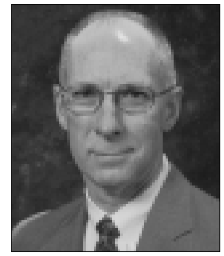
Our Economic Past

The New Deal and the State and Local Governments



BY ROBERT HIGGS

Until the twentieth century the average American in peacetime had little contact with the federal government, except for the post office, and the federal government's policies and actions affected most people only indirectly—for example, through land-disposition policies or the tariff's effect on commodity prices. State and local governments provided nearly all the government services the citizens needed, wanted, or merely endured: definition and enforcement of private property rights; construction and maintenance of roads, streets, sewers, water-supply systems, bridges, canals, and most other economic infrastructure; provision of most schools and some universities; regulation of many economic activities and much personal behavior; and so forth.

In the late-nineteenth and early-twentieth centuries, governments at all levels never spent more than 9 percent of gross national product (GNP) during peacetime. Of the total, local governments spent the biggest share, the federal government somewhat less, and state governments less still. In 1927, for example, local governments accounted for 56.7 percent, the federal government 30.4 percent, and state governments 12.9 percent.

Employment figures mirrored the spending breakdowns. In 1929 state and local governments combined employed 2.6 million persons, more than a million of them in education, whereas the federal government employed only 981,000 persons, including 267,000 in the military and many of the others as postal workers. (At that time, the total U.S. labor force numbered roughly 48 million.)

With the onset on the Great Depression and the advent of the New Deal, the structure of government underwent drastic change. People who know anything at all about these years understand that government became both larger and more centralized, yet few appreciate exactly how and why the overall structure of government changed or what consequences flowed from this change.

In mid-1929 the economy began to contract, and as the contraction continued, business failures and unemployment increased, and relief rolls lengthened. Cities and counties, which had traditionally borne the responsibility for public relief of the destitute, faced increasing demands for relief spending. At the same time, however, their revenues were shrinking, as property values fell and hence property-tax receipts, the major source of local government funds, fell along with them. In addition, tax delinquencies increased, and borrowing became more difficult. More and more cities and counties found themselves in a fiscal squeeze. States provided some assistance, but they faced similar difficulties as their own property-tax and other receipts dropped. Three states—Arkansas, Louisiana, and South Carolina—defaulted on their debts, and by the end of 1933, approximately 1,300 local governments also had defaulted and many other state and local governments verged on default.

Everyone looked increasingly to the federal government to save the day, and even before Franklin D. Roosevelt's election, Congress began to respond. In July 1932 the Emergency Relief and Construction Act was passed, providing $300 million to be lent to the states (and thence to cities and counties) for relief. Everybody understood that these loans probably would never be repaid, and eventually they were indeed written off. This statute constituted, as it were, the first big leak in the federal relief dam. After Roosevelt took office in March 1933 the dam burst.

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When it did, the federal government's expenditures increased rapidly relative to those of the state and local governments. In 1932 the shares of the federal, state, and local governments in total government spending (net of intergovernmental grants and receipts) were 32.4, 16.3, and 51.3 percent, respectively; in 1934, they were 38.8, 16.7, and 44.5 percent; and in 1940, they were 45, 17.4, and 37.6 percent. Notice that the state share did not fall; indeed, it rose slightly. The big shift came because the federal proportion and the local proportion traded places. Once this shift had occurred abruptly in the 1930s, the shares did not change much afterward; in 1990 they were 56.2, 17.9, and 25.9 percent. Thus although the depression that had provoked the shift ended in the 1940s, the status quo ante was never restored.

These developments did not mean that the local governments spent much less in absolute terms after 1932; in fact, they reduced their spending only slightly in the mid-1930s and then increased it in the latter years of the decade; by 1940 they were spending about 21 percent more than they had in 1932. State governments increased their spending much faster, by 84 percent between 1932 and 1940.

Tax revenues did not move in tandem with these spending changes because from 1932 on, the federal government was making greatly increased grants to the lower levels of government. By 1940 almost a third of all state spending was funded by federal grants. Between 1932 and 1940, not counting intergovernmental grants, local revenues increased by only 8 percent, state revenues by 120 percent; and federal revenues, excluding borrowed funds, by 166 percent.

Eager for the Money

The foregoing figures might tempt us to conclude that the federal government simply overwhelmed the other levels of government during the New Deal era, but the image of the feds riding into Dodge City like the James gang and taking over the town (and Kansas, too) is not true to the facts. Recall first that the state and local politicians were literally begging for federal bailouts in the early 1930s; the money was scarcely forced down their throats.

Second, in some states, such as Michigan, Pennsylvania, and New York, state politicians embraced the same ideology and political objectives as the dominant faction in Congress, and they proceeded to enact so-called Little New Deals that implemented state-level reforms, especially union-friendly labor laws and anti-business tax laws, similar to those the New Dealers enacted nationally. Twenty-four states adopted general sales taxes in the 1930s, 20 of them during the period 1933–35.

Third, many of the programs the federal government was establishing for relief and other purposes were not only financed with matching grants (in varying proportions), but also administered "cooperatively," that is, in large part by state or local employees, especially at the lower levels. Owing to this style of administration, state and local politicians gained considerable control over the newly created patronage jobs, and in some cases they could also shape the local rules or select the particular projects to be undertaken. In short, the lower-level politicos were definitely cut in on the deals.

Dependent on Government

The political profits the politicians reaped at every level do not signify, however, that other people gained, especially in the long run. Of course, each recipient of a welfare handout or a make-work job viewed the largess as beneficial at the moment it was received. For many, however, that "first drink" was indeed the road to hell because they became dependent on government support and therefore increasingly incapable of supporting themselves or rearing their children to become self-supporting—ultimately an unfortunate outcome for everyone concerned. In addition, the welter of relief, subsidy, bailout, and other programs that the New Dealers brought forth in constantly changing configurations, in the hope (very successfully realized, especially in 1936) of buying votes, also contributed to the creation of uncertainties about the future security of private property rights, which impeded economic recovery—another unfortunate outcome for nearly everybody.