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FDR's Reconstruction Finance Corp. Model

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In the period 1933-45, President Franklin Roosevelt used the Reconstruction Finance Corporation (RFC) as a Hamiltonian instrument to direct cheap and abundant credit into the physical economy to produce magnificent new infrastructure projects, generate explosive economic growth, and thereby defeat the Depression.

Today, the critical task defining America's survival is again, a mobilization to construct vital technology-transmitting infrastructure projects, with a 25- to 50-year horizon, to overcome America's severe infrastructure breakdown. Financing this infrastructure mobilization requires a national credit-generating institution, with power like that of the RFC to generate abundant long-term credit, at 1-2% interest rates.

Only a sovereign government can create the basis for the revival of an economy, when the "private sector" had failed utterly. It is the sovereign government that has the responsibility to set the broad parameters for a pathway for the science and infrastructure policy one or two generations hence, and must have national credit institutions that will realize that vision. Private banks and Wall Street are incapable of doing that, though the private sector can support the effort by participating through sufficient lending to achieve the objective of recovery measures.

Franklin Delano Roosevelt's wielding of the RFC can serve as a working precedent of the method by which a "Hamiltonian" credit policy can bring an economy out of collapse and revitalize it. As with Roosevelt then, today's deeper crisis requires simultaneously putting the bankrupt financial system through reorganization.

'Hamiltonian' Banking Policy

On Roosevelt's inauguration on March 4, 1933, the banking system had collapsed, and the physical economy was in Depression. The Reconstruction Finance Corporation already existed, having been created by President Herbert Hoover and the Congress in January 1932. But Hoover used the RFC in a disastrous way, without putting the banks through bankruptcy reorganization, or making any fundamental change in the economic and financial policy of the country. Hoover's RFC made loans to the troubled banks and insurance companies, to try to bail them out. During 1932, it dispensed $1.624 billion in this manner, but the bail-out policy was a failure: the economy and banking system continued to get worse.

Roosevelt used the RFC in an entirely different way: he made it part of a interconnected package—bankruptcy reorganization, restoring the banking system, building technology-transmitting infrastructure, creating productive jobs through public works, and revitalizing manufacturing and agriculture. This was an integral package, and no part could succeed, simply by itself.

FDR immediately appointed a new RFC director, Jesse Jones, a former lumberman and banker from Texas, who generally shared Roosevelt's mistrust of Wall Street. Working with Roosevelt, Jones was crucial to the RFC's success. With Jones, Roosevelt first used the RFC to put the banking system through reorganization and restore it to functioning. He could then give it a larger-scale role in building infrastructure and the physical economy.

With the March 5, 1933 National Bank Holiday, President Roosevelt closed all of the nation's banks (superseding state bank holidays which had already closed them in all 48 states). On March 9, FDR sent the Emergency Banking Act to Congress, which passed it and sent it back for signing into law the same day. It carried out a partial but substantial bankruptcy reorganization, facilitating the writing off of portions of the banks' speculative financial paper (much of that had already been "written off" by the crash and Depression). It set up three classifications for action: banks that were sound and could open under their own power; banks that required an RFC capital infusion; and banks that a conservator (created under the Act) would liquidate.

Next, abandoning the unsuccessful Hoover policy of bank-bailout loans, the RFC instead purchased capital (stock equity) and capital notes of troubled banks. The purchases would capitalize the troubled banks, without adding to their debts.

By March 15, some 70% of the 18,300 nationally chartered banks that had been in existence, before the March 5 bank holiday—sound and unsound—had reopened without RFC assistance; and 76% were so operating by April 12. Some knew they needed RFC assistance from the get-go, but others, which thought they could open on their own power, soon had to take RFC help. By June 1935, the RFC had made cash investments to the tune of $1.3 billion in the purchase of stock and capital notes of 6,800 banks; it owned more than one-third of outstanding capital in the American banking system.

At that point, with the banks stabilized, the RFC started a disinvestment from them which it completed in a few years. The hemorrhaging of the banking system had been halted, but with aid as well of the other parts of the New Deal package.

Building the New Deal Infrastructure

In the period 1933-37, Roosevelt's New Deal stopped the descent into Depression, most of all by building infrastructure. Typified by the revolutionary Tennessee Valley Authority, the projects would transmit new technology, increase productivity and the productive powers of labor; create millions of productive public works jobs; and through creating industrial orders, revive private manufacturing, re-open factories, and re-hire workers.

Many of the large money-center commercial banks, still dominated by Wall Street, refused to extend credit to the physical economy, in an attempt to sabotage the New Deal; among some Wall Street bankers, this was part of a plot to overthrow Roosevelt.

Roosevelt knew with great urgency that he had to get directed, "Hamiltonian" credit into the economy, and the RFC was his chosen instrument. He transformed it by using the full powers inhering in enabling legislation and mode of operation. At its inception, the RFC had issued stock bought by the U.S. government, meaning that the government owned it. But it was a self-supporting public corporation, financed through its own revolving fund; by selling its own notes to the public through the Treasury Department, it could pursue an independent policy.

In June 1934, FDR gained from Congress a change in the RFC's charter, which enabled it to make direct loans to business and industry. Roosevelt told an American Bankers Association meeting in 1934, "The old fallacious notion of the bankers on the one side and the Government on the other side, as being more or less equal and independent units, has passed away. Government by the necessity of things must be the leader, must be the judge of the conflicting interests of all groups in the community, including bankers."

Under Roosevelt and Jones, the RFC functioned almost as a Hamiltonian national bank. Between 1933 and 1938, the RFC loaned $9.5 billion, including $4 billion to banks, $1.5 billion to infrastructure/public works, $1.5 billion to agriculture, $1 billion to railroads, and hundreds of millions to housing. *It became the largest single investor in economic projects, and biggest bank, in terms of volume of lending, in the United States.*

Consider what the RFC achieved. It extended at least $500 million to the Federal Emergency Relief Administration (FERA); with these funds, Harry Hopkins ran FERA's Civil Works Administration that built infrastructure and provided jobs to the unemployed. The RFC spent hundreds of millions of dollars purchasing securities from Harold Ickes' Public Works Administration (PWA), the program for great infrastructure projects in the United States, such as the Hoover Dam. The RFC lent $246 million for programs carried out through the Rural Electrification Administration, including the construction of power lines across rural America, and providing financing for rural families to purchase electrical appliances. And it lent money to 632 different levee and irrigation districts, so that these districts could construct water-management and flood-control projects.

In 1934, the RFC created the Export-Import Bank of the United States as a division. Initially it financed trade with the Soviet Union; a few years later the Export-Import Bank's charter was changed, to finance and expand American capital goods and other exports worldwide.

The RFC set up two public corporations, whose stock it wholly owned, which were of great note between 1933-36: the Home Owners Loan Corporation (HOLC) refinanced one-fifth of the private urban home mortgages and stopped the flood of home foreclosures; the Federal Farm Mortgage Corporation (FFMC) refinanced more than 20% of all farm mortgages nationally, savings tens of thousands of farms.

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RFC Mobilizes for World War II

Between 1940 and 1945, Roosevelt and Jesse Jones used the RFC to disburse $23 billion to the economic mobilization for World War II, while utilizing the infrastruture that had been built during the New Deal. The RFC set up agencies like the Defense Plants Corporation, and through them sent disbursements, including:

- $4.5 billion to the aviation industry, including the airframe industry, and those sections of the auto industry that converted to aircraft production.
- $1.5 billion to aluminum and magnesium producers. Both industries are largely products of World War II.
- $250 million to build 45 plants to produce high-octane gasoline to fuel airplanes.
- $1.223 billion to build and upgrade 183 steel and pig iron plants, adding 11 million tons of new capacity.
- $715 million to build 51 synthetic rubber plants, which were wholly owned by the government. Before this, the United States had no synthetic rubber industry.
- $2 billion for building an abundant number of new machine tool production facilities, and greatly upgrading machine tool design.

The extension of credit by the RFC, as an instrument in the mold of Hamiltonian national banking, facilitated the transformation of the U.S. economy around its machine-tool sector, producing anti-entropic growth. *For the period of 1933 to 1945, the RFC extended a stunning $33 billion in new credit, more than the volume of new loans of the entire U.S. commercial banking system.* Through such an instrument today, the President and Congress could successfully direct an American crash program of reconstruction of economic infrastructure.