Occupy History:
The Roosevelt Financial Checklist and President Obama

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In the middle of October 2011, as I was making my way out of the Wall Street subway station, I met a lively crowd that did not quite match the local dress code. They were going from one passer-by to the other, asking directions for “the historical site of JP Morgan bank”. The young bankers with bespoke suits did not seem to have either a minute or a clue. Being a financial historian whose day was over after a downtown seminar on interwar financial crises and reforms, I certainly owed them directions to 23rd Wall Street. As we traded jokes it became obvious they were part of what is known today as the Occupy Wall Street movement, and they were on their way to a rally that social websites had coordinated there.

The experience struck me, because during the seminar I had delivered earlier that day, I had emphasized some aspects of the interwar crisis that involved finance, politics and symbols. I had spoken a lot of the House of Morgan, and how the New Deal Financial Acts of the 1930s could be interpreted as a power fight between the Roosevelt Administration and the incumbents of the US financial system. I had received enormously useful feedback from the discussion. Yet the image of the “Occupy” people rambling the financial district in search of Morgans brought additional perspective, that had been missing in my talk and that was missing in the conventional parallels that are conventionally being drawn between the Great Depression and the subprime crisis.

Since the beginning of the Great Contraction of 2007, Great Depression Era “lessons” have inspired much economic policy action. It is fair to say that the first efforts at crisis fighting were devoted to addressing what was identified as a replica of 1929. Austere charts showing the parallel spiraling down of stock prices, trade and the economy after 1929 and after 2007 gained Tweeter currency. Thus policy makers have taken for granted that history matters

In fact, the extent to which economic discussion and debate have turned to historical precedent and analogy is astonishing. Macroeconomic ideas of the pump priming variety – which had precisely been tailored in the aftermath of the Great Depression -- were taken out from the closet where they were stored and adjusted to the fashion of the day. Government checkbooks were set wide open: not as wide open as some would have wanted but certainly wider than interwar policy makers dared and that some modern constituencies want. This first round of history-inspired policy responses bought policy makers precious time, and ensured divergence between interwar and current economic curves: Economics 101 had saved the world.

Expansionary policy making may have saved the world, but it did not save President Obama whose reelection is anything but assured. This is an enormous contrast with the 1930s when President Roosevelt’s victory in the election of 1932 was followed by a landslide in the 1936 campaign. Timing of the election cycle probably explains part of the differences in outcomes. President Roosevelt had the good luck to be elected in 1932 and came to power in 1933 as the crisis reached unprecedented depths and a lot of the mischief could be associated with the previous Administration. Roosevelt and the New Deal, by contrast, were part of the solution. President Obama, on the other hand, was elected in the immediate aftermath of the frightening September 2008, of Lehman and AIG fame – in retrospect, a relatively early stage of the sub-prime crisis – making it harder for the current Administration to distance itself from the inevitable pitfalls of early crisis management.

But this would be hardly enough to explain the differences in historical and current trajectories. In fact, there have been some tremendously important differences between Administration policy making. I argue they have little to do with macroeconomic policy making, and a lot with politics, narratives, communication, alliances, in short with the more traditional tool book of the modern policy maker. In particular, I am struck by the fact that the Great Depression played into the hand of President Roosevelt, and came to become an asset when the election year came. Indeed, it is not on the macroeconomic front that the election of 1936 was won: Paul Krugman's cherished emphasis that it took WWII to extirpate the US economy from the doldrums of the Great Depression is significant because it corrects the popular misinformed inference that if Roosevelt was successful in 1936 it must have been because of the economy. It was not, or rather, it was not because of the macroeconomics of the economy.

What, then? Here follows a few "lessons" on the Roosevelt era that focus on his "microeconomic" legacy: in short, his successful attempt at transforming critical aspects of the US financial system. The lessons are machiavelian in that I take no view on overall efficiency or desirability of given policies. I am not, in particular, trying to gauge the relative managerial performance of the New Dealers and the Obama Administration. They are machivellian in that they are told from the vantage point of the Prince, or for the case, President, and seek to explain how policy moves may strengthen his power – in a democracy, the *ability to get reelected*.

Piecemeal: Of Weasels, Rabbits and Cats

New Deal financial legislation is usually considered as revolutionary and Wikipedia awards Dodd-Frank the prize for being the "most sweeping change to financial regulation in the United States" since the New Deal. Yet few seem to realize that New Dealers, instead of going for a comprehensive bill such as Dodd-Frank (that covers everything from credit card charges to banks' proprietary trading to reorganization or creation of regulatory bodies) preferred a piecemeal approach that went after one issue at a time. There isn't a single New Deal Financial Act but several ones, and they were spread over time. The major bits were: the Glass-Steagall Act of 1933 which created deposit insurance and separated commercial and investment banking; The Securities Act of 1933 on liability and disclosure which established "truth in securities" and ingrained the "seller beware" principle in US financial regulation; The Securities Exchange Act of 1934 that extended the Securities Exchange Commission Power and paved the way for its redrafting of the statutes of the New York Stock Exchange in 1937; and the Public Utility Holding Company Act of 1935 on financial conglomerates. In fact there was a rolling fire of public meddling with things financial leading Vincent Carosso, a prominent historian of Wall Street during the New Deal to describe years ago the banking profession as having rarely been subjected to such persistent "harassment" by public authorities.

Reasons for the choice of such dramatically different approaches (comprehensive now, piecemeal then) would deserve a book-length study. But such a study would inevitably begin by remarking that the strategy adopted during the 1930s fitted a presidential narrative that emphasized both the "sweeping" and "experimental" dimensions of the task. Sweeping reforms required bold changes that would shy from nothing. The experimental aspect of the attempt gave FDR full control over policy story telling. Each step taken was just one phase into a general program and would accordingly be adjusted in future legislation which the Administration would still be originating. Policy discussion would always go back to the overarching goal of the reforms – improving the operation of the nation's financial markets and making sure that they were the country's servant, not its master – and this ensured that policy makers would always "own" their policies.

The per-issue approach (now the banking system, now the underwriters and the transparency of information on securities, now the pricing and operation of the Exchange, now the cost for consumers and risk for investors of bigness in public utilities, etc.) enabled the Roosevelt Administration to pick its fights and it raised the coordination costs of opponents. With the piecemeal approach, opponents to some bits of legislation had more trouble finding sympathies in other parts of the financial systems. Individual incentives to oppose reforms affecting *others* were more limited. New Deal's financial Acts organized civil war within the financial community. Of commercial banks against investment banks, of investment banks against prime brokerage, of small against big, of outsiders, against insiders. As a result, the Administration's ability to achieve the results it sought were leveraged.

The difference with the strategies adopted by modern reformers are readily seen: the current focus on "Economics 101" disposed of the Administration's control on financial reform. Any policy move would inevitably be gauged from the vantage point of its relation with short term variation of output. Policy makers were hard pressed to produce a whole purpose legislation that would swiftly put the economy "back on track". But tackling all issues at once nurtured the kind of solidarities that had been at the heart of the crisis and raised the kind of hostilities that New Dealers had deftly dissolved. This may explain why certain criticisms – such as the preposterous notion that government takeover of problem companies was undercover communism – appears to have impressed the Obama Administration when Roosevelt's shrugged off.

Illustration of how FDR's divide-and-conquer tactics worked can be got from the way certain key reforms played out. As is well-known, a key argument about the adoption of Glass-Steagall was that competition between investment banks and commercial banks in the field of security origination (which the latter had recently entered through the creation of "shadow investment banks" known as security affiliates) had led to excessive risk taking. Since commercial banks were the more recent entrants, the policy narrative initially focused on them and in the first days of the Roosevelt Administration, it was decided to force commercial banks to dispose of their investment banking arms (the so-called "Security Affiliates"). At that point, Winthrop W. Aldrich of Chase National Bank moved to suggest that if the nation demanded commercial banks to give up underwriting, so be it. But the investment banks would have to give something in return – a pound of flesh that would have to be close enough to the heart of competitors to create competitive damage. Aldrich suggested that investment banks should give up the right to take public deposits and to sit in the boards of commercial banks, too. The contemporary press analyzed this move as reflecting the fight that was occurring inside the banking system between the old investment banking elite run by JP Morgan and the new commercial banking lords close to the Rockefeller group. A more recent generation of researchers have crunched the numbers of commercial and investment banks and found that commercial banks were not worse offenders than their investment banking counterpart. They have suggested this as a motivation for the view that Glass-Steagall was not "justified". But this misses the Machiavellian point, that the whole argument for the separation of commercial and investment banking was just this – separation. Glass-Steagall drove a wedge between competing interests and, by unsettling their precarious harmony, revived a gang war that consolidated the Administration's grasp. By hearing the rabbit, the cat could get its hands on the weasel.

The same technique is evident as well (albeit with slower effects and success) in the way the Roosevelt Administration sought to rely on tensions inside the NYSE in order to push forward its reform agenda and eventually re-write the rulebook of the Exchange. To reach that goal, the Administration relied on insider's opposition to the status quo, providing rewards to the defectors of the old order. This included the appointment of the first Chairman of the SEC, Joseph Kennedy, undoubtedly a man of the old order who was thus bribed into becoming an agent for the new. Likewise, New Dealers sought to rely on a new generation of brokers who may have seen in the change of rules an opportunity to increase their market share at the expenses of the Old Guard. In particular, the Administration had noticed that there was much discontentment inside the Exchange stemming from the fact that a majority of the members were prevented by Exchange rules to exercise effective power. Decision was taken to handle the problem as one of governance, which, once exposed, gave the Administration legitimacy outside and support inside, while cornering opponents into the unsavory role of public enemies. In the somewhat mysterious language of New Dealers, "it takes a snoop to catch a jiggle".

Intellectual Foundations of Crisis Management

At the same time New Dealers worked to split opponents into smaller groups which they could then round up and defeat, they got their own act closely coordinated. Coordination was achieved through a variety of mechanisms that included the President's own vision of and experience with finance and financial markets. That Roosevelt was a connoisseur of American finance and knew quite well where he was stepping into is illustrated, as Ron Chernow has told it, by the President insistence that in the New Deal's Administration, there should not be anyone, not even a counsel, from "23rd" (meaning 23rd Wall Street, the address where our modern friends wanted to hold their rally). The New Deal Financial Acts were adopted with close monitoring of Congress and Senate by the President who micromanaged decisive votes with the help of personal letters of the "Dear George" variety. Yet as important as the President's own views were, the consistency of the New Deal's financial policies owed more fundamentally to powerful intellectual origins that all New Dealers shared – including the President – and to which the financial reforms of the 1930s could and did constantly relate.

These origins consisted in the body of thought that had led to the pre-1914 attacks by Louis Brandeis against the "Money Trust" (a.k.a. J.P. Morgan and associates). In essence, the Brandeisian critique of finance consisted in a simple proposition: that a set-up that would have financiers as “servant of two masters” would not be satisfactorys. A central tenet of the Brandeisian wisdom had been that banks’ role as middlemen enabled them to control the savings of ordinary Americans thus transforming them, unsuspecting, into speculators. The middleman, would collect the fee and the upside, and the ignorant investor would bear the risk. Another was that the alleged positive effects of “relationship banking” (better knowledge of the borrower enabling lender to offer crisis support etc.) that resulted from information asymmetries, created insider rents and encouraged bigness, since only big agents endowed with super-rents would have some incentives for a modicum of truthful behavior. But bigness, Brandeis reasoned, was inconsistent with democracy, a conclusion that was supported by many progressive politicians – including “cousin Teddy”. Such were the foundations of the New Freedom agenda whose relevance was only made more obvious by the Great Depression.

The link between Brandeisian teachings and the endeavors of the 1930s is all too evident. It is obvious from Roosevelt’s repeated, almost obsessive, use of the phrase “Other people’s money” which he took from the title of Brandeis’ famous book of 1913. It is obvious, from the involvement of people sharing Brandeisian values. Among New Deal financial Acts drafters as well as providers of advice or inspiration we find men such as Benjamin V. Cohen, Thomas V. Corcoran, William O. Douglas or Felix Frankfurter. It is, finally, obvious from the way the various financial Acts of the 1930s specialized, as if to address one Brandeisian theme at a time: the separation of commercial and investment banking which spoke to concerns that investment banks would use control of commercial banks to leverage their power; the Securities Act of 1933 which spoke to the concern that conflict of interest ridden underwriters would misrepresent the true value of the securities they marketed; the Securities Exchange Act of 1934 which drew on the Brandeisian theme that publicity and broad daylight would be the best “disinfectant” of Exchange practices; and last the Public Utility Holding Company Act, which transcribed into actual regulation Brandeisian loath of bigness and of the shrewd ways financiers had to defraud the general investor. Hatred of bigness, concern with the fiduciary role of banking intermediaries, calls to make finance the servant (the people is the master), had been brushed aside in the 1910-1913 debates on the grounds that the nation’s financial organization served rather well its growth purposes. Brandeis’ emphasis that economic efficiency was not good enough could not triumph on full stomachs and full employment, but now in the 1930s, stomachs were empty and employment ebbing and ears as a result, were eager to listen.

The deep legal and political foundations of the New Dealer’s intellectual toolkit are an important aspect of their success. They enabled them to reason on first principles as architects of a new, safer but above all *more democratic* financial world. They enabled them to escape the tyranny of short term efficiency that is undermining President Obama and focus on long term transformations. And they enabled them to remain in charge – to own their own agenda. The Administration, by “originating” ideas on financial reform and spelling them out one after the other, could present itself as the producer of financial wisdom. This approach put time on it side, and gave the New Dealers the tactical advantage of speaking from a position where they acted as architects of a never ending construction.

The contrast with today is gaping. Not that modern firefighters lacked a bible. In fact, they had two: Both Keynes’ *General Theory* and Friedman and Schwartz’ *Monetary History of the United States* concurred on the need for expansionary policies thus creating the kind of bi-partisan support that *Other People’s Money* had mustered. Friedman and Schwartz are famous for having faulted the Federal reserve’s flawed policies for “causing” or amplifying the Great Depression, a view which is now part of the basic teachings of all economics textbooks in the West. As was the case during the 1930s, the wisdom of the time was carried and extended by scholars who happened to be in charge of policy making when the storm came (one is reminded of economist Ben Bernanke refinement of the Friedman and Schwartz’ insight on the contractionary effect of inadequate monetary policy known as the “credit channel” which may have led the Fed Chairman Ben Bernanke to be rather willing to flood the financial system with liquidity in the fall of 2008 and resist retrenchment afterwards). But the modern textbook has one major difference with the interwar bible. While Brandeis’ work described a political philosophy rather than a specific policy advice or recipe, the modern text is fiercely technical and professional. As a result, it says nothing about what should be done once the initial contraction is met by fiscal and monetary expansion. In the textbook case, the one we teach our students, monetary and fiscal stimulus take care of themselves. The deficit generates output expansion which generates revenues, which limits the deficit. Exit the problem. But this wisdom is silent on what happens after round 1, in case the contraction persists, or in case there remains, at the end of the day, a public liability to be funded. As to how many times the expansion should be played, or as to who should pay for this, there is no professional consensus – only poignant Opeds.

To sum up, both the interwar and modern policy making could benefit from the availability of an intellectual framework, although the two frameworks differed profoundly from one another. The first came from lawyers who reflected on democracy and political principles. The second came from economists who had macroeconomic efficiency and performance in mind. This conclusion may come as a surprise to those, like myself, who have grown accustomed to the view that one major problem with the interwar was a lack of "policy understanding" and as a result, the improper policy response that was given to the Great Depression (a story which, unsurprisingly, has been told by economists). To account for this, students of the interwar have referred to ideology, misconceived adherence to the Gold Standard, etc. This may well have been so. But it is intriguing that lawyers-inspired "inadequate" thinking on how to deal with a major macroeconomic "shock" left President Roosevelt ensured (at least, did not prevent) his swift reelection, enabling him to complete his task of financial overhaul. On the other hand, the allegedly more adequate and informed advice that President Obama received from economists who would have successfully fought the Great Depression of the interwar left him substantially more exposed with, as a legacy, a rather terse financial reform bill, which some Republican opponents have already announced they plan to scrap down.

Politics of Narrative: I Told You So and Back Again

Thus Brandeisian thinking was a faithful companion for Neal Deal policy making over the long run in that it was a natural, multiple use, instrument of sense-making. It initially came at hand with a distinctive flavor of I Told You So and the financial disasters came in close succession after 1929 had the good taste of inserting themselves into a story of wrongdoings: bigness, which was pyramiding; banking intermediaries, who were more like gangsters; the financier as self-proclaimed a servant of growth, but in an age of Depression, a man whose political connections were exposed to the crude light of the day. This totally vindicated Brandeisian premises -- something New Dealers recognized and utilized.

One key word of the Brandeisian campaigns before WWI was "publicity" – as the phrase went, the "best disinfectant". Central in the New Deal's financial check list was the policy narrative it organized which actually ensured the Administration control over policy making: The Administration talked of scraping financial intermediaries of their power and motivated it by reference to wrongdoings which the crisis had proved. Continued financial and policy problems gave grounds for policy reform. Paradoxically, persistence of problems permitted to maintain control over events.

This facilitated control of those whose interests were harmed by regulation: The only way out for intermediaries was to acquiesce to the verdict of wrongdoing, which of course scraped their power. Well-known highlights of this use of publicity was the interaction between the disclosures (by public commissions) and admissions (by bankers): the investigation on stock exchange practices (or "Pecora" commission) or the investigation of lobbying against the Utility Holding Company bill. Each of these investigations, which attracted heavy media coverage, were organized into the unfolding of a new chapter of the Brandeisian tale which the Roosevelt Administration told the US people. For instance, in the hands of the New Dealers, the investigation on stock exchange practices morphed into a powerful political machinery which created sensation.

The nation held its breath as revelations piled up. Morgan's lists of preferred customers, who received preferential treatment, National City Bank's President Mitchell who did not pay taxes, New York Stock Exchange's shady pools that served hard to comprehend purposes and looked like plain market rigging, etc. Bankers could try sophisticate and perhaps valid answers that emphasized the need to rely on buy and hold investors which had to be somehow enticed, or emphasize that the loopholes in the tax system was not of their making, or argue that issue price support was not always synonymous to wrong doing. Likewise, the investigation of lobbying against the Utility Holding Company bill in 1935 exposed the financial barbarians at the doors and suggested they were anything but defeated. In several campaign speeches and again in the inauguration discourse, the President had pledged to "drive the money changers out of the Temple" – the evidence that surfaced from such investigations was that the money changers were deeply ingrained in the American polity and vindicated the Administration's trying harder.

Publicity has already played an important part in the struggle against the money trust

Drawing illustrating Louis D. Brandeis, “What Publicity Can Do” in *Harper’s Weekly*, December 20, 1913, p. 12.

The political logic at work is well exemplified by the fight that developed in 1937 between the New Dealers in charge of the Securities Exchange Commission and the authorities of the New York Stock Exchange. The SEC had decided to push the Exchange to reform itself. Their plan was to have the authorities of the NYSE to write a letter to the SEC that would include a reference to the severe market decline that had just happened (the 1937 replica of the crash of 1929) and ask for cooperation about reform. The SEC would then reply approvingly and offer its cooperation for reorganization. But Stock Exchange authorities were uneasy to publicly admit that the reorganization “responded” to market turbulences, as this would amount to a guilt clause. The NYSE thus shrank from admitting anything leading the SEC to threaten to make full use of its organizational powers. The institution of the NYSE, it claimed, was “so vested with the public interest” that its management ought to be in the hands of those who had a “clearer sense of public responsibilities”. Faced with the explicit threat of seeing its affairs administered by the SEC, NYSE authorities surrendered.

This narrative was powerful and engrossing. Its roots were deeply enmeshed with bipartisan aspirations of the progressives. The populist ring of the candidate’s lashing out at the “money changers” courted a vote that broadened the Democratic platform. So did the New Dealers’ repeated statements on the need to establish “truth in securities” and to make the seller of securities, not the buyer, beware. As a result, the President could cast his political net far beyond party lines to Midwest and Western mavericks, such as Progressive Republican Senator Hiram Johnson of California or Father Coughlin’s and his Michigan broadcasts. In so doing, New Dealers kept the populist vote in their fold – if not the populist leaders, who repeatedly clashed with the Administration -- and secured the easy reelection of President Roosevelt. The Administration proved extremely good at controlling the populist territory by establishing strong credentials as a fighter of the “fat cats” for the benefit of ordinary Americans. Pure and simple, the New Deal financial checklist transformed FDR into a Main Street hero. It was Roosevelt who had given Pecora the means to chastise the bankers: This had permitted the regular Joe to get his hands on New York financial aristocracy. The circus midget who jumped on Jack Morgan’s lap during a recess of the Pecora hearings was a metaphor of this.

For economists, this is perhaps a troubling introspection to make. Economists through their advocacy of massive spending, through the construction of expert knowledge that has prevented a full public discussion of the wrongdoings uncovered for this crisis in the modern commissions (after all we have models for or against any single market imperfections and the outrage of the regular Joe may only have to do with his failure at understanding the complex mathematical formulas that are really behind all this), and last, through their professional defense of the monopoly they own over the interpretation of a certain class of events, have contributed to put history on a totally different course. In the end, the contrasted relations of the two democratic Presidents then and now with populist movements (from left to right) summarizes the difference between the two periods. The modern reliance on the economic *professional* and her *professional* knowledge of the virtues of government spending on the one hand and, on the other hand, the historical reliance on the legal expert turned into financial engineer (or regulator), her condemnation of the conflicts of interest, and her firm belief that society can be redesigned. To these alternative emphases, correspond alternative forms of blindness: Ignorance of Economics 101 back then, we are told. But what about nowadays?

There are literally dozens of quotes to the effect of history repeating or not repeating itself and they look good in conclusions. I have been tempted to use one. Yet the moral of my story is more about a curious case where policy makers decided that history was repeating itself and consciously set to avoid what they constructed as being the mistakes of their forerunners. The reason why things were played out the way they were in both historical instances, I suggest, can be understood by reference to the story about history that the President and his advisors held as true. They may have little to do with "history" as a univocal truth. So let's try this before we part: There is more than one way to occupy (or leave) history -- as the angry and joyful crowd rummaging Wall Street in search of the House of Morgan in mid-October reminds us.