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Robert R. Keller

The state's role in the U.S. economy during the 1920s has been interpreted from wide-ranging perspectives. The three presidents of the decade each offered a particular view of the state's role. Warren Harding longed for a state that would "return to normalcy;" Calvin Coolidge wanted a state that embodied a "business government;" and Herbert Hoover promoted what came to be called the "associative state." Scholars of the period also present divergent interpretations of the state's role. Jonathan Hughes characterizes the 1920s as a "fabled interlude"—a decade that interrupted the trend whereby the market price mechanism was weakened by government. William Barber and Guy Alchon, on the other hand, describe the 1920s as a "new era," where government moved to the middle ground between laissez-faire and statist planning.[1]

The multifarious views of the state's role in the 1920s, ranging from government drifting back toward laissez-faire to government moving toward indicative planning, present a problem of interpretation. Did the state become larger and more interventionist or not? There is not a simple answer to this question. Institutionalists know that the state's role is complex and encompasses many functions and activities, and that it reflects to a different degree, the influence of factors such as ide-

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ology, continuity with past institutions, and new technology. Moreover, the evolution of the state typically embodies areas of increased intervention and growth, and instances of decreased intervention and decline.[2]

The modest objective of this article is to utilize an institutional economics perspective to examine three important aspects of the state's role in the 1920s. My research focuses on the stabilizing function of macroeconomic policies, the changing size of the federal government sector, and the evolving federal regulations on business.

Macroeconomic Policy

The state's macroeconomic policy during the 1920s reflects a pattern for fiscal policy that differs from the thrust of monetary policy. Macroeconomic stabilization was not an objective of fiscal policy; monetary policy, on the other hand, was directed, at times, toward macroeconomic stabilization. Thus, the state's role moved toward more intervention with monetary policy, and less intervention with fiscal policy.

Monetary Policy

There is debate and disagreement about the role of the Federal Reserve in macroeconomic stabilization during the 1920s. Milton Friedman and Anna Schwartz describe the 1920s as a time of "high tide" in the Federal Reserve's monetary management.[3] Elmus Wicker, on the other hand, claims that the Federal Reserve managed money only for the brief interlude from 1922 to 1924.[4]

Friedman and Schwartz state that the Federal Reserve escaped from its subservient role of financing the Treasury, and refined its knowledge and kit of monetary policy tools (especially open market operations) during the 1920s. The Federal Reserve used expansionary monetary policy to counteract mild recessions in 1923–1924 and 1926–1927, and sterilized gold inflows in the course of the 1920s to promote price level stability.[5] Wicker agrees that the Federal Reserve used its policy instruments to stabilize the economy in 1923–1924. However, he states that there are other objectives that account for the Federal Reserve's behavior from 1925 to 1929, namely, international considerations and the indebtedness of member banks in New York and Chicago.[6]

Fiscal Policy

World War I bequeathed to the early 1920s a legacy of a greatly enlarged public sector. Table 1 presents information on spending, taxation, and the public debt from 1915 to 1929. The impact of World War I on these variables is dramatic. In 1915, government expenditures were $746 million; in 1919, the peak year of spending, expenditures reached $18.5 billion. The rapid increase in spending was financed by a combination of increased taxation and borrowing. Government receipts rose from $683 million to $5.13 billion, and the national debt increased from $1.2 billion to $25.5 billion between 1915 and 1919.

The federal government's pattern of expenditures, taxation, and debt management during the 1920s is explained by demobilization after World War I, international arms control, and the implementation of conservative Republican supply-side economic policies. Demobilization featured a precipitous decline in spending. Governmental outlays (Table 1) were slashed by $12 billion and had the effect of reducing the level of spending in 1920 to one-third of its 1919 level.

The continuation of the decline in government spending also reflected the pursuit of arms control. Majority opinion in the United States was against senseless arms rivalry, and the major powers saw arms control as mutually beneficial. The Washington Conference in November 1921 initiated disarmament discussions between powers with interests in the Far East. From the Washington Conference came three major treaties and a number of small agreements that provided for arms control and the preservation of the balance of power.[7]

Demobilization and disarmament provided the backdrop for the implementation of conservative Republican supply-side fiscal policies. The chief architects of these policies were Calvin Coolidge, Vice President under Harding and President from 1923 to 1929, and Andrew Mellon, Secretary of the Treasury under Harding, Coolidge, and Hoover. The supply-side fiscal policies embodied the ideology of business, as expressed by the National Association of Manufacturers and the Chamber of Commerce, of the 1920s. Charles N. Fay, Vice President of the National Association of Manufacturers, defined the fiscal role of government by the principle of "Least Government, with its companion principle of Least Taxation."[8] Calvin Coolidge defined the spending role of government as one of "constructive economy."[9] Constructive economy referred to establishing a more efficient government, while at the same time reducing government spending and lowering the national debt. Andrew Mellon emphasized the importance of constructive economy for tax reduction. He believed that "tax reduction must come out of surplus revenue."[10] Mellon also articulated supply-side arguments for tax reduction. He believed that a reduction in tax rates would increase total tax revenues and provide incentives for increased production. Mellon's arguments for tax reduction and the business ideology of Least Taxation were primary forces in the series of four tax cuts that were implemented between 1921 and 1928.[11] Thus, conservative Republican supply-side fiscal policies explain the further reductions in government spending, the decline in tax revenues, the budget surpluses, and the reduction in national debt that occurred after 1920 (refer to Table 1).[12]

Table 1. ***Federal Expenditures, Receipts and Debt, 1915–1929 (millions of dollars).***

Year	*Federal Budget Expenditures*	*Federal Budget Receipts*	*Budget Surplus or Deficit*	*Public Debt*
1915	746	683	− 63	1,191
1916	713	761	+ 48	1,225
1917	1,954	1,100	− 853	2,976
1918	12,662	3,645	− 9,032	12,455
1919	18,493	5,130	−13,362	25,485
1920	6,358	6,649	+ 291	24,299
1921	5,062	5,571	+ 509	23,977
1922	3,289	4,026	+ 737	22,963
1923	3,140	3,853	+ 713	22,348
1924	2,908	3,871	+ 963	21,251
1925	2,924	3,641	+ 717	20,516
1926	2,930	3,795	+ 865	19,643
1927	2,857	4,013	+ 1,155	18,512
1928	2,961	3,900	+ 939	17,604
1929	3,127	3,862	+ 734	16,931

SOURCE: U. S. Department of Commerce, *Historical Statistics of the United States* (Washington, D.C., 1975). Series Y 335–338, p. 1104.

The Size of the Federal Government Sector

A cursory examination of Table 1 reveals that the size of the federal govenment sector exploded during World War I and imploded after the Treaty of Versailles. On the basis of the comparison of the federal budget for the war and postwar years, and implementation of conservative Republican supply-side fiscal policies during the 1920s, it is reasonable to conclude that the federal government rapidly moved toward laissez-faire. However, if a longer perspective is taken, one that includes the prewar years, a different conclusion is reached. If per capita levels of non-defense spending for the 1920s is compared to prewar levels, then the size of the federal government sector shows remarkable expansion.

World War I and the 1920s

Table 1 shows that the end of the war transformed an extraordinary budget into an ordinary budget. In 1919, federal expenditures were $18.5 billion, government receipts were $5.13 billion, and the national debt was $25.5 billion. By 1922, federal expenditures fell to $3.3 billion, government receipts declined to $4.0 billion, and the national debt was reduced to $22.9 billion. For the remainder of the 1920s, expenditures averaged about $3 billion, receipts averaged slightly less than $4 billion, and the national debt was reduced to $16.9 billion. The shrinking size of these federal budget categories is most certainly consistent with interpretations that the state rapidly moved toward laissez-faire.

Prewar and the Twenties

Jacob Metzer has provided the most detailed examination of the federal budget in the 1920s.[13] He notes that real per capita *nonwar-related* expenditures increased from $3.60 per year in the 1901–1908 period to $5.75 per year in the 1921–1928 period.[14] Unfortunately, the nonwar-related expenditures category is not disaggregated. However, fragmentary information indicates that the expansion of federal spending occurred in the areas of public goods, relief assistance, and social welfare services. A few examples are listed below.

The growing importance of the automobile led to the Federal Highway Act of 1921, which in turn set the stage for a boom in road building. Between 1922 and 1929, 80,000 miles of federally assisted roads were constructed at a cost of $670 million to the federal government.[15]

The federal government also responded to natural disasters by providing relief payments and by constructing flood control projects. It provided direct relief, in partnership with private charitable institutions, to the victims of the Mississippi River flood in 1927.[16] Also, the Jones-Reid Act of 1928 appropriated $300 million to construct levees, drainage basins, and spillways.[17]

Finally, the federal government provided, through grants-in-aid to states, modest funds to maintain the health of children, to rehabilitate disabled workers, and to create vocational education programs. Edward Berkowitz and Kim McQuaid note that the federal government's per capita expenditures on welfare increased from $.09 in 1913 to $0.25 in 1928.[18]

Thus, when the 1920s is compared to the prewar era in nonwar-related expenditures, the evidence is consistent with interpretations of the state expanding its activities.

Federal Regulation of Business

Federal regulation of business was primarily influenced by a conservative Republican ideology, by a new view of an "associative state," and by the imperatives of new technology.

The conservative Republican ideology on regulation embodied the view of business expressed by the National Association of Manufacturers and the Chamber of Commerce. The business attitude toward the regulatory role of government rested upon three tenets. First, natural economic laws make government regulation of business unnecessary. Second, government regulation, if allowed to persist, must reflect business attitudes and views. Third, business success demonstrated worth and competence in all areas. Thus, if regulatory agencies exist, public servants on the regulatory boards should be selected from the business community.[19] The conservative Republican ideology is consistent with appointment of pro-business interests to the Federal Trade Commission, with the decreasing interest of the Federal Trade Commission in pursuing anti-competitive business practices, and with the increased laxity of anti-trust enforcement by the Justice Department.

However, the posture and behavior of the Federal Trade Commission and the Justice Department is also consistent with a new view of government's role that was evolving in the 1920s—namely, the associative state. The associative state, and its chief architect Herbert Hoover, saw government operating in the middle ground between unsocial individualism/laissez-faire and state planning. The associative state was to be a coordinating mechanism in the following ways: (1) by gathering economic statistics that would provide information for business on costs and macroeconomic tendencies; (2) by engaging in cooperative activities with business and professionals, for example, by encouraging business trade associations and professional associations and societies; and (3) by coordinating a countercyclical pattern of public and private spending on capital goods.[20] Hoover, as the Secretary of Commerce, promoted trade associations and encouraged the Federal Trade Commission and the Anti-Trust Division of the Justice Department to be more cooperative with business.[21]

Finally, the federal government expanded its regulatory activities in areas where new technology overlapped local and state boundaries. The Air Commerce Act of 1926 and the Federal Radio Commission of 1927 are two noteworthy examples of new federal regulatory activities that responded to new technologies.[22]

Conclusion

Let us return to the original question. Did the state become larger and more interventionist in the 1920s? If the state's role in the 1920s is compared to its role during World War I, then the answer is a resounding no! However, if a longer perspective is taken, one that includes the prewar years, then instances of an expanded public sector can be found.

Hoover's new view of an associative state battled the old ideology, expressed by Coolidge and Mellon, of a laissez-faire state. Conservative Republican supply-side ideas dominated fiscal policy actions, and conservative views promoted the deregulation of many governmental controls over business. Nevertheless, some aspects of the associative state—gathering economic statistics, promoting cooperation between government and business, and expanding the welfare system—were incorporated into the federal government's activities.

There were other areas of an increased federal government presence. The Federal Reserve intervened, at times, for macroeconomic stabilization purposes. The federal government provided relief for flood victims and funded flood prevention projects. Finally, the state responded to the imperatives of new technology by funding highways and regulating the nascent air transport and radio industries.

Notes

1. Refer to: Guy Alchon, *The Invisible Hand of Planning* (Princeton: Princeton University Press, 1985); William J. Barber, *From New Era to New Deal* (Cambridge: Cambridge University Press, 1985); Jonathan Hughes, *The Governmental Habit* (New York: Basic Books, 1977); and James T. Patterson, *America in the Twentieth Century* (New York: Harcourt Brace Jovanovich, 1976).
2. Two excellent sources on the role of the state are: Robert Delorme, "A New View on the Economic Theory of the State," *Journal of Economic Issues* 18 (September 1984): 715–44; and Robert Solo, *The Positive State* (Cincinnati: South-Western Publishing Co., 1982).
3. Milton Friedman and Anna Schwartz, *A Monetary History of the United States* (Princeton: Princeton University Press, 1963), Chap. 6.
4. Elmus R. Wicker, *Federal Reserve Monetary Policy, 1917–1933* (New York: Random House, 1966).
5. Friedman and Schwartz, *A Monetary History of the United States,* pp. 296–8.

6. Wicker, *Federal Reserve Monetary Policy,* pp. x–xi.
7. Arthur S. Link and William B. Catton, *American Epoch,* Vol. II, 1921–45 (New York: Alfred A. Knopf, 1973).
8. James W. Prothro, *The Dollar Decade: Business Ideas in the 1920s* (Baton Rouge: Louisiana State University Press, 1954), p. 118.
9. Calvin Coolidge, *Foundations of the Republic* (New York: Books for Libraries Press, 1926), p. 200.
10. Andrew W. Mellon, *Taxation: The People's Business* (New York: Macmillan, 1924), p. 20.
11. Robert R. Keller, "A Macroeconomic History of Supply-Side Fiscal Policies in the 1920s," *Review of Social Economy* 42 (October 1984): 130–42.
12. Robert R. Keller, "Supply-Side Economic Policies during the Coolidge-Mellon Era," *Journal of Economic Issues* 16 (September 1982): 773–90.
13. Jacob Metzer, "How New was the New Era," *Journal of Economic History* 45 (March 1985): 119–26.
14. Ibid., p. 120.
15. Jim Potter, *The American Economy between the World Wars* (New York: John Wiley and Sons, 1974).
16. Edward Berkowitz and Kim McQuaid, *Creating the Welfare State* (New York: Praeger Publishers, 1980), p. 62.
17. Oscar Barck, Jr. and Nelson Blake, *Since 1900* (New York: Macmillan, 1959), p. 317.
18. Berkowitz and McQuaid, *Creating the Welfare State,* p. 66.
19. Prothro, *The Dollar Decade,* pp. 138–52.
20. Barber, *From New Era to New Deal,* pp. 7–22. There are strong parallels between some aspects of the associative state and the views of John R. Commons and Wesley C. Mitchell.
21. Ibid., pp. 8–13.
22. Hughes, *The Governmental Habit,* p. 151.