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Investing in Hard Times

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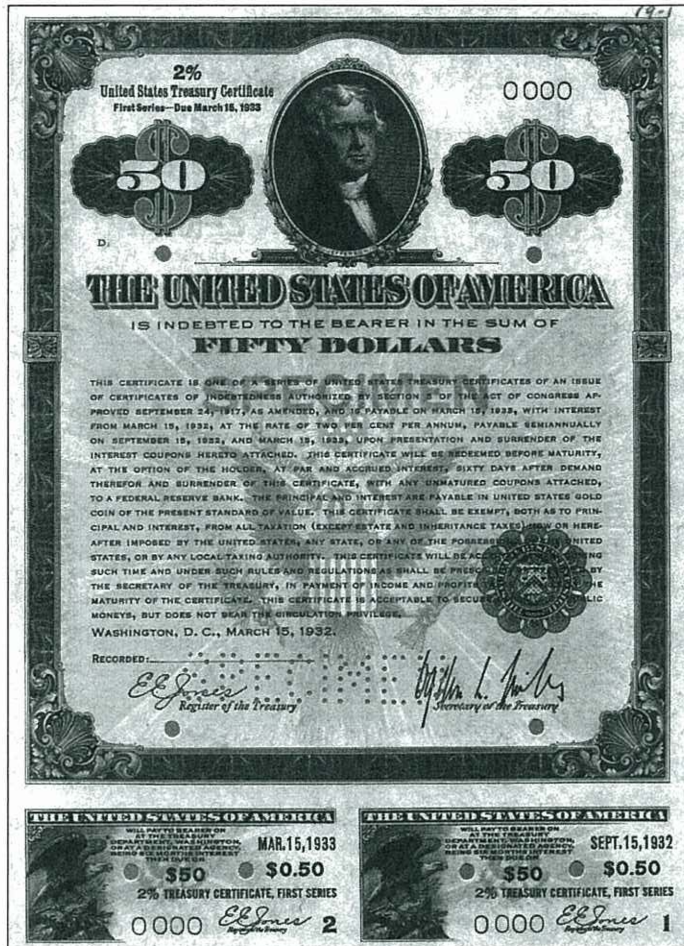
INVESTING IN HARD TIMES

US Government Thrift Securities in the Great Depression

By Franklin Noll

On October 29, 1929, a day now known as Black Tuesday, the stock market crashed, ending the economic boom of the 1920s. The crash was part of a worldwide economic depression that would last into the early 1940s. At one point in the early 1930s, a quarter of the workforce was unemployed as businesses in every sector of the economy closed their doors. As the Great Depression deepened, many banks also failed, wiping out the savings of depositors. Banks simply were no longer safe places to keep money. As a result, depositors withdrew their money and hid it at home or kept it in safe-deposit boxes. This action denied banks the assets they needed to make loans, further dampening business activity during the Depression.

To combat the withdrawal of funds, the Government began to experiment with thrift securities, bonds, notes and certificates designed to help average people become savers and investors. Low-denomination securities aimed at savers were nothing new; they first appeared during World War I in the form of Thrift and Savings Stamps and Savings Certificates as part of the wartime funding campaign. However, the popular urge to save withered in the peace and stock market boom of the 1920s. With the return of hard times in the 1930s came the resurrection of thrift securities. By having Americans invest in Treasury securities, the government hoped to get money back into the economy while giving people a safe place to invest their money.



Bureau of the Public Debt

$50 United States Treasury Certificate.

The Depression-era return to thrift securities began under the Hoover administration. Seeking to stop the flight of deposits from the banks, President Herbert Hoover began an "anti-hoarding campaign" on February 3, 1932. He estimated that $1.5 billion (25% of all US currency) was sitting idle outside of the banking industry, resulting in the loss of up to $15 billion in available credit. It was therefore the patriotic duty of everyone, he declared, to enlist in the war against the economic downturn by depositing their money in a bank. Doing so, Hoover stated at a White House conference on the hoarding of currency, would be "a patriotic service to the country as a whole."

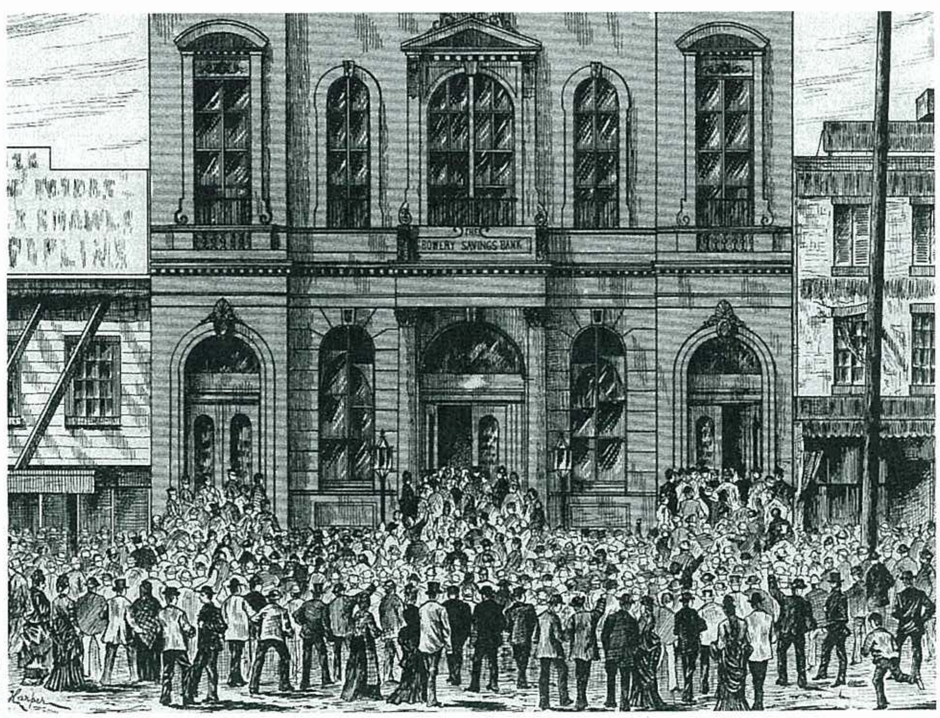
To lead this campaign, the President recruited Frank Knox, publisher of the *Chicago Daily News*. Knox created a Citizens Reconstruction Committee that carried on an educational campaign involving the creation of thousands of local committees across the country. The goal was to spread the message that "hoarded currency means that high-powered dollars are idle and that in turn means idle business, idle men and depreciated prices." Knox urged Americans to buy consumer goods and deposit money in banks. However, as Knox stated in a press release, "If the owners of idle, hidden dollars do not want to employ them in normal ways, Uncle Sam will give them a job—and pay them wages." In other words, Americans should buy government securities.

With the start of the anti-hoarding campaign, Knox had requested that the Treasury provide a special security that could be sold on subscription by the local committees. The purpose of the security was to provide an alternative to a hoarder who wanted to invest his money but did not want to deposit it in a bank that might fail and close its doors, taking his money with it. In response, the Treasury created for Knox savings certificates officially titled United States Treasury Certificates. These were one-year certificates redeemable on 60 days notice. They were issued as couponed, bearer bonds in denominations of $50, $100 and $500 and were payable in gold. The interest rate paid was 2%, which was slightly below the average rate paid on a savings account. The rate of the certificate was set lower to discourage people from withdrawing money from banks to buy these securities.

The Treasury leadership did not share Knox's enthusiasm for thrift securities. It was very concerned that the Treasury certificates would become too popular among the public as a safe alternative to bank savings accounts. Secretary of the Treasury Ogden Mills wanted to keep the certificates as quiet as possible with no national publicity and only local sales efforts. The "great danger," as he saw it, was "that an obligation sufficiently attractive to the hoarder will be equally attractive to the depositor and will result in the wholesale withdrawal of deposits from banks." Mills was right to be concerned about the public's demand for a safe, government savings deposit alternative. The Treasury certificates proved immensely popular, and the Treasury asked Knox to end sales as quickly as possible. Despite only being offered for less than a month under quiet conditions, almost $35 million worth was sold.

However, the idea of a Treasury security aimed at the average citizen caught on among statesmen and economists. In early 1932, a plan was put before Congress to fund massive public works projects to revitalize the economy through the sale of low-denomination bonds to average citizens. One economist argued that "large amounts of hoarded money would come out of hiding" if the government gave the public a safe, sensible way to put their money to work. He added that Hoover's Treasury certificates were not the best solution: "Instead of saying to John Jones, 'You are a hoarder. Buy these anti-hoarding bonds,' [the government] should say, 'You are a fine citizen with some surplus funds. Here is a good investment.'" These bonds might lead to a reduction in bank deposits, but this loss would be offset by the influx of previously hoarded, non-productive money used to buy bonds and the government's use of that money to boost the overall economy. However, such thinking proved too radical for Congress and the Hoover administration. Nothing came of the plan to use thrift securities to finance an economic stimulus.

More amenable to these kinds of ideas was Franklin Roosevelt's Treasury Secretary, Henry Morgenthau, Jr. In the first months of 1935, he was tasked with the job of finding money for the public works programs recently passed by Congress. These New Deal programs had an initial cost of $4.8 billion. As part of his funding plan, Morgenthau picked up the idea of low-denomination securities sold to the general public, which was also becoming popular in Europe. Such securities would help finance the New Deal while giving Americans a safe place to put their money as had been the case with the Hoover Treasury certificates. For even though the worst of the banking crisis had passed and the FDIC had been created, many Americans still distrusted the security of savings deposits in banks.



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Run on the Bowery Savings Bank in New York, 1930.

Morgenthau also saw thrift securities as a way not only to boost the economy but also as a way to instill the habit of saving, to educate Americans about government securities, and to involve all Americans in their government or "to sell shares in America." Buying bonds from the Treasury would give citizens a vested interest in the actions of the government, especially its spending, as well as its continued success. In sum, he saw buying bonds as a citizen's investment in democracy.

In early 1935, Morgenthau introduced legislation in Congress to permit the issuance of a new, popular type of security to be known as a United States Savings Bond. The bill readily passed both the House and Senate and, on February 4, 1935, was signed into law by President Roosevelt.

Morgenthau's savings bonds were designed to be the ultimate in safe investments. Unlike the Treasury certificates of the Hoover administration, they were registered securities which could be replaced in the event of loss, theft or destruction. To make them immune to market risk, the bonds were also non-transferable and could not be pledged as collateral for loans.

More extraordinary was the fact that the bonds had guaranteed redemption values throughout their lives. At any time after a 60-day holding period, the savings bonds could be redeemed at full purchase price plus accumulated interest. To drive home this point to the investor, a table of redemption values was printed on the face of every bond. This enabled "the purchaser to know its redemption value at all times."

They were also discount bonds, meaning the bonds were sold at less than par (25% below par for savings bonds) and would increase in value over time until they reached face value in 10 years. Savings bonds were available in popularly-priced denominations, starting at $25 (purchase price $18.75) and topping-out at $1,000 (purchase price $750). Their interest rate was a competitive 2.9%, compounded semi-annually, when held to its 10-year maturity. The federal income tax-exempt yield was graduated by year to promote the long-term holding of the bonds with it doubling after the seventh year.

The first savings bonds, Series A, were issued on March 1, 1935, and were sold at the 14,000 post offices across the country. The initial marketing campaign was modest, starting with a newsreel of President Roosevelt at the White House buying bonds for himself and his grandchildren. Sales were at first slow, as selling efforts were limited to posters at local post offices and advertisements in financial publications. But, savings bonds proved extremely popular and, within a year, the Treasury sold $400 million worth.

Corbis

Frankin Roosevelt's Treasury Secretary, Henry Morgenthau Jr.

This encouraging success led Morgenthau to create a Division of Savings Bonds in the Treasury Department in 1936 to oversee and promote sales. It was headed by Eugene Sloan of the advertising agency of Sloan and Bryan of Saint Louis. He initiated an "aggressive direct-mail campaign" as well as a series of "posters, magazine ads, car cards and point-of-sale material," which netted another $600 million in savings bond sales. By the end of 1939, total sales were above $3 billion.

The Treasury eventually settled on a sales strategy based on direct mail efforts to known investors. With a staff of less than 200 and Congressional criticism of paid advertising, the Division of Savings Bonds could do little else. Yet, these modest efforts resulted in an enthusiastic base of regular buyers that over the six-year period from March 1935 to April 1941 bought $4 billion in Series A, B, C and D bonds.

In a survey of the first one million purchasers of savings bonds, the Treasury discovered that the chief reasons for buying a bond were retirement savings, emergency funds, education, home building, estates, travel and recreation. Occupationally, the bond holders were, from largest to smallest, skilled laborers, clerks, housewives, salesmen, teachers, professionals, executives, students and farmers. However, contrary to Secretary Morgenthau's hopes for a truly "small savers" program, the overwhelming majority of the approximately 18 million savings bonds sold were of the three largest denominations: $100, $500 and $1,000. This may have been inevitable, given the type of selective marketing employed.

The savings bonds program would not become the home of the small saver until the start of World War II. In May 1941, savings bonds were re-designated defense bonds as the Treasury began a major campaign to raise funds for the United States defense build-up and to focus the average American on the real possibility of the United States entering the war. When war came to the country, defense bonds became war bonds and an unprecedented sales campaign preoccupied the country until the end of World War II. It gave birth to the Payroll Savings Plan and a generation of savers buying savings bonds.

The idea of the government issuing a thrift security during hard times has lived on to the recent past. In the 1970s the idea of "energy bonds" to meet the fuel crisis was circulated within the Treasury. September 11 brought patriot bonds and, in 2005, the notion of "Katrina bonds" was explored. There have also been calls to revamp the savings bond to meet the needs of the unbanked, modern day "hoarders" who do not worry that the neighborhood bank will fail but who cannot maintain minimum deposits or pay monthly service fees. In these hard times, it is asked by some, should not the Treasury again become the "trustee for the inexperienced investor" by offering to the smallest saver "a share in America"? FH

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We Do Our Part: Henry Ford and the NRA

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