Journal of the History of Economic Thought,
Volume 37, Number 1, March 2015

EUGENE MEYER AND THE GERMAN INFLUENCE ON THE ORIGIN OF US FEDERAL FINANCIAL RESCUES

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While federal financial rescues have become a common response to crises, the 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.

I. INTRODUCTION

During the Great Recession of 2007 to 2009, the United States federal government provided hundreds of billions of dollars of assistance 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 that the provided 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.

Economics, University of Delaware. I acknowledge the helpful research assistance of Lauren Elfner, and the helpful comments of Daniel Hammond, William Harris, Jeffrey Miller, James Mulligan, two anonymous referees, and the editor of this journal, and I thank Donald Graham of the *Washington Post Company* for permission to use the Eugene Meyer papers.

ISSN 1053-8372 print; ISSN 1469-9656 online/15/0100057-77 © The History of Economics Society, 2015
doi:10.1017/S1053837214000741

https://doi.org/10.1017/S1053837214000741 Published online by Cambridge University Press

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 finance was not an original function of our national government. Authors Raymond J. Saulnier, Harold G. Halcrow, and Neil H. Jacoby (1958) trace the origin of federal financial intermediation to the creation of the federal land banks in 1916. However, while the land banks were federally chartered, capitalized, and supervised, they were cooperatively operated by the owner-borrowers.

The first federally operated credit agency was the War Finance Corporation (WFC), established in 1918. The WFC's wartime 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 to 1933 contraction, Meyer, now governor of the Federal Reserve Board, convinced President Herbert 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 Franklin D. Roosevelt (FDR) welcomed the many opportunities afforded by the off-budget lending authority of the RFC.

Meyer's advocacy of intervention was contrary to the conventional policy wisdom of his era. Barry Eichengreen (1992) notes that during the period from the end of World War I through the Hoover administration, the dominant view within the US Treasury and Federal Reserve was to allow economic slumps to follow their natural course. This was Treasury Secretary Andrew Mellon's advice to President Hoover, to liquidate to "purge the rottenness out of the system" (quoted in Eichengreen 1992, p. 251).

Milton Friedman and Anna J. Schwartz (1963) explain that the real bills doctrine espoused by many Federal Reserve officials required a passive response to economic downturns. As will be discussed below, Meyer resigned from the WFC because he disagreed with Treasury Secretary David Houston's decision to end intervention during the early months of the 1920–21 recession. Meyer believed that positive action would have limited the deflation that he believed was unnecessary. His view was not widely shared by policy-makers.

Eugene Meyer (1875–1959) is an important but little-known figure in interwar US 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 of 1929 to 1933, 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.

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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.[1] 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 following section provides a brief biography of Eugene Meyer's professional career. Next, the thinking of his two influential teachers, Sumner and Wagner, are reviewed. Then, his economic philosophy is presented. The rescue operations of the WFC and RFC are recounted, followed by a discussion of how Meyer might have viewed the responses to the 2007–08 financial crisis. The final section concludes the paper.

II. EUGENE MEYER—PROFESSIONAL CAREER

Eugene Meyer amassed a sizable fortune in fifteen years as an investment banker/venture capitalist, and would accumulate much more as later investments reached fruition. Meyer's career began with a speculative gamble. Sensing that a McKinley victory in the 1900 election would spark a stock market rally, he used his financial capital of $5000 to purchase railroad stock options. By January 1901, his holdings were worth $50,000, and he used the entire sum to purchase a seat on the New York stock exchange, beginning his own investment banking firm (Meyer 1974, Box 179).[2]

Almost immediately, Meyer learned a strategy that would often profit him handsomely. In a 1901 panic involving Northern Pacific Railroad stock, he began buying, for both himself and his customers, during the selling frenzy. Once the selling ended, Meyer and his clients were considerably enriched.[3] Meyer also anticipated the 1907 panic, liquidating assets early and buying into the worst of the decline, again reaping considerable profit.

In 1904, while on vacation, Meyer reflected on his investing successes and failures, and how the influence of his studies in Germany altered his investing strategy. While in Berlin, Meyer had taken a course in "The Theory and Techniques of Statistics." He decided to develop a new approach to investing by employing experts and analysts to conduct statistical and scientific analysis to relate the prospects of individual companies to economic trends, and he was the first on Wall Street to practice this now common method of security analysis. In 1909, Meyer's firm produced a famous report on the economic prospects of U.S. Steel. Impressed by the report, J. P. Morgan warned a partner to "watch out for that fellow Meyer, because if you don't he'll end up having all the money on Wall Street" (Pusey 1974, p. 72).

[1]Meyer was a first-generation American with a strong international orientation, as discussed in Butkiewicz (2008).

[2]Boxes 179–181 of Meyer's Papers contain a lengthy, unpublished autobiography that Meyer dictated to author Sidney Hyman. Although they are written in the third person, these passages are Meyer's account of his experiences.

[3]Bernard Baruch offered the twenty-six-year-old Meyer a partnership in his firm. However, Meyer felt that he was an investor, and Baruch a speculator, and declined (Meyer 1974, Box 179).

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Meyer was also known for his system of estimating freight-car loadings to predict economic trends.

Meyer's financial strategy was to invest in new businesses essential to the growth of the economy. Feeling that the use of electric power and light would grow rapidly, but reluctant to invest in electric utilities, he focused on copper mining. His successes had by 1915 resulted in a personal fortune estimated to be between $40 and $60 million (Graham 1997, p. 24).[4]

Meyer realized that World War I would curtail shipment of German dyes to the United States, and he provided financing to a German chemist to develop a dye manufacturing company. In 1916, this initiative led to the formation of the National Aniline and Chemical Company, and in 1921, Meyer negotiated a merger of this company with four other chemical companies to form Allied Chemical and Dye Corporation. By 1931, his stock in Allied Chemical added an additional $43 million to his net worth, and the continuous dividends during the Depression covered his losses during his early years as publisher of the *Washington Post* (Graham 1997, p. 24).

Early in his career, he was interested in railroads, frequently investing in railroad stocks. But, by 1910, Meyer felt that the prospects for the railroads were declining, while those of automobiles were bright. This led to an investment in Maxwell Motors that, while ultimately profitable, proved frustrating and placed him under rare financial pressure. But he also underwrote and invested heavily in the first stock offerings of an auto-body company. Had he accepted stock rather than cash, he would have become one of General Motors's largest shareholders when GM purchased the Fisher Body Company that Meyer helped finance (Graham 1997, p. 20).

Anxious to serve his country during the First World War, Meyer closed his investment banking business in 1917. The next phase of his life was devoted to public service, primarily through the War Finance Corporation, Farm Loan Commission, Federal Reserve Board, and Reconstruction Finance Corporation.

Meyer resigned from the Federal Reserve in 1933 and embarked on a new career in publishing, secretly purchasing the *Washington Post* at a bankruptcy auction. Later aided by his son-in-law and daughter, Philip and Katharine Graham, Meyer and the Grahams reversed the fortunes of the once-failing paper. Meyer returned to government service again during World War II as a member of the National Defense Mediation Board. After the war, when President Truman experienced difficulty filling a new position, Meyer agreed to serve as the organizer and first president of the International Bank for Reconstruction and Development, although he resigned after six months, tiring, at age seventy, of a power struggle within the bank (Pusey 1974, p. 353).

III. WILLIAM GRAHAM SUMNER AND YALE

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.

[4]Taking the midpoint of $50 million, adjusted for inflation, Meyer would be a billionaire today.

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Joseph Dorfman (1949) identifies Sumner as the great spokesman of the New England School of *laissez-faire*. Richard Hofstadter (1959, p. 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's economics synthesized classical economics, the Protestant ethic, and Darwinian natural selection. Richard 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, p. 66).

Dominick Armentano (1967) examines Sumner's economics. He finds that Sumner's influences include David Ricardo, Thomas Robert Malthus, and Charles 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, p. 133).

Bruce Curtis recounts that for Sumner, Adam 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, p. 76).

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. Sumner did not contribute to the advance of economic theory. Rather, he accepted the existing classical economic theory, and defended its implications.

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, p. 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 divert his "labor and self-denial … from his maintenance" (Sumner 1883, p. 15) to "The man who has done nothing to raise himself above poverty…" (Sumner 1883, p. 23). To Sumner, this was the ultimate evil. The wealthy were the product of natural selection and helping the poor interfered with *laissez-faire* and thus was wrong.

Sumner objected to government intervention because the result was the worst of all monopolies, the purpose of which was the exploitation of others (Sumner 1924, p. 227). He believed that the German historical school was attracting a generation of American economists away from the truth (Bannister 1973).[5] The German historical school favored an extensive welfare state that required a sacrifice of personal liberty (Sumner 1924, p. 268).

[5]Dorfman (1949, pp. 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.

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During his time at Yale, Sumner's influence on Meyer was profound:

> The highlight of his senior year was Professor Sumner's course in social science. Eugene was one of a half dozen who pressed around the lectern after class to ask questions and test the professor's wit.
>
> …
>
> Subsequent events would deal harshly with Sumner's thesis, and Meyer would help dethrone it as national policy. In 1895, however, Eugene carried away the wisdom of the granite-faced economist as the most significant contribution of his Yale education. (Pusey 1974, p. 22)

Meyer likely found Sumner so compelling because he had learned the same ideas from his father, whom young Meyer greatly admired and respected: "Sumner seemed to lay out a broad philosophical basis for what young Meyer heard from his own father about the virtues of sound money, free trade, the evils of state interference, and the like" (Meyer 1974, Box 179).

The essays Meyer wrote at Yale demonstrated Sumner's influence. In one such essay, Meyer wrote about the folly of a recent union strike. Another dealt with regional disputes over tariffs and the threat these disputes posed for national unity. His senior thesis for his advanced economics class, taught by a Professor Schwab, attacked the silver inflationists and defended sound money (Meyer 1974, Box 179).[6]

IV. ADOLPH WAGNER AND THE GERMAN INFLUENCE IN AMERICA

German academe and scholarship exerted tremendous influence in nineteenth-century America. Young Americans would frequently complete their education with a post-graduate tour and period of study in Europe, and Germany was the most respected destination. Before 1870, Americans were attracted to Germany to study science and medicine; afterward, they were attracted to study social science and liberal arts (Herbst 1965, pp. 6–8).

Various scholars (Coats 1985; Letiche 1955; and Spengler 1976) date the development of the professional science of economics in America to the last decades of the nineteenth century. Previously, economics was taught as part of a philosophy or social science class.

A significant step in the development of American economics was the founding of the American Economic Association (AEA) in 1885. The association was organized by American economists, including Richard Ely and General Francis Walker, who had studied in Germany and had been influenced by the teachings of the German Historical School of economics.

[6]When discussing proposed legislation to establish a price-level target for monetary policy, Meyer recalls that the 1932 bill was supported by his former professor Irving Fisher (Meyer 1974, Box 181). In a letter to his son (February 4, 1934) Meyer expressed his dislike of Fisher's views, especially the commodity dollar that Fisher advocated (Meyer 1974, Box 4). Fisher's proposal for stabilizing a price index required abandoning Meyer's beloved gold standard.

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The new association was modeled after the Historical School's Verein für Sozialpolitik (Union for Social Politics). The Verein was founded by the leader of the younger historical school, Gustov Schmoller.[7] The Verein was explicitly political, promoting a welfare state, or "social market economy," as it is known in Germany (Senn 1997). These conservative socialists were known as *Kathedersozialisten* (Professorial Socialists or Socialists of the Chair).

Dorfman (1955) characterizes the Verein as a revolt against eighteenth-century reasoning based on natural law. Extreme *laissez-faire* was opposed. Members saw a conflict between self-interest and moral forces, and felt that the working classes had not benefited from industrialization as had the owners of capital.[8]

The founders of the AEA intended that it be the American equivalent of the Verein, promoting a similar progressive agenda (Carlson 1999). Ely said that the new association "must not include men of the Sumner type" (quoted in Dorfman 1949, p. 206). However, by 1887, the AEA altered its constitution, essentially eliminating its progressive agenda and focusing solely on research in an effort to attract young, classically trained economists as members (Dorfman 1949).

Dorfman (1949) notes that, initially, Harvard and Yale economists did not join the AEA. Thus, Meyer, educated at Yale, learned only that the Historical School agenda was contrary to *laissez-faire* principles. Meyer's exposure to German economic ideas came directly, from his study in Germany.

Shorty after his graduation from Yale, Meyer went to Europe, working and studying in Paris, various German cities, and London. In Germany, Meyer first stayed and worked in Frankfurt, living with a German family and studying German (Pusey 1978).[9]

Meyer next accepted a banking position in Berlin. 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 1,000 students, was "Selected Questions in Social Policies," taught by the German state socialist, Adolph Wagner. What Meyer heard from Wagner was the opposite of the teachings of William Graham Sumner.[10]

Although he was 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 for a time to the Verein, 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, p. 58).

Donald Wagner (1939) describes Wagner as accepting self-interest but rejecting the classical application emphasizing *laissez-faire.* Wagner combined historical methods

[7]Wagner's active participation in the Verein ended around 1877 because many members held views more moderate than state socialism (Senn 1997).

[8]The Historical School's advocacy of social legislation intended to prevent the working class from drifting into Marxism (Balabkins 1988).

[9]In addition to German, Meyer knew Latin, Greek, French, and Spanish.

[10]Meyer also read Wagner's books (Meyer 1961, p. 50).

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and deductive reasoning, and was critical of the Historical School's rejection of abstract and deductive reasoning.

Benny 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 (Backhaus 2003).

Wagner's moral reasoning derived from his Christianity (Drechsler 1997).[11] Wagner explained in his famous "Speech on the Social Question" that economics must ethically address social issues, stressing "the moral and therefore Christian obligations which wealth, education, and social position impose, even in dealing with the social question from the economic standpoint" (quoted in Wagner 1934, p. 489).

While Sumner believed the distribution of income should be derived from natural selection, Wagner did not, and, unlike Sumner, argued that "the redistribution of national income in favor of the lower classes is a conscious aim of modern social policy" (Wagner 1958, p. 9).

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, p. 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 Backhaus 2003, p. 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 who 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.

[11]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, pp. 104–110) critiques Clark's (1940) assertion that Wagner was a forerunner of Nazism.

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V. EUGENE MEYER—POLITICAL ECONOMY

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. As noted above, at the time of his graduation, Meyer felt that what he learned from Sumner was the most significant contribution of his Yale education.

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 might be needed in the future. But, if that was the case, economic policies were relative, determined by time and place, not based on universal natural laws. So Meyer concluded that economics was a highly pragmatic art rather than a science, as Sumner had taught. "From the force of this idea then, Meyer began to look upon political economy in ways that stood a bit to the side of Sumner's orthodoxies" (Meyer 1974, Box 179).

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:[12] "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.*[13] More than ever before Government and big business need to take council together" (Meyer 1974, Box 78). Thus, Meyer, inspired by his exposure to Wagner's economic philosophy, 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 (Meyer 1974, 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 1974, pp. 82–84).

Before Meyer entered government service during World War I, he advised Bernard Baruch, who was negotiating the purchase of forty-five 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, which 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 non-ferrous metals unit of the Raw Materials Committee.[14] Acting for Baruch, Meyer prevented an army purchase of steel at what Meyer felt was an exorbitant price.

[12]The speech was "Some After-War Economic Problems," delivered to the American Association for the Advancement of Science on December 29, 1916.

[13]In this context, *faire marcher* means taking action to make things happen.

[14]His responsibilities included procurement of copper, lead, zinc, antimony, aluminum, nickel, silver, and, later, cement (Pusey 1974, p. 140).

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Meyer suspected that companies were canceling civilian contracts hoping to sell at higher prices to the government. 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 1974, pp. 140–148).

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.[15] He argued that waiting for supply and demand to clear the labor market took too long and entailed too much suffering. He argued that "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 1974, 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 explained his change of thinking when discussing his proudest accomplishment in government service, the creation of 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 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)

In sum, while never characterized as such, Meyer was a Republican progressive, in the vein of President Theodore Roosevelt, whom Meyer admired: "I was in fact a very great admirer of Theodore Roosevelt" (Meyer 1961, p. 64). Meyer espoused many of the progressive ideals of the late nineteenth and early twentieth centuries.[16] He rejected *laissez-faire* and classical liberalism. He embraced measurement and an empirical/scientific approach in all that he did. His emphasis on the importance of "administration" is similar to the progressive embrace of Taylor's scientific management.[17] And, as described below, he advocated a larger role for central government, contrary to Sumner's *laissez-faire* philosophy.

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[15]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.

[16]For a discussion of the progressive movement's effect on American economics, see Thomas Leonard (2009).

[17]A suggested title for Meyer's 1954 Harvard address, not used, was "Administration is Nine-Tenths of the Law" (Meyer 1974, Box 167).

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While the progressive movement in his own country undoubtedly influenced Meyer, his time in Germany was also important. Meyer's French father had instilled in his son an anti-German hostility. But his time in Berlin evoked a change in attitude: "But now that Eugene Jr. was in Berlin, his anti-German prejudices began to ebb … Meyer fell easily into the cadence of a true Berliner. The air over-head—as he first breathed it—seemed so free, so liberal, so progressive" (Meyer 1974, Box 179). His time in Germany had a profound influence on Meyer's economic philosophy.

VI. THE WAR FINANCE CORPORATION

Scant attention has been paid to the activities of the War Finance Corporation or their significance. Saulnier et al. (1958, p. 192) do note that WFC lending in 1921–22 was a "significant extension of the scope of government activity in the farm credit field." In actuality, WFC lending was even more significant, as the loans were made directly to banks and other financial institutions that were under pressure due to the agricultural depression. Rescuing the farmers required rescuing the bankers.

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 create a legal basis for this committee and make its recommendations binding. The *War Finance Corporation Act*, signed April 5, 1918, created the formal authority.

The Act created a new, formal Capital Issues Committee comprised of seven members, three from the Federal Reserve and four unrestricted members. The unrestricted members could be Federal Reserve or government officials or representatives from business. However, contrary to Secretary McAdoo's desire, the new committee's recommendations on security issues were not binding. The Act created a legal basis for the committee and expanded its membership, but otherwise made no significant changes in the committee's authority.

The WFC began operations on May 20, 1918. In addition to making recommendations on private borrowings,[18] the WFC was to provide funding to industries essential to the war effort. The WFC received capital of $500 million from the US Treasury. The legislation authorized the WFC to borrow up to an additional $3 billion through bond issues. The WFC was an off-budget agency, not 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 authorized the WFC to deal in government bonds. The Treasury delegated to the WFC the responsibility to purchase Liberty and subsequently

[18]Woodbury Willoughby (1934, p. 39) claims that the committee's existence discouraged many private applications.

https://doi.org/10.1017/S1053837214000741 Published online by Cambridge University Press

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 intention of the repurchases was to stabilize prices in the hope that stable prices would facilitate subsequent bond issues without increasing the coupon rate.

The WFC did engage in significant bond purchases. Between its bond issues, the Treasury bridged its financing needs, including WFC bond repurchases, through sales of short-term certificates of indebtedness. The endeavor was profitable due to the significant discount at which the bonds sold during the buy-back period. The WFC purchases, while not returning prices to par, appear to have had some stabilizing impact, as bond prices dropped sharply when the purchases ended.[19]

Figure 1 depicts the yields to maturity on the Third and Fourth Liberty bonds that comprised the majority of WFC purchases, and the coupon rate on Treasury certificates of indebtedness.[20] The higher yields on the war bonds until mid-1920 made the purchases profitable, as well as possibly keeping the yields on subsequent issues lower than they would otherwise have been. Meyer recalls that in 1920, Assistant Treasury Secretary Russell Leffingwell "was finding difficulty in selling ninety-day treasury bills [sic] at six percent" (Meyer 1961, p. 335). It was at this time that the bond purchase program was terminated.

Meyer's public career began when he volunteered for military service in 1917 at the age of forty-one. Unable to serve as a soldier because he was color-blind, he went to Washington as a dollar-a-year man. Being a staunch Republican, he was not welcomed with open arms by the Wilson administration. Through the assistance of Justice Brandeis, Meyer obtained a position on the Advisory Committee on Finished Goods and eventually worked for his friend Baruch in the War Industry Board.

Subsequently, he was appointed as one of the original directors of the WFC and was put in charge of the bond price-stabilization program. Federal Reserve Board Governor W. P. G. Harding was the first 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, after 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.[21] Federal financial intermediation now was extended beyond the emergency of war to a perceived post-war emergency. However, Treasury Secretary David Houston, a staunch

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[19]See Butkiewicz and Mihaela Solcan (2012).

[20]Monthly average yields are computed as $[C + ((F - P)/n)]/[(F + P)/n]$ where C is the coupon rate on war bonds, F is par value, P is price, and n is time to maturity. Data for war-bond prices is from the War Finance Corporation, *Records of the War Finance Corporation,* National Archives Record Association II. Treasury certificates were sold at par (Garbade 2012, p. 109), so the coupon rate is the relevant financing cost. Certificate coupon rates are from Secretary of the Treasury (1921, p. 293). From February 1918 through September 1919, all certificates were issued at 4.5%. There were no issues in October or November, so 4.5% is used for those months to maintain continuity of the series. The rate for the December 1919 issue fell to 4.25%. This 4.25% rate is used for the first three months of 1920 as there were no issues during these months. Rates for the April 1920 issues increased sharply.

[21]This authority was granted in March 1919. Meyer drafted the amendment authorizing export loans (Meyer 1954, p. 11).

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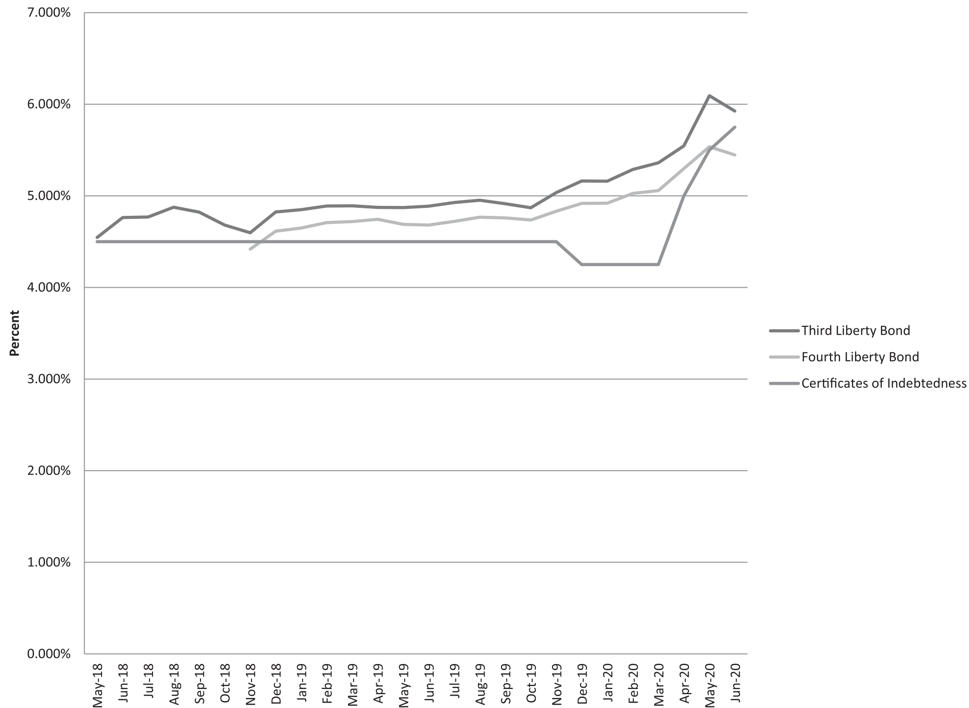

FIGURE 1. War Bond Yields and Certificate of Indebtedness Rates.

advocate of *laissez-faire,* decided to suspend 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 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 advocated continued federal provision of credit: "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 1974, Box 180).

Meyer's campaign succeeded. After 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 cooperatives. It was this version of the WFC that later was his model for the RFC.

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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. The WFC loans provided banks with liquidity and the ability to repay loans to their correspondents, with the hope that would make the banks 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.[22] In January 1925, he returned $499 million of WFC capital to the Treasury, and resigned from the WFC.[23] 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.

The WFC loans to industries essential to the war never approached the anticipated amount, as the war ended six months after WFC initiated its operations.[24] The 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.

VII. THE RECONSTRUCTION FINANCE CORPORATION

Research on the RFC has generally focused on the effectiveness of RFC policies. James Butkiewicz (1995), Charles W. Calomiris, Joseph R. Mason, Marc Weidenmier and Katherine Bobroff (2012), and Mason (2001) examine whether RFC loans and provision of capital to banks contributed to financial stability. Daniel Schiffman (2003) finds that RFC loans failed to help troubled railroads. Butkiewicz (1999) and Richard H. Keehn and Gene Smiley (1988, 1993) investigate whether publicizing the identity of banks receiving RFC loans contributed to the 1933 financial crisis. Mason (2003) finds that RFC loans were not directed to localities to reap political benefit. Less is made of the fact that Eugene Meyer's RFC resulted in a vast expansion of federal intervention into the economy.

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[22]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.

[23]Meyer served as commissioner of the Federal Farm Loan Board during the years 1927 to 1929, thereby remaining active in the federal provision of credit.

[24]The 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 after 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 government bonds from 1918 through 1920 totaled $2.1 billion (War Finance Corporation 1918, 1919, 1920, and 1926).

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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 a financial agency similar to the WFC was necessary even before Britain left gold. 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 legislation was passed on January 22, 1932. Like the WFC, the RFC was initially capitalized by the US 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).[25] Total RFC lending in 1932 was $1.5 billion (Saulnier et al. 1958, 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 rediscount:

> 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 rediscounts, 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, pp. 679–681)[26]

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, financing many New Deal projects and agencies.[27] Under Roosevelt, the RFC recapitalized many banks through purchases of preferred stock and capital notes and bonds. It created the Commodity Credit Corporation to assist farmers and made direct loans to businesses. The RFC Mortgage Company and the Federal National Mortgage

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

[26]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 Federal Reserve employees worked simultaneously with the RFC.

[27]For a more complete discussion of the RFC, see Butkiewicz (2002).

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Association (Fannie Mae) were RFC creations. It funded the Export-Import banks and dealt in gold when FDR manipulated the value of the dollar.

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 2).[28] 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.

The 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. Four agencies' lineage traces directly to the RFC: the Commodity Credit Corporation, the Export-Import Bank, Fannie Mae, and the Small Business Administration (SBA). The first three agencies were created as part of or with RFC funding. The SBA was created in 1953 to replace the RFC's lending to small businesses.

While Meyer may have intended 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 United States federal government has become a permanent and prominent influence in the allocation of credit.

VIII. MEYER TODAY

Would Meyer have supported the US Treasury and Federal Reserve responses to the 2007–08 financial crisis? It seems clear that he would have favored intervention to stabilize the economy. He always believed that provision of finance was essential to support economic activity, which is no surprise, given his career in investment banking. And one of his stated goals was to eliminate financial panics. After the panic of 1907, he wrote to his sister stating his desire to find a way to end financial disruptions, as he planned to enter public service in the future:

> I have in mind a political order that has neglected to provide the nation with a monetary mechanism that can prevent the kind of panics we have lately experienced. I should like myself to come to grips with these questions. But I have no doubt that they will still be with us by the time I am in a position to leave business behind me, and follow through on my long-standing plan for some sort of direct participation in the management of governmental affairs. (quoted in Pusey 1974, p. 59)

The fact that the 2007–08 crisis was the result of a speculative bubble would not have deterred Meyer. He felt the Great Contraction of 1929 to 1933 was preceded by speculation in both stocks and real estate, and that "real estate speculation was perhaps worse than the stock market speculation had been, though less spectacular" (Meyer 1974, Box 181).

[28]Nominal GDP data are from the Bureau of Economic Analysis web site: http://www.bea.doc.gov/ (accessed 18 august 2011). RFC data are from Secretary of the Treasury (1959).

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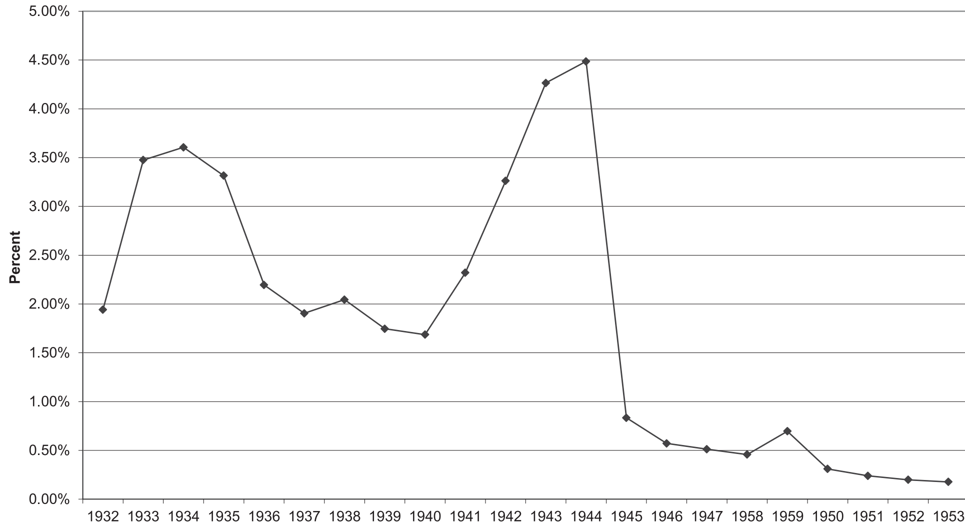

FIGURE 2. RFC Outstanding Balances/GDP.

As noted above, Meyer believed that unemployment was wasteful and that reducing unemployment should not be left to the market if alternative policies would reduce it faster. He would not have wanted the crisis to devolve into a depression.

Meyer was not wedded to the status quo. He believed that economics was an art and that its application evolved over time. Late in life, he reflected on the legislation of securities market regulations as a necessary response to the speculation that preceded the Great Contraction, observing: "You never could have passed a federal law at that time dealing with the supervision of bonds, stocks, flotation of companies publicly under any federal authority, just because they hadn't gotten around to thinking of those problems as national problems in the sense that the depression made clear as necessary" (Meyer 1961, p. 542).

While Meyer's tenure at the Federal Reserve is characterized as a period of failed response to the contraction of 1929 to 1933, he did push for more aggressive policies (Butkiewicz 2008). He wanted an aggressive policy of open market operations, but was thwarted by the governors of the district banks, who held the operational authority for policy. He created the RFC when he felt that the Federal Reserve was not doing enough to help banks, especially non-member banks. As Friedman and Schwartz conclude, "Perhaps, if he had had more time to develop his leadership of the System, he might have been able to lead the System along a different route" (1963, p. 417). Meyer favored intervention during the interwar period, and would have continued to favor intervention today.

IX. THE INFLUENCE OF ACADEMIC SCRIBBLERS

Eugene Meyer disavowed the *laissez-faire* economic philosophy he had learned from William Graham Sumner at Yale. His thinking was heavily influenced by the German

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economics professor Adolph Wagner. Meyer concluded that Wagner's teachings were 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 1974, Box 179).

Applying his pragmatic approach to economics, Meyer believed that markets function well under "normal" conditions, but that the "abnormal conditions" after the war created economic instability that could be remedied only through government intervention (Meyer 1974, 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, with the hope of reversing some of the deflation that had depressed prices of agricultural products, thereby providing relief to distressed farmers. The WFC lending in 1921–22 was the first federal bank rescue operation.

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, the Reconstruction Finance Corporation. Under Meyer, the RFC primarily lent money to provide liquidity to the distressed banking sector, while 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.

Whether, or when, federal intervention into credit markets and the US economy would likely have occurred had Eugene Meyer never held a government position is a matter of speculation. Meyer opened the door, and FDR, following him, plowed a much wider path.

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.

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