the program was ended and was winding down.

Table 5
National Government Revenues, Outlays, and expenditures
on Cooperative programs and Relief Programs
1929 to 1940
(Millions of nominal dollars)

	National Revenues (1)	National Outlays (2)	Outlays - Outlays in 1933 (3)	Cooperative Programs (4)	Relief Programs (5)
1929	3861	3127			
1930	4057	3320			
1931	3115	3577			
1932	1923	4659			
1933	1996	4598	0	432	154
1934	3014	6644	2046	2857	2126
1935	3795	6497	1899	3649	2221
1936	3997	8421	3823	3969	2343
1937	4955	7733	3135	4273	2405
1938	5588	6764	2166	3518	2047
1939	4979	8841	4243	4794	2671
1940	6879	9055	4457	3922	2188
Total			21769	27414	16155

Source: Wallis (1984). Note that all of the relief programs column (5) were ‘cooperative’ and therefore are included in the total for cooperative programs, column (4).

Appendix I
The Atlantic Charter, 1941

Joint Statement by President Roosevelt and Prime Minister Churchill, August 14, 1941(1):

The following statement signed by the President of the United States and the Prime Minister of Great Britain is released for the information of the Press:

The President of the United States and the Prime Minister, Mr. Churchill, representing His Majesty's Government in the United Kingdom, have met at sea.

They have been accompanied by officials of their two Governments, including high ranking officers of the Military, Naval and Air Services The whole problem of the supply of munitions of war, as provided by the Lease-Lend Act, for the armed forces of the United States and for those countries actively engaged in resisting aggression has been further examined.

Lord Beaverbrook, the Minister of Supply of the British Government, has joined in these conferences. He is going to proceed to Washington to discuss further details with appropriate officials of the United States Government. These conferences will also cover the supply problems of the Soviet Union.

The President and the Prime Minister have had several conferences They have considered the dangers to world civilization arising from the policies of military domination by conquest upon which the Hitlerite government of Germany and other governments associated therewith have embarked, and have made clear the stress which their countries are respectively taking for their safety in the face of these dangers.

They have agreed upon the following joint declaration: (2)

The President of the United States of America and the Prime Minister, Mr. Churchill, representing His Majesty's Government in the United Kingdom, being met together, deem it right to make known certain common principles in the national policies of their respective countries on which they base their hopes for a better future for the world.

First, their countries seek no aggrandizement, territorial or other;

Second, they desire to see no territorial changes that do not accord with the freely expressed wishes of the peoples concerned;

Third, they respect the right of all peoples to choose the form of government under which they will live; and they wish to see sovereign rights and self government restored to those who have been forcibly deprived of them;

Fourth, they will endeavor, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity;

Fifth, they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement and social security;

Sixth, after the final destruction of the Nazi tyranny, they hope to see established a peace which will afford to all nations the means of dwelling in safety within their own boundaries, and which will afford assurance that all the men in all the lands may live out their lives in freedom from fear and want;

Seventh, such a peace should enable all men to traverse the high seas and oceans without hindrance;

Eighth, they believe that all of the nations of the world, for realistic as well as spiritual reasons must come to the abandonment of the use of force. Since no future peace can be maintained if land, sea or air armaments continue to be employed by nations which threaten, or may threaten, aggression outside of their frontiers, they believe, pending the establishment of a wider and permanent system of general security, that the disarmament of such nations is essential. They will likewise aid and encourage all other practicable measures which will lighten for peace-loving peoples the crushing burden of armaments.

Signed by: Franklin D. Roosevelt & Winston S. Churchill

Footnotes:

(1) The copy in the Department files is a press release which indicates signature by President Roosevelt and Prime Minister Churchill. Apparently, however, there was no signed copy.

(2) Known as the Atlantic Charter, published in Department of State Executive Agreement Series No.236.

Appendix II

DECLARATION BY UNITED NATIONS

(Subscribing to the Principles of the Atlantic Charter, January 1, 1942)

Source:

Pamphlet No. 4, *PILLARS OF PEACE*
Documents Pertaining To American Interest In Establishing A Lasting World Peace: January 1941-February 1946
Published by the Book Department, Army Information School,
Carlisle Barracks, Pa., May 1946

...A Joint Declaration by the United States of America, the United Kingdom of Great Britain and Northern Ireland, the Union of Soviet Socialist Republics, China, Australia, Belgium, Canada, Costa Rica, Cuba, Czechoslovakia, Dominican Republic, El Salvador, Greece, Guatemala, Haiti, Honduras, India, Luxembourg, Netherlands, New Zealand, Nicaragua, Norway, Panama, Poland, South Africa, Yugoslavia.

The Governments signatory hereto,

Having subscribed to a common program of purposes and principles embodied in the Joint Declaration of the President of United States of America and the Prime Minister of the United Kingdom of Great Britain and Northern Ireland dated August 14, 1941, known as the Atlantic Charter.

Page 6

Being convinced that complete victory over their enemies is essential to defend life, liberty, independence and religious freedom, and to preserve human rights and justice in their own lands as well as in other lands, and that they are now engaged in a common struggle against savage and brutal forces seeking to subjugate the world,

DECLARE:

(1) Each Government pledges itself to employ its full resources, military or economic, against those members of the Tripartite Pact and its adherents with which such government is at war.

(2) Each Government pledges itself to cooperate with the Governments signatory hereto and not to make a separate armistice or peace with the enemies.
The foregoing declaration may be adhered to by other nations which are, or which may be, rendering material assistance and contributions in the struggle for victory over Hitlerism.

DONE at Washington
January First, 1942

The signatories to the Declaration by United Nations are as listed above.

The adherents to the Declaration by the United Nations, together with the date of communication of adherence, are as follows:

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Mexico ......... June 5, 1942 Ecuador ........ Feb. 7, 1945
Philippines .... June 10, 1942 Peru ........... Feb. 11, 1945
Ethiopia ....... July 28, 1942 Chile .......... Feb. 12, 1945
Iraq ........... Jan. 16, 1943 Paraguay ....... Feb. 12, 1945
Brazil ......... Feb. 8, 1943 Venezuela ...... Feb. 16, 1945
Bolivia ........ Apr. 27, 1943 Uruguay ....... Feb. 23, 1945
Iran ........... Sept. 10, 1943 Turkey ......... Feb. 24, 1945
Colombia ....... Dec. 22, 1943 Egypt .......... Feb. 27, 1945
Liberia ........ Feb. 26, 1944 Saudi Arabia ... Mar. 1, 1945
France ......... Dec. 26, 1944
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