II. Hope, Recovery, Reform: The Great Depression and FDR’s New Deal

2. The Banking Crisis: Ordeal of a Nation, Test for a New President

When Franklin D. Roosevelt assumed the presidency on March 4, 1933, America’s banking system was in the midst of chaotic collapse. Waves of bank failures and panics begun after the historic stock-market crash of 1929 had reached a nightmarish climax; for the last several weeks, depositors had been running on banks all over the country in a desperate attempt to extract their funds. To halt the stampede, most states had temporarily closed all their banks. The very morning of FDR’s inauguration, at 4 a.m., New York had shuttered its banking system. Illinois had quickly followed suit. People who’d traveled to the capital for FDR’s swearing-in found their hotels refused checks drawn on out-of-town banks.

This was an emergency of alarming proportions, especially when set against widespread unemployment, falling prices, plummeting production, mounting property foreclosures, and the thousands of bank failures that already had wiped out hundreds of millions of dollars in deposits. Now Americans not only couldn’t access credit to invest in businesses or homes, many couldn’t get cash to pay workers or feed their families. Even in places where banks were open for business, the loss of faith in the banking system raised the specter of a return to barter and bare subsistence. Neither the Federal Reserve,
nor the outgoing administration of Herbert Hoover, nor the Congress, nor the private banking sector had shown itself capable of stemming the death spiral.

FDR came to Washington, DC, ready to act. Though he refused to announce his policies before taking office, the president-elect had spent February conferring with advisors on how to address the banking crisis. As he rode the train to Washington for the inaugural ceremonies, FDR reviewed drafts of two presidential proclamations, one declaring a nationwide bank holiday, the other calling Congress into special session to vote on emergency banking legislation.

At 11 p.m. March 5, FDR called Congress into session. At 2 a.m. March 6, he closed the banks. Over the following three days, he and his advisors (including Hoover administration officials) worked out a bill establishing a procedure for reorganizing troubled banks and reopening those deemed solvent.

There was one especially thorny question: How could you reopen banks so depleted of currency? Any failure to honor depositors’ withdrawals might set off more bank runs. After forty-eight hours of nonstop deliberation with staff, Treasury Secretary William Woodin decided against filling the gap with scrip, a kind of promissory note. Instead, the government would authorize the Federal Reserve to issue special currency, as much as might be required. “It’ll be money that looks like money,” he said. These dollars would be backed not by a specific amount of gold, as had been required for generations, but by all the assets of the Federal Reserve and, implicitly, by the power and wealth of the United States of America.

Staff finished the bill at 3 a.m. on March 9. An eager Congress passed it by dinnertime.

On March 12, FDR went on the radio in the first of his intimate addresses to the American people, known to history as the fireside chats. He carefully described the mechanics of the banking problem, explaining that banks typically keep only a fraction of deposited money on hand as currency, investing the rest to “keep the wheels of industry and of agriculture turning around.” The massive, panic-driven withdrawals had forced banks to sell assets at fire sale prices, and sucked them dry of currency. FDR assured Americans that reopened banks would “be able to meet every legitimate call” for money, thanks to emergency currency that was “backed by actual, good assets” and was being sent at that very hour to every part of the country. And he asked the American people to forego the frantic cash and gold hoarding that had accelerated the crisis. “It is your problem, my friends, your problem no less than it is mine,” he said. “Together we cannot fail.”

A week after taking office, FDR had defined the banking problem as a national rather than a local one. He had at last offered a national solution, based in part on faith in an implicit promise by the federal government. And he had addressed fellow Americans as equals, urging them to draw on their own wells of strength and confidence to face down this bewildering situation.

When banks began reopening on March 13, lines of patrons waited outside to redeposit their cash. By the end of the month, they had returned two-thirds of the funds hastily withdrawn in the month before the national bank holiday. The Depression would grind on for many long months. But the banking crisis was over.
American banking grew and changed dramatically in the first three decades of the twentieth century.

In 1900 Congress halved the capitalization (assets minus debts) required to run a national bank, to a mere $25,000. This led to vigorous proliferation of small banks across neighborhoods and countrysides, greatly expanding access to credit for ordinary people, especially farmers. "Towns that barely supported a general store or a livery stable felt a thrill of civil pride when some farmer or grocer set himself up in the banking business," remarked Raymond Moley, an economic advisor to Franklin D. Roosevelt. State and local regulations were inconsistent and generally lax.

Meanwhile, as corporations increasingly turned to stock-market investors to raise money for operations, banks likewise found new sources of revenue. Between 1923 and 1929, banks tripled their investment in mortgages and boosted their loans to stockbrokers by 60 percent.

Bank failures were higher than usual in the 1920s. But as the speculative stock bubble of the 1920s burst and economic activity slowed dramatically, the crisis deepened. Banks' investments, often undiversified, suffered from stock-market losses, mortgage defaults, and falling prices that left farmers unable to repay their debts. Meanwhile, demand for cash withdrawals grew, often in unpredictable spurts when worry spread that a particular institution might be on shaky ground.

The first major bank to fail after the crash of 1929 was the publicly traded Bank of United States, with dozens of branches across New York City. Rumors spread of its insolvency, seemingly confirmed when the bank canceled a previously announced merger just two months after the crash. The state closed the bank.

The fevered bank run that unfolded in the weeks before FDR's inauguration began in Detroit, where a decimated auto industry, diving real estate values, and devastating unemployment rates led to the insolvency of leading banks. Union Guardian Trust's attempt to secure a loan from the federal Reconstruction Finance Corporation failed when its biggest depositor, Henry Ford, refused to secure the loan (having himself sustained great personal and business losses). Michigan closed all its banks, sending a shudder of fear—and widespread bank runs—across the country.
In the months leading up to Franklin D. Roosevelt’s inauguration, Americans were afraid. Many were angry. The Roaring Twenties had lifted the wealthy into unprecedented luxury; income disparities had yawned ever wider. The Depression, meanwhile, affected everyone. Working people lost their jobs; small depositors lost their meager life savings in failing banks.

The people’s mounting frustration and even rage confronted President Herbert Hoover in the waning days of his bid for reelection. In the autumn of 1932, hungry Detroit crowds meeting his campaign train chanted, “Hang Hoover! Hang Hoover!” so loudly the Secret Service summoned mounted police. In Kansas disgruntled farmers hurled tomatoes. As Hoover returned home to Palo Alto, California, to vote, his train was halted when men were spotted digging up the spikes that secured the railroad and, later, trying to dynamite a bridge.

On February 15, 1933, just weeks before his inauguration, FDR himself endured an assassination attempt by a deranged, unemployed bricklayer who sprayed several bullets into a Miami rally, fatally wounding Chicago mayor Anton Cermak. The assassin railed against kings, presidents, and capitalists before going to his death in the electric chair.

The populace reserved particular fury for bankers. In February 1933, even as bank failures and panics accelerated, an investigation by the Senate Banking and Currency Committee was uncovering rampant conflicts of interest and scandalously unethical behavior by financial titans. For example, Charles E. Mitchell, the president of National City Bank, admitted dodging income taxes in 1929 by selling stock in his own bank to his wife at a much lower price than he’d paid for it—creating a $2.8 million “loss” and eliminating his tax liability. He also revealed that his bank offered its officers secret no-interest loans to buy stock. The loans, seldom repaid, were funded by bank shareholders who’d suffered tremendous losses.

As the wealthy businessman and investor Joseph Kennedy later recalled, “The belief that those in control of the corporate life of America were motivated by honesty and ideals of honorable conduct was completely shattered.”

FDR’s administration would reform rather than tear down the banking industry, rejecting calls to nationalize banks, for example. But FDR understood, articulated, indeed harnessed popular resentment of bankers and financiers, promising to fight the powerful interests that exploited ordinary Americans as “industrial cannon fodder.”

“The money changers have fled from their high seats in the temple of our civilization,” FDR announced in his inaugural address. “We may now restore that temple to the ancient truths.”

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Unemployed men wait outside a soup kitchen opened in Chicago by gangster Al Capone in 1931, as the misery of the Depression deepened. In the midst of this suffering, Americans became increasingly outraged at the role bankers and financiers had played in fueling—and profiting from—the speculative excesses of the 1920s. LOC
Government should stand by and "let the slump liquidate itself." That was the advice Herbert Hoover recalled getting from his treasury secretary, the banker Andrew Mellon. "Liquidate labor," Mellon continued, "liquidate stocks, liquidate the farmers, liquidate real estate." The economy should be allowed to utterly unravel, no matter the consequences in human suffering, so that value could be built anew.

Hoover took a more moderate view. Despite his fundamental stance that the government should be "an umpire instead of a player in the economic game," he did launch large-scale public-works projects to stimulate the economy. To help ailing banks specifically, he established the National Credit Corporation, a credit agency voluntarily funded by bankers that provided small loans to banks. In early 1932, his administration founded the Reconstruction Finance Corporation, an independent agency that gave government-secured loans to small banks as well as railroads and insurance companies. The RFC is credited with at least temporarily slowing bank closures; Franklin D. Roosevelt would greatly expand the flexible agency under the New Deal to help stabilize a variety of businesses.

But in the final weeks of Hoover’s administration, as the nation’s banking system teetered on the edge of ruin, his approach was one of agonizing hesitation. Hoover and his advisors discussed but rejected various actions. Most important, he considered shutting the banks and blocking gold exports but, uncertain of the legality of such a move, refused to do so unless FDR joined him in the action.

Just weeks before FDR’s inauguration, Hoover wrote the president-elect a ten-page letter insisting that the country’s “major difficulty” was “the state of the public mind.” He urged FDR to restore confidence by proclaiming his administration would permit no “tampering” with the currency (Hoover favored continuing the gold standard, which limited credit and spending by requiring that every dollar represent a claim to a particular quantity of gold) and no increase in government debt or deficit spending, even if that meant higher taxation.

Such a proclamation, as Hoover understood, would amount to staunchly holding the line on Republican economic policy—despite a resounding Republican defeat in 1930 midterm elections, and FDR’s own landslide victory in ’32.

FDR would later call Hoover’s letter “cheeky.” His response, ostensibly waylaid by a secretary’s error, never arrived.
A New Deal for Depositors and Investors

The bank holiday and other emergency measures taken in Franklin D. Roosevelt’s first week as president shocked the dying heart of America’s banking system and set it beating again. FDR and Congress also administered remedies they hoped would have important long-term benefits. These included:

- Pumping liquidity into struggling but basically sound banks by authorizing the Reconstruction Finance Corporation (an agency created by Hoover that issued government-secured loans) to buy preferred stock in the banks. This was included in the emergency law of March 1933.

- Taking the United States off the gold standard in a series of actions during 1933.

- Dollars were no longer redeemable in gold. This allowed the Federal Reserve to put more money into circulation to stimulate lending and spending.

- In the Securities Act of 1933, requiring sellers of securities (stocks and bonds) to disclose important information about these products, and setting up the Securities and Exchange Commission in 1934 to regulate the industry.

- Taking old, at-risk home mortgages off banks’ books in exchange for safe government bonds, then issuing new long-term, low-interest mortgages to the homeowner. The Home Owners’ Loan Corporation, created in 1933, implemented this program.

- Separating commercial banks—those offering traditional checking and savings accounts—from investment banks, and limiting the speculative investments commercial banks could make with depositors’ money (the Banking Act of 1933, also known as Glass-Steagall). Congress repealed key provisions in 1999.

- Establishing federal deposit insurance. The Banking Act of 1933 created the Federal Deposit Insurance Corporation to pay depositors in insured banks that failed, and to liquidate those banks in an orderly way. Deposit insurance is commonly credited with eliminating widespread bank runs and greatly softening the impact of bank failures on the economy.
Leadership “with a Smile”

Shortly after becoming a key member of Franklin D. Roosevelt’s so-called Brain Trust, economic advisor Raymond Moley noted of then governor Roosevelt, “I don’t find that he has read much about economic subjects. What he gets is from talking to people.”

Never was FDR’s particular way of talking to people more critical than in the dawning days of his administration, the country awash in the fear and distress of the worst banking crisis in its history. His signature confidence and energy supplied a very real asset that the people sorely needed—and that the banking system, which relies on trust, needed even more.

The day after his inauguration, FDR met with congressional leaders to promote his emergency banking bill, and he left one senator astonished by his “readiness to assume responsibility . . . with a smile.” The next day he met with forty-eight of the nation’s governors, and, after allowing he’d been too busy to prepare remarks, outlined his plan to stem the bank crisis. The governors rose to applaud the new president. “He is ready to lead if we are ready to follow,” they said in an official statement. The day after that, FDR invited 125 reporters to the Oval Office; he spoke candidly at times but charmingly evaded any question he wasn’t ready to answer. Asked whether he could define the “adequate but sound” currency to which he’d referred in his inaugural address, FDR answered simply, “No.” The reporters laughed and, later, clapped.

FDR’s first of many presidential radio addresses, coming eight days after his swearing-in, wowed the public and press alike. It moved Americans with its warmth and sincerity, and reassured them with its lucidity. In a telegram the following day, the comedian Will Rogers cheered the president for skipping the big vocabulary words. FDR had taken the dry subject of banking, Rogers famously quipped, and “well he made everybody understand it, even the bankers.”