THE GERMAN INFLUENCE ON THE ORIGIN OF U.S. FEDERAL FINANCIAL RESCUES

By

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The German Influence on the Origin of U.S. Federal Financial Rescues

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Abstract

While federal financial rescues have become a common response to crises, federal provision of finance was not one of the original powers of the federal government. One man, Eugene Meyer, is largely responsible for the origin of federal financial rescues, through both the War Finance Corporation and Reconstruction Finance Corporation. Meyer learned *laissez faire* economics from William Graham Sumner at Yale. However, German economist Adolph Wagner’s state-socialism philosophy heavily influenced Meyer’s thinking, and Meyer developed an interventionist philosophy. Serving in key government positions, Meyer put his beliefs into practice. These channels of influence and the resulting policies are examined.

**Fields:** B - History of Thought; N - Economic History
During the recent Great Recession, the federal government provided hundreds of billions of dollars of financing to troubled financial institutions and other corporations. Federal financial rescue of private business is justified on the grounds that without this intervention, the recession might have become a depression, and such assistance would speed economic recovery. Similarly, in an effort to contain the recession, the Federal Reserve, under the authority of section 13(3) of the Federal Reserve Act, created facilities to extend credit to many sectors of the economy, far beyond its normal lender-of-last-resort lending to banks.

While not without its critics, federal financial rescues have become a common, often expected, response to crises. In addition, federal financial intermediation has become a continuing function of government, with activities including direct loans, loan guarantees, government sponsored enterprises, and rescues of private businesses, including financial institutions.

Federal provision of financing was not an original function of our national government. Saulnier, Halcrow and Jacoby (1958) trace the origin of federal financial intermediation to the creation of the federal land banks in 1916. However, while the federal land banks were federally chartered, capitalized, and supervised, they are cooperatively operated by the owner-borrowers.

The first federally operated credit agency was the War Finance Corporation (WFC), established in 1918. The WFC’s war-time objective was to make loans to businesses vital to the war effort that were unable to obtain private funding. The war ended shortly after its creation, but the WFC continued its operations attempting to stabilize bond prices for the Treasury, another function provided by the original legislation.
Eugene Meyer, the Managing Director of the WFC, worked single-handedly to obtain Congressional approval to extend the life of the WFC with authorization to engage in the first federal financial rescue activities, providing financing in an effort to promote exports and then to assist the distressed agricultural sector. Then, during the 1929-1933 contraction, Meyer, now Governor of the Federal Reserve Board, convinced President Hoover to recreate the WFC as the Reconstruction Finance Corporation (RFC) to assist and rescue troubled banks, other financial institutions, and railroads. While Meyer’s stated intention was that the RFC be a temporary agency as was the WFC, the RFC’s operations were greatly expanded during the New Deal and Second World War, as President Roosevelt welcomed the many opportunities afforded by the off-budget lending authority of the RFC.

Eugene Meyer (1875 – 1959) is an important, but little-known figure in interwar U.S. economic policy making. He orchestrated the original federal financial rescues through the WFC and RFC. In addition to serving as Governor of the Federal Reserve Board during most of the Great Contraction, he also served as federal Farm Loan Commissioner. Interestingly, while Meyer’s education at Yale was under the tutelage of the champion of laissez-faire, William Graham Sumner, Meyer’s economic philosophy about the appropriate role of government was heavily influenced by the German economist and state socialist, Adolph Wagner.

Meyer was, successively, a very successful and prosperous investment banker, a federal government official and economic policy maker, and a newspaper publisher. He received formal education in economics at Yale and afterward studied in France and Germany. Events during his investment banking career also shaped his view of the functioning of markets.

This paper examines how Meyer’s economic philosophy led to the origin of federal financial rescues. First, the thinking of his two influential teachers, Sumner and Wagner, are reviewed.
Then Meyer’s own economic philosophy is presented. The rescue operations of the WFC and RFC are recounted, followed by concluding remarks.

**William Graham Sumner**

After a year of study at the University of California, Meyer enrolled in Yale in 1893, and by accelerating his studies, graduated Phi Beta Kappa in 1895. At Yale, Meyer studied social science during his final year with William Graham Sumner.

Joseph Dorfman (1949) identifies Sumner as the great spokesman of the New England School of *laissez faire*. His conservative social philosophy followed Herbert Spencer. He was influenced by Malthus, arguing that living standards were determined by the ratio of population to land. The wealthy were the product of natural selection and helping the poor interfered with *laissez faire* and thus was wrong.

Richard Hofstadter (1959, 51) characterizes Sumner as “The most vigorous and influential social Darwinist in America…” and states that he had the widest following of any faculty member at Yale. Sumner read economics as a boy (approximately age 14) and claimed his ideas about economics were all formed at that time. His economics synthesized classical economics, the Protestant ethic and Darwinian natural selection. Hofstadter notes that Sumner’s writings have a religious fervor, not surprisingly, as Sumner was a minister prior to becoming a professor. Sumner believed that men should accept the natural law of competition: “Competition is a law of nature which can no more be done away with than gravitation” (quoted in Hofstadter 1959, 66).

Sumner’s economics are thoroughly examined by Dominick Armentano (1967). He finds that Sumner’s influences include Ricardo as well as Malthus and Darwin. His model was based on perfect competition and assumed full employment. The proper activities of government
include upholding law and order, the administration of justice, the protection of private property, and the preservation of civil liberty. Beyond these, *laissez faire* was to be the norm. Sumner said that there “are not many ways that governmental interference in economic matters can bring about the desired beneficial consequences” (quoted in Armentano 1967, 133). Sumner particularly opposed tariffs. He opposed bimetallism in favor of the gold standard, but he did like National banks and a uniform currency and said that unions were legitimate. He also wrote on monetary economics.

Bruce Curtis (1981) recounts that Sumner did favor public education for all. For Sumner, Smith’s “Invisible Hand” became social Darwinism. Sumner “replaced God with nature as man’s disciplinarian and judge when he transgressed natural law” (Curtis 1981, 76). Curtis explains that in 1896 Sumner began his move from economics to sociology, for which he is far better known. Sumner most lasting publication is his book on sociology, *Folkways* (1906). Curtis (1964) and Robert Bannister (1973) both argue that with his move into sociology, his philosophy evolved. Curtis claims that in his last years, to defend the middle-class society in which he believed, Sumner’s views became progressive, no longer social Darwinist.

Both Armentano and Curtis note that Sumner was not influential in economics beyond his own time. Curtis (1964) argues that in economics, Sumner was a defender, not a questioner.

Perhaps Sumner’s most noted contribution to economics is his “Forgotten Man”:

…A and B decide what C shall do for D. …I call C the Forgotten Man, because I have never seen that any notice was taken of him in any of the discussions. (Sumner 1883, 23).

Sumner’s Forgotten Man is the middle class worker going about his life, working at his job, raising his family and enjoying the fruits of his labor. However, the state may tax him to support others. To Sumner, this was the ultimate evil:
…a man whose labor and self-denial may be diverted from his maintenance to that of some other man is not a free man, and approached more or less toward the position of a slave. (Sumner 1883, 15).

The man who has done nothing to raise himself above poverty finds that the social doctors flock about him,…and promising him the aid of the State to give him what the other had to work for. (Sumner 1883, 23).

Sumner was egalitarian in his support of the Forgotten Woman as well. He wrote at length about how women sewing garments were required to purchase their own thread, and how the higher price of thread due to a protective tariff subtracted from their meager $0.75 daily wage (Sumner 1883, 145 – 8).

Government intervention in economic affairs created monopolies, the purpose of which was the exploitation of others:

…if, however, the state enters as an agent into the industrial or social relations of its own subjects, it becomes the greatest and worst of all monopolies, the one best worth having under one’s control, the best prize of base struggles, and the most powerful engine by which men may exploit others. (in Keller and Davie 1924, 227)

Sumner believed that the German historical school was attracting a generation of American economist away from the truth (Bannister 1973). The German historical school favored an extensive welfare state, that Sumner believed required a sacrifice of liberty:

…it if we want to be taken care of as Prussians and Frenchman are, we must give up something of our personal liberty. (in Keller and Davie 1924, 268).

What Meyer learned from Sumner was that economic systems were determined by the natural law; that government intervention into economic affairs violated natural law, burdened

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Dorfman (1949, 206 - 210) notes that by 1890, Sumner still refused to join the American Economic Association that was founded in 1885 by German-trained and/or influenced Americans. The original aim of the association was to promote progressive economic policies in the United States, although the constitution was soon changed to focus on research so as to attract young economists having a classical orientation.
the forgotten man, and created exploitive monopolies; and thus *laissez faire* was the only appropriate policy.

**Adolph Wagner**

Within a year of his graduation, Meyer went to Europe, working and studying in Paris, various German cities, and London. While in Berlin he took several courses at the University of Berlin. One course had a profound impact on his economic thinking. The course, attended by about 1000 students, was “Selected Questions in Social Policies” taught by the German state socialist, Adolph Wagner. What Meyer heard from Wagner was opposite of the teachings of William Graham Sumner.²

While often identified as a member of the German historical school, Wagner was not strictly a member of the school (Senn 1997). While sharing similar views on the role of the state and belonging to a common society, Wagner was often critical of the historical school and debated with them over methodology. He rejected the historical school’s inductive approach, favoring deductive reasoning and the use of statistics. Wagner described himself as a “German State socialist, who is used to government intervention and disposed to favor it…” (quoted in Senn 1997, 58).

Wagner was an original member of the Verein für Sozialpolitik (Union for Social Politics) founded by his contemporary and leader of the younger historical school, Gustov Schmoller.³ The Verein was explicitly political, promoting a welfare state, or “social market economy” as it is known in Germany (Senn 1991). These conservative socialists were known as Kathedersozialisten (Professorial Socialists or Socialists of the Chair).

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² Meyer also read Wagner’s books (Meyer 1961, 50).
³ Wagner’s active participation in the Verein ended around 1877 because many members held views more moderate than state socialism (Senn 1997).
Dorfman (1955) characterizes the Verein as a revolt against 18th century reasoning based on natural law. Extreme *laissez faire* was opposed. Members saw a conflict between self-interest and moral forces.

Donald Wagner (1939) describes Wagner as accepting self-interest but rejected the classical application emphasizing *laissez faire*. Wagner combined historical methods and deductive reasoning, and was critical of the historical school’s rejection of abstract and deductive reasoning.

Carlson (1999) notes that Wagner sought a middle way between British liberalism’s focus on production and scientific socialism’s focus on distribution. The most important roles of the state were to create public order and national defense. Regulation was necessary to protect the weak from the economically strong. He favored nationalization of certain industries to generate revenue for the redistribution of income. Also, to create a new social economics, attention must be paid to matters of psychology, customs, the legal system, ownership and freedom. Wagner did worry about the impact of the state on civil liberties that he hoped, as much as possible, to preserve (U. Backhaus 2003).

Wagner’s moral reasoning derived from his Christianity (Drechsler 1997). Wagner explains this in his famous “Speech on the Social Question”;

My idea, briefly stated, proceeds from the notion that political economy must again partake rather of the character of an ethical science in order to be able properly to handle the social question. …I wish to stress the moral and therefore Christian obligations which wealth, education, and social position impose, even in dealing with the social question from the economic standpoint. (in D. Wagner 1934, 489).

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4 Wagner served for a time in the Prussian legislature as a member of the Christian Social Party, although this party is known for its anti-Semitism (Clark 1940). Senn (1997, 104 – 100) critiques Clark’s (1940) assertion that Wagner was a forerunner of Nazism.
While Sumner believed the distribution of income should be derived from natural selection, Wagner did not, and unlike Sumner, argued for redistribution:

…there will always be differences in wealth which cannot be traced to actual merit or personal guilt. But it is for us to diminish, so far as we can, the resulting evils and existing inequities. (in D. Wagner 1934, 506).

Like Sumner, Wagner is perhaps best known for his normative work on the role of the state, that economists “should point out what should be” (quoted in Senn 1997, 61). Also, both wrote on monetary issues.

Wagner’s lasting scientific contribution is his work in fiscal policy. Specifically, Wagner’s Law predicts an ever expanding role for the state:

On the whole, the realm of the state’s activities has become ever more extensive, as the concept of the state developed, as people achieved higher and higher levels of civilization and culture, and as more demands were consequently addressed to the state. This has also led to a continuous increase in the required state revenues, an increase which was generally even higher relative to the increase of the extent of state activity. The cause for this relative difference lies in the means employed by the state: these have become ever more complex, comprehensive and costly as one and the same need required an ever more perfect, higher and refined way of being satisfied. …the requirements of the state are constantly rising as people progress. (quoted in U. Backhaus 2003, 125).

Carlson (1999) and Senn (1997) attempt to assess Wagner’s influence in the United States. Dorfman (1955) does the same for the German historical school. All find that a primary, likely the most important, channel of influence was through the many Americans that studied in Germany. This was also the channel of German influence on Eugene Meyer, the class he took from Adolph Wagner, as well as reading Wagner’s books.
**Eugene Meyer**

Eugene Meyer studied economics under two very influential economists who espoused opposing philosophies. At Yale Meyer actively engaged Sumner in discussions of his teachings. Meyer’s concern for individual liberty made him receptive to Sumner’s advocacy of competitive markets. At the time of his graduation, Meyer felt that what he learned from Sumner was the most significant contribution of his Yale education (Pusey 1974, 22).

After reading and studying under Wagner, Meyer concluded that Wagner’s views were appropriate for Germany with its inflexible labor market, but that level of government intervention was not yet needed in the United States. But if that was the case, economics was not based on universal natural laws. He concluded that the appropriate economic policies were relative, determined by time and place:

> Therefore political science or political economy was not a science but an art, because if it were a science, it would be of universal application.

> …That gave a sort of pragmatic approach to my mind on these problems – that is, the fact of the economy to which political economy applies is the deciding factor in what kind of practical application of what kind of principles are suited. What may be good for us today may be no good in twenty years; or what was good twenty years ago is no good for today. (Meyer 1961, 50-51).

As the United States approached entering World War I, Meyer delivered a speech, in which he rejected *laissez faire* and called for greater cooperation between government and business:⁵

> Our policy is still too much under the influence of outworn *laissez faire* doctrine. Europe, even prior to the war, had as its policy *faire marcher*.⁶

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⁵ The speech was “Some After-War Economic Problems”, delivered to the American Association for the Advancement of Science on December 29, 1916.

⁶ In this context, *faire marcher* means taking action to make things happen.
More than ever before Government and big business need to take council together. (Meyer papers, box 78)

Thus, Meyer arrived at the Progressive Era conclusion that the *laissez faire* philosophy was outdated. He believed that “abnormal” conditions often controlled markets, and that men attempted to control and regulate markets for their own benefit (Eugene Meyer papers, Box 180).

Meyer was no stranger to market instability. In 1910, while traveling in Asia and Europe with his new wife, Meyer received cables about a copper production and price war that was depressing the value of his investments. Meyer negotiated an “understanding” among the principal producers to cut production, ending the price war. The agreement was unwritten, leaving no evidence of explicit price fixing that would be construed as an antitrust violation (Pusey, pp. 82-84).

Before Meyer entered government service during World War I, he advised Bernard Baruch, who was negotiating the purchase of 45 million pounds of copper for the armed services. Baruch sought Meyer’s advice regarding a “fair” price, and Meyer recommended a price based on a ten-year average that the copper producers accepted, even though it was significantly below the prevailing market price. This negotiated agreement earned both men considerable notoriety.

In Washington, Meyer eventually joined Baruch’s Raw Materials Committee of the General Munitions Board, later the War Industries Board. Meyer became director of the nonferrous metals unit of the Raw Materials Committee.7 Acting for Baruch, Meyer prevented an army purchase of steel at what Meyer felt was an exorbitant price. Meyer suspected that companies were canceling civilian contracts hoping to sell at higher prices to the government.

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7 His responsibilities included procurement of copper, lead, zinc, antimony, aluminum, nickel, silver and later cement (Pusey, p.140).
He advocated the creation of a central purchasing agency to “regulate the whole industrial situation.” In his position at the War Industry Board, Meyer sought to purchase metals at prices that he felt were “fair” (Pusey, pp. 140 – 148; Eugene Meyer papers, Box 180).

Clearly Meyer believed that sizable price changes resulting from rapidly changing demand or supply could be “unfair.” In such instances, Meyer felt action should be taken to “stabilize” markets. With his background as a very successful investment banker, his solution was the provision of credit or financing until markets returned to a more “normal” condition.

In an address about the WFC, Meyer advocated the federal provision of temporary financing of exports, claiming that the normal channels of export finance had broken down, and thus the WFC should make loans financing exports. In the same speech he advocated government intervention in the labor market:\(^8\)

The question of unemployment was more or less ignored by us – it was felt it might be left to take care of itself, and our old friend, “the law of supply and demand”, was relied upon until we suspended that law very materially during the period of war. The “law of supply and demand” under certain conditions will always operate to bring about a result, but we have learned that if you want to get the result quickly, and are unwilling to allow the difficulties and sufferings which exist in connection with unemployment, we must at times act with regard to the social aspects of the problem which the brutal application of the old law of supply and demand does not contemplate. (Meyer papers, box 78).

Thus Meyer had abandoned the laissez-faire philosophy he had learned from Sumner at Yale for what he felt was a more pragmatic, interventionist approach to economic issues. He summarized his change of thinking when discussing his proudest accomplishment in government service, the Reconstruction Finance Corporation:

If William Graham Sumner spoke for the laissez-faire theory of the nineteenth century into which I was born, the RFC was the dramatic

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\(^8\) The address “The War Finance Corporation” was delivered to a conference of governors and mayors with the President and Secretary of Labor on March 5, 1919.
symbol of the opposite theory. It represented the need for far-reaching governmental intervention in the functioning of the private enterprise system – a system which had undergone a cataclysmic cycle of boom and bust. (Meyer, 1954, p.22).

**The War Finance Corporation**

The War Finance Corporation (WFC) evolved from the Capital Issues Committee. This committee, formed in January 1918 at the request of the Secretary of the Treasury, was comprised of three members of the Federal Reserve Board. The committee determined whether corporate and municipal borrowings would detract from the war effort, and recommended postponing issuing securities for projects that did not support the war effort. Restricting unessential borrowings would also free resources for the war effort.

Compliance with the committee’s recommendations was voluntary, but Treasury Secretary McAdoo wanted to formalize the authority and make it binding. The War Finance Corporation Act, signed April 5, 1918, created the formal authority. Compliance was now mandatory for all security issues of $100,000 or more.

The Act created a new, formal Capital Issues Committee comprised of seven members, three from the Fed and four unrestricted members. The unrestricted members could be Fed or government officials or representatives from business.

The WFC began operations on May 20, 1918. In addition to restricting private borrowings, the WFC was to provide funding to industries essential to the war effort. The WFC was capitalized at $500 million provided by the U.S. Treasury, and was authorized to borrow an additional $3,000 million through bond issues. The WFC was an off-budget agency, not

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9 This section is based primarily on the Eugene Meyer papers, box 180; Pusey, 1974; Saulnier, et al. al., 1958; and Willoughby, 1934.

10 Willoughby (1934, p. 39) claims that the committee’s existence discourage many private applications.
requiring annual appropriations. The original legislation required the WFC to close six months after the end of the war; however, its existence was extended several times.

Another provision of the act directed the WFC to purchase Liberty and subsequently Victory bonds to limit fluctuations in the market price of these bonds, as their prices had fallen sharply after they were issued, resulting in many complaints. The WFC did engage in significant bond purchases. While the Treasury sold short-term certificates of indebtedness at 6% to fund WFC purchases of 4-4.5% coupon bonds, the endeavor was profitable due to the significant discount at which the bonds sold during the buy-back period. The deep price discounts at which the bonds sold suggest that stabilizing prices proved an elusive objective.

Meyer was an original director of the WFC and was put in charge of the bond price-stabilization program. Federal Reserve Board Governor W. P. G. Harding was the original managing director of the WFC, but he rarely attended meetings and relied heavily on Meyer to run the agency. Meyer was elected managing director in January 1919 following Harding’s resignation from the WFC board.

As noted above Meyer felt that the World War had created an emergency situation for American agriculture, as the normal channels of export finance had broken down. In 1919 Meyer sought and gained Congressional approval for the WFC to make loans to European buyers to help American agricultural exports and American farmers.\(^{11}\) Federal financial intermediation now was extended beyond the emergency of war to a perceived post-war emergency. However, Treasury Secretary David Houston, a staunch advocate of *laissez faire*, decided to suspended WFC activities in May 1920. Meyer resigned, as he was opposed to what he correctly felt were Houston’s deflationary polices, expressing his belief in the benefit of federal intervention: “that

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\(^{11}\) This authority was granted in March 1919. Meyer drafted the amendment authorizing export loans (Meyer, 1954, p. 11).
the Corporation – if it had continued to function – would have been able to mitigate, to some
degree at least, the suddenness and extent of the collapse in commodity markets and prices in the
fall of 1920…” (Meyer, 1923, p. 83).

But while Meyer had resigned, he had not retired from promoting continued WFC lending.
He began a propaganda campaign seeking a revival of the WFC. At the New York Chamber of
Commerce he said:

On principle, I have argued against [government interference in business].
But we face an emergency in which private credits will not of their own accord be
forthcoming to finance foreign trade. The government alone is in a position to
bolster and again set in motion the normal operations of the international credit
mechanism… (Meyer papers, box 180)

Meyer’s campaign succeeded. Following the election, Meyer urged Congress to pass a
resolution reviving the WFC’s operations, which it did in January 1921, even overriding
President Wilson’s veto. President Harding reappointed Meyer to the WFC board, and he was
again elected managing director.

In 1921, Congress passed Meyer’s bill known as the Agricultural Credits Act of 1921. The
bill transformed the WFC into a support agency for the distressed agricultural sector. In addition
to financing exports, the WFC’s activities expanded to include lending to rural banks and co-
operatives. It was this version of the WFC that later was his model for the RFC.

As a result of the 1921 Agricultural Credits Act, much of the WFC’s lending went to banks.
The objective of the lending program was to assist banks and co-ops in agricultural regions.
WFC loans provided banks with liquidity and the ability to repay loans to their correspondents,
hopefully making the banks were more willing to carry farm loans than to call them, and to make
new loans, providing relief for beleaguered farmers. Total advances for agricultural and
livestock purposes under the authority of the 1921 act were $298 billion, most of which was
extended in 1921 and 1922. Outstanding balances peaked at $201 billion in May 1922 (War Finance Corporation, 1926).

With the creation of the Federal Intermediate Credit Banks to provide agricultural financing on a permanent basis, Meyer felt the WFC was no longer needed, and worked to close the agency.\textsuperscript{12} In January 1925 he returned $499 million of WFC capital to the Treasury, and resigned from the WFC.\textsuperscript{13} A small amount of direct lending continued through 1928, after which the WFC continued to collect on its outstanding loans until it was closed in 1939.

WFC loans to industries essential to the war never approached the anticipated amount, as the war ended six months after WFC initiated its operations.\textsuperscript{14} WFC purchases of Treasury bonds were sizable, but ultimately were financed by Treasury sales of short-term debt that financed the repurchase of the war bonds. Rather than the volume of its lending, the significance of the WFC was the precedent it set for federal intervention into credit markets.

**The Reconstruction Finance Corporation\textsuperscript{15}**

Meyer was appointed Governor of the Federal Reserve Board in September 1930. There was a banking crisis in the final months of 1930, and another banking crisis following Britain’s departure from the gold standard in September 1931. To address banking problems, Meyer felt that a financial agency similar to the WFC was necessary even before Britain left gold.

\textsuperscript{12} The WFC’s lending authority ended on December 31, 1924, although a small amount of lending continued as “expense advances” (War Finance Corporation, 1926, p. 16). If Meyer had felt a need for the WFC to continue, he likely would have again requested an extension from Congress.

\textsuperscript{13} Meyer served as Commissioner of the Federal Farm Loan Board during the years 1927-1929, thereby remaining active in the federal provision of credit.

\textsuperscript{14} WFC advances to business and agriculture from May through November 1918 totaled $71 million. Still using its war powers, another $236 million was advanced after the war, almost all of which was lent to the nationalized railroads. Export advances prior to suspension of operations were $46 million, and another $39 million was advanced for exports following the resumption of operations. Advances to banks and co-ops under the 1921 provisions totaled $298 million. Total advances, including the agricultural and livestock lending cited above through November 30, 1926 totaled $690 million. Purchases of Liberty and Victory bonds from 1918 through 1920 totaled $2.1 billion. (War Finance Corporation, 1918, 1919, 1920 and 1926).

However, President Hoover preferred voluntary private action, leading to the creation of the National Credit Corporation (NCC). Due to the NCC’s ineffectiveness, Meyer convinced Hoover of the need for a federal agency.

The Reconstruction Finance Corporation (RFC) legislation was passed on January 22, 1932. Like the WFC, the RFC was initially capitalized by the U. S. Treasury at $500 million, and could issue bonds to the public or the Treasury to raise an additional $1.5 billion. The RFC’s original powers authorized lending to banks and other financial institutions, railroads, and for crop loans. An amendment to the RFC Act, *The Emergency Relief and Construction Act of 1932*, approved on July 21, 1932 extended RFC lending powers to self-liquidating public works projects and authorization to lend to states to provide various types of relief (United States Congress 1932). Total RFC lending in 1932 was $1.5 billion (Saulnier, et. al., p. 381). Subsequent amendments vastly expanded the scale and scope of RFC lending authority.

Meyer viewed the RFC as supplementing and extending Federal Reserve lending authority, including making loans on low-quality assets that the Fed could not rediscout:

> I had to get the RFC to supplement the federal reserve with powers that the federal reserve didn’t have and couldn’t, wouldn’t, and shouldn’t have, such as making loans on slow assets. They [the Fed] had a currency responsibility. The RFC was there to take the slow assets the federal reserve couldn’t take. … The quick assets there wasn’t any trouble about. They [banks] could go to the federal reserve bank. The trouble was they didn’t have enough of that kind of asset to meet the demands of the depositors by loans from the federal reserve bank or rediscouts, because of the sums being withdrawn. … I got up the RFC to save the federal reserve system, to do the things that we couldn’t do in the federal reserve. I used all the machinery of the federal reserve – the personnel – to get it into action fast! (Meyer 1961, 679 – 681).

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16 The amendment also contained an amendment to the Federal Reserve Act, section 13(3) authorizing the Fed to lend to businesses and individuals in emergencies (United States Congress 1932, 17). While not used much at that time, this authority was used extensively during the 2008 financial crisis.

17 Meyer used the resources of the Federal Reserve to expedite RFC’s operations. RFC loan offices were located in Federal Reserve banks and branches, and many Fed employees worked simultaneously with the RFC.
Meyer left the RFC Board at the end of July 1932 for health reasons. In his later years, he stated that his intention was that the RFC be temporary, as was its predecessor, the WFC. However, President Roosevelt greatly expanded the RFC’s activities, financial many New Deal projects and agencies.\textsuperscript{18} World War II raised RFC activity to a new high; with RFC activities and extensions of credit reaching 4.5\% of GDP in 1944 (Figure 1).\textsuperscript{19} Of the $33.3 billion disbursed by the RFC during its existence, $20.9 billion was disbursed to the RFC’s wartime subsidiaries. As was the original purpose of the WFC, the RFC also financed businesses essential to the war effort.

RFC lending decreased dramatically following the war. Congressional concerns about the RFC’s post-war lending practices led to a decision to end RFC lending in 1953. Its operations were terminated in 1957, with residual activities distributed to other governmental agencies.

While Meyer may have intended that the RFC to be a temporary agency, providing relief to troubled banks, the precedent he set through both the WFC and the RFC opened the door to a vast expansion of federal lending powers. He had paved the way for a new and ultimately expanding role of government as a financial intermediary and rescuer of troubled businesses, a revolution in federal financial intervention. The federal government has become a permanent and prominent influence in the allocation of credit.

\textbf{The Influence of Academic Scribblers}

Eugene Meyer disavowed the \textit{laissez faire} economic philosophy he had learned from William Graham Sumner at Yale. His thinking was heavily influenced by the German economics professor Adolph Wagner. Meyer concluded that Wagner’s teachings were

\textsuperscript{18} For a more complete discussion of the RFC, see Butkiewicz (2002).
\textsuperscript{19} Nominal GDP data are from the Bureau of Economic Analysis web site: \url{http://www.bea.doc.gov/}. RFC data are from Secretary of the Treasury (1959).
appropriate for Germany but not yet for the United States. This conclusion convinced him that
economics was not determined by universally applicable “natural laws”, as Sumner taught, but
was relative to the circumstances. Meyer concluded that economics was a pragmatic art, not a
science (Meyer papers, box 179).

Applying his pragmatic approach to economics, Meyer believed that markets function well
under “normal” conditions, but that the “abnormal conditions” following the war created
economic instability that could be remedied only through government intervention (Meyer
papers, box 180). Thus, he became the foremost proponent of federal government financial
intervention to stabilize markets during periods of economic difficulty.

His first duties during the war included purchasing essential commodities for the war effort.
Frequently he would refuse to make purchases at the prevailing market price. In these instances,
he typically sought to negotiate a price he considered to be “fair”.

His responsibilities at the War Finance Corporation included buying Liberty and Victory
bonds to stabilize price fluctuations. Later, he was able to convert the WFC into an export and
then agricultural credit agency. His objective was to stabilize markets, hopefully reversing some
of the deflation that had depressed prices of agricultural products, thereby providing relief to
distressed farmers.

During the contraction phase of the Great Depression, Meyer again felt the need for a federal
financial rescue, ultimately convincing President Hoover of the need for a federal financial
agency. Under Meyer, the RFC primarily lent money to provide liquidity to the distressed
banking section, although RFC activities greatly increased during the New Deal and second
world war.
Meyer understood that the RFC was the direct opposite of *laissez faire* philosophy he had learned in college. He concluded that “abnormal” circumstances justified government intervention. However, he also felt that such intervention should be temporary, and should be terminated when conditions returned to “normal” (Meyer, 1954, p. 27).

But the door that Meyer opened with the WFC and RFC was never closed. During FDR’s presidency, the off-budget borrowing and lending powers of the RFC afforded numerous opportunities for federal intervention into the allocation of credit and the resulting resource allocation of the economy. Federal intervention in the allocation of credit and financial rescues have continued to the present, much of it through the descendants of the RFC, including the Commodity Credit Corporation, the Export-Import Bank, Fannie Mae and the Small Business Administration.

Had Eugene Meyer never held a government position, federal intervention into credit markets and the entire economy would likely have occurred, probably at a later date. Meyer opened the door, but Roosevelt plowed a much wider path.

Still, almost single-handedly, Eugene Meyer paved the way for a revolution of federal financial rescues in the American economy. For better or worse, this is his legacy.
References


