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Working Paper No. 165

**“The Veterans’ Bonus of 1936 and the Abortive
Recovery from the Great Depression”**

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The Veterans' Bonus of 1936 and the Abortive Recovery from the Great Depression*

Lester G. Telser

Abstract: The Veterans' Bonus, enacted January 1936, disbursed 9 year nonmarketable U.S bonds with a 3 percent annual interest to 3 million World War I veterans when bank savings accounts paid a 2.5 percent annual interest rate. The average bonus receipt per person exceeded 30 percent of the mean household income for the veterans' age bracket. The June 1936 Federal deficit was a peacetime record. In two weeks that June veterans cashed in 46 percent of their total bonus, an amount nearly one percent of annual GNP. The economic recovery in 1936 was more than 2.5 times bigger than in the preceding two years probably because of the effects of this Bonus. The redemptions of the veterans' bonus bonds in June 1937 were 45 percent of the amount the year before, but did not stimulate the economy as much because the Federal deficit in June 1936 was 4 times larger than in June 1937. JEL E65 Studies of Particular Policy Episodes.

The Veterans' Bonus of 1936 furnishes a valuable opportunity to see how a large increase in the Federal deficit can stimulate economic activity. To set the stage for the analysis of this event, the figures in Table 1 show consumption expenditures, annual changes in these expenditures and the Federal deficit from 1929 to 1940.

Table 1: U.S. Consumption Expenditures, Annual Changes in Consumption Expenditures and Federal Deficit in Millions of Current Dollars, Annually, 1929-1940

Year	Consumption ^a	Annual Change Consumption	Federal Deficit ^b
1929	77222		912.0
1930	69880	-7342	403.6
1931	60464	-9416	-1634.5
1932	48589	-11875	-2621.0
1933	45795	-2794	-2543.2
1934	51335	5540	-4064.2
1935	55699	4364	-2986.2
1936	61912	6213	-4160.6
1937	66597	4685	-1877.0
1938	63920	-2677	-2446.9
1939	66834	2914	-3968.0
1940	70824	3990	-3824.6

a. Historical Statistics (1976, Table G416). b Firestone (1960, Table A-3, not seasonally adjusted).

While the biggest increase in consumption in 1936 coincides with the biggest deficit, the biggest decrease in consumption does not coincide with the biggest surplus. That there were surpluses in 1929 and 1930 at the start of the Great Depression does not warrant the conclusion that these surpluses were its cause although it is likely that these surpluses depressed the economy.

* I am grateful to Sheldon Kimmel for helpful comments. All defects and errors remain my responsibility.

Moreover, the Federal government had a surplus in most of the 1920's, a prosperous period. The following regression summarizes the relation between the Federal deficit and changes in consumption for 11 years, 1930-1940.

$$\Delta C_t = -8925.7 - 3.088 \text{ Deficit}_t \quad \text{Adj } R^2 = 0.345, \text{ F-ratio} = 6.26$$

t-ratio - 2.4 - 2.5

All these statistics are significant at above the 3 per cent level. The regression coefficient of the deficit says that for each 1 dollar rise in the deficit, consumption would rise by 3 dollars. Since the veterans bonus of 1936 did raise the deficit in that and in the next year, this regression is a benchmark to gauge its effect on the economy.

The peculiar efficacy of these federal deficits as stimulants of recovery becomes understandable by observing the level of interest rates. In January 1935 the rate on U.S. Treasury Bills stood at 0.13 percent and a year later at 0.10 percent. Some would claim with good reason that the U.S. economy was in the grip of the Keynesian Liquidity Trap. In January 1937 the T-Bill rate was 0.36 percent. Between 1937 and 1940 there were months when this rate was zero. Even more recovery might have been the result of direct cash payments to the veterans instead of the open market operations made necessary by the administration's fiscal policy. Moreover, the superiority of the veterans' bonus compared to the other forms of the New Deal's fiscal stimulus is clear because the bonus took effect without the delay common for public works programs, payment went directly to the recipients without complicated investigations to determine who was eligible and the bonus did not result in a permanent expansion in the size of government.

Congress overrode the veto of President Roosevelt and enacted the veterans' bonus on January 27, 1936. It was the third presidential veto of a veterans' bonus. The first in spring 1932 by Hoover led to the bonus riot (Lisio, 1994). The second was Roosevelt's veto in 1935. In February 1931 Congress enacted over Hoover's veto an act that allowed World War I veterans to borrow up to the smaller of either the maximum 50 percent of their Adjusted Service Certificates or \$500 at a 4.5 percent rate of interest (Lisio, 1994, pp. 38-40). This Act seems to have had little effect on the economy judging from monthly Federal disbursements.

The 1936 bonuses took the form of special nonmarketable U.S. bonds in \$50 denominations that paid 3 percent interest annually to the holders until the maturity date June 15, 1945. A veteran had to hold the bond for at least one year to receive interest. Thereafter interest was paid annually. World War I veterans could cash in their bonds at any time after June 15, 1936. The interest rate on these bonds was generous relative to alternatives. The Federal Reserve System set the maximum interest rate on savings accounts at member banks at 2.5 percent effective January 1, 1936. Because the veterans could have obtained a higher interest return on their bonds than on

savings deposits, it is very likely that the veterans spent most of their redemptions.¹ The total bonus payment initially was \$1.745 billion, increased by \$141 million in the next fiscal year. The bonus was paid to 3.004 million World War I veterans on the basis of \$50 for each month of service during the Great War. The average bonus was \$581. (Based on the figures available to the Treasury by June 30, 1936, it was \$547.50, U.S. Treasury Report, 1936, p. 253). Of this total, veterans took \$800 million in cash in the two week period June 15 to June 30, 1936. They redeemed \$696.5 millions of the bonds between July 1, 1936 and June 30, 1937. Of this amount, \$233 millions were redeemed before June 30, 1936 but were not paid to the veterans until after July 1, the beginning of the 1937 fiscal year. From August 1, 1936 to June 30, 1937, \$463 millions were redeemed. Most of these redemptions almost certainly occurred during two weeks from June 15 to June 30, 1937. Therefore, from June 15, 1936 to July 31, 1936 the amount paid in cash to the veterans was \$1.033 billions.

The evidence for these assertions while strong is perforce indirect. Firestone's figures (1960, Table A-3) for Federal expenditures by months shows a surge to \$2.3365 billion in June 1936 and a second smaller surge to \$1.2995 billion in June 1937. It is highly likely, therefore, that those veterans who did not cash in their bonds at once held them for one year to collect the higher interest rate paid on these bonds relative to the interest rate on bank saving accounts. Consumption rose by \$6.2 billion in 1936 so the redemptions are over 16 percent of this figure. By July 1, 1937, only \$389 million of the bonds remained outstanding, 20.7 percent of the total. (U.S. Treasury Report, 1937, p. 16). In little more than a year the veterans redeemed nearly 80 percent of their bonus and most likely spent all of it. Here is a case in which most of the transitory income seems to have been consumed and little to have been saved.

The median family income with household head 35-44 years, the relevant age bracket for the veterans, was \$1,449 in 1939 (Historical Statistics 1957, G153) and the mean family income in 1935-36 was \$1,784 (Historical Statistics, 1957, G126). The mean personal income before taxes for families and unattached individuals was \$1,631 before taxes and \$1,608 after taxes for 1935-36 (Historical Statistics, 1957, G120, G122). Hence the payment to a veteran is a sizable fraction, at least 30 per cent, of these figures for income. Although we do not know the incomes of the veterans who took their bonuses in cash, it is safe to infer that they were probably not well-off. There were 38.4 million families and unattached individuals in this period (Historical Statistics, 1957, G118). Veterans who got bonuses constitute 7.6 percent of these units. The Treasury financed the cash disbursement to the veterans by borrowing from the public. In June 1936, the Federal deficit exceeded \$1.8 billion. The 1936 GNP in current dollars was \$82.7 billion so the cash

¹ The Banking Act of June 16, 1933 gave the Federal Reserve temporary authority to set maximum interest rates on time and demand deposits. The maximum rate on demand deposits was set at 0. This authority over interest rates became permanent by the Banking Act of 1935

payments in the 2 week period of June 1936 were nearly one percent of GNP for the whole year (Historical Statistics 1957, F-1). It was 1.25 percent of 1936 GNP including the payments in July 1936. Note that the open market purchases by the Fed between February and August 1932, 1.9 billion, made possible by the Glass-Steagall Act of February 27, 1932 amounted to about 1.9 percent of national income. Hence the stimulus to the economy of the payments to the veterans was comparable in size but much larger in intensity than the Fed purchases. How did these payments to the veterans affect the economy?²

First, consider how the bonus entered the economy. Since nearly half of the total veterans' bonus was cashed in only 2 weeks, the U.S. Treasury had to sell bonds to nonveterans to finance the bonus payments to the veterans. The immediate effect would tend to raise interest rates. Although interest rates on 90 day Treasury Bills did rise from 0.18 percent in May to 0.23 percent in June, they fell to 0.14 percent in July and remained close to that level until December 1936 when they rose to 0.23 percent. Say a buyer of these bonds pays by check. Funds go from the bank, lowering its reserves at the Fed, to the Treasury account at a Federal Reserve Bank. This would reduce the money supply. To the extent the veterans deposit the cash they get from the government into their bank accounts, bank reserves go up, offsetting the contractionary effect. To the extent the veterans spend the money on commodities, inventories fall and production may rise. The net revenue from the veterans' expenditures flows to the banks so that reserves return to their original level. Soon everything on the financial scene returns to the initial positions apart from a bigger Federal debt. In the meantime production may rise. Even payment in cash to the Treasury by buyers of the bonds would not affect the banks unless the buyers took cash from their own hoards for this purpose, which is highly unlikely. Even in this unlikely case, paying for Treasury bonds in cash would have no effect on the money supply. A stimulating effect on production caused by the deficit can occur in this case without a change of the money stock.

Theoretically, buyers of Treasury bonds might reduce their consumption and save more in response to the higher interest rates. If so, there would be no effect on consumption due to the veterans' bonus because the bigger outlays on commodities of the veterans would be offset by the smaller outlays on commodities by the buyers of the Federal bonds. However, as noted above, the effect on interest rates was so small, it is unlikely that buyers of Treasury bonds would reduce their consumption outlays, keeping mind that they could finance their purchases by the sale of other

² Although Friedman (1957, p. 215) discusses some tests of his permanent income hypothesis using the special life insurance payments to veterans in 1950, he does not mention the veterans' bonus of 1936 anywhere in his book.

All that Friedman and Schwartz (1963, p. 538, n. 38) say about the veterans' bonus deserves to be quoted in full. "Under the terms of the Adjusted Compensation Act of Jan. 27, 1936, passed over Presidential veto, more than \$1.5 billion in bonus nine-year interest-bearing bonds, convertible into cash at any time, was distributed on June 15 to World War I veterans."

financial assets. Moreover, the rise in interest rates was so slight, it would probably not affect the demand for business loans.

Putting aside these theoretical musings, there is solid evidence on consumption outlays. According to Barger and Klein's estimates of personal income, seasonally adjusted and available quarterly from the first quarter of 1921 to the last quarter of 1941, personal income rose by \$1.34 billion (\$17.16 billion - \$15.82 billion) from the first to the second quarter of 1936. This increase just about equals the payments to the veterans at the end of that quarter. Personal income remained at about the higher level for the rest of 1936. It reached nearly \$19 billion in the second quarter of 1937 and then fell for the next 6 quarters to about \$16.8 billion. (Moore, 1961, Table 19.1, p. 140).

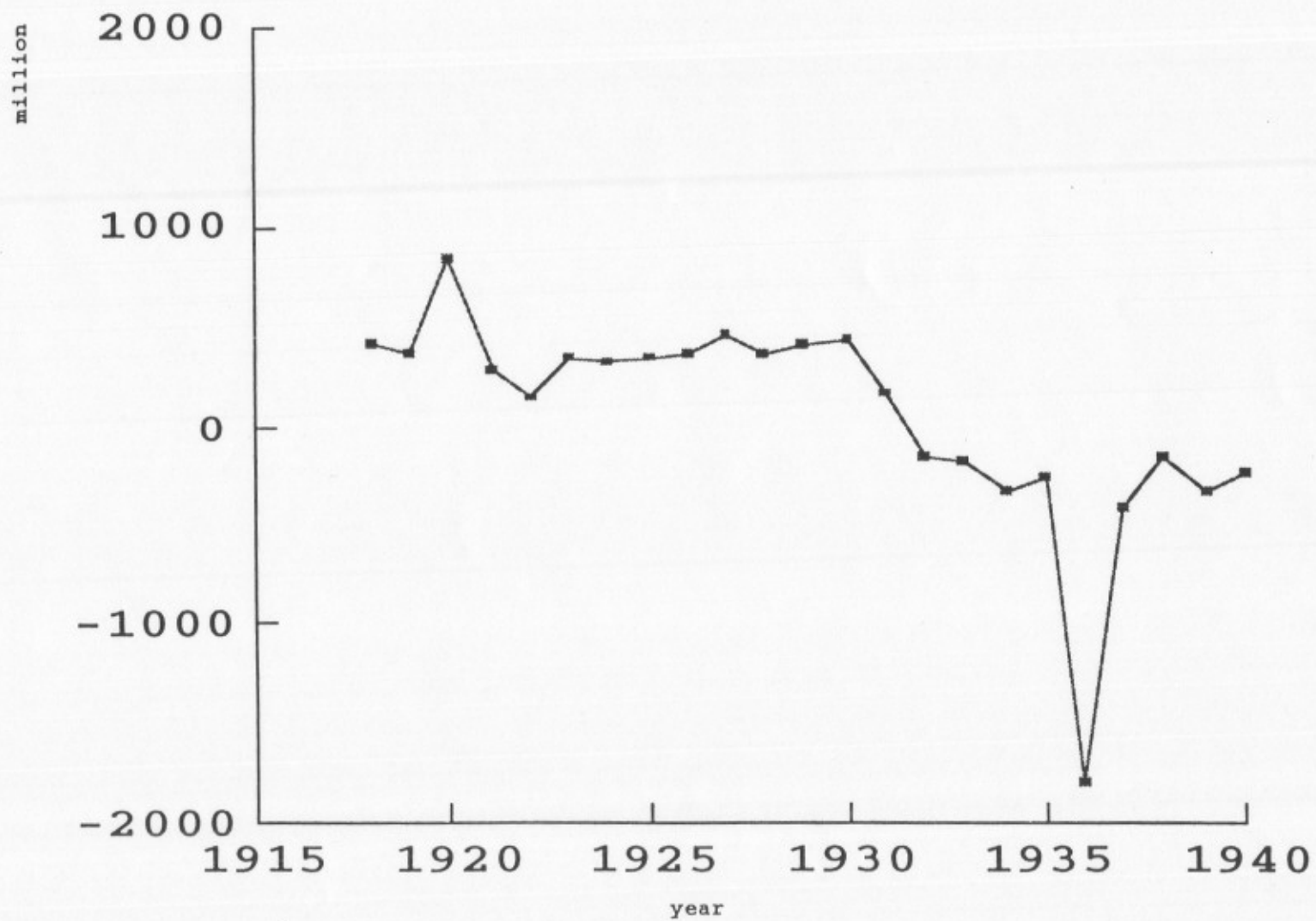
My point is simple. The relatively big direct payments to a sizable fraction of the population in needy or modest circumstances had a commensurate and immediate stimulating effect on the depressed U.S. economy that did not persist after the initial impact. However, we lack the data to trace in detail how the veterans spent their bonuses so we must perforce study the effects indirectly.

June is typically a surplus month for the Federal government. Figure 1 shows the June Federal deficits and surpluses annually from 1918 to 1940.³ The June 1936 deficit is a peacetime record up to that time. Figure 2 shows total Federal outlays for these Junes. Note the surge in 1936 and the aftermath in June 1937 marking the redemptions one year later. Figure 3 shows the seasonally adjusted M1 money supply monthly from January 1933 to December 1938. It rose steadily from April 1933 to March 1937. Hence any rise in 1936 economic activity begs the question of why the cause in the form of a bigger money supply in the preceding months did not have the effect of stimulating the economy. Moreover, because that part of the Veteran's Bonus that the veterans cashed in was financed by Federal borrowing from the public, this did not raise the money supply. The correlations between M1 and three measures of economic activity, the FRB Index of Production, the Wholesale Price Index and nominal income are 0.5, 0.3 and 0.48, respectively. Figures 4 and 5 show the Federal Reserve Board index of Production and the Wholesale Price Index monthly from January 1933 to December 1938. The scatter in Figure 6 shows M1 and FRB Production monthly from January 1936 to December 1939. The sharp break in this scatter with little change in M1 marks the 1937-38 depression.

Next, reconsider the level of economic activity. Figure 4 shows the FRB Index of Production monthly from January 1933 to December 1938. The picture is very ragged during 1933. The drop in the first 3 months is followed by a sharp upturn until September when the nation relapses to depression. The somewhat steadier rise from January 1934 to December is only 10.3 percent (even smaller with the revised FRB Index, 6.9 percent). The next year, 1935, shows a somewhat larger

³ Firestone (1960, Table A-3) has the figures for Federal expenditures, receipts and deficits monthly. He says nothing about the huge deficit in June 1936.

Figure 1 Federal Deficits in June Annually 1918-1940



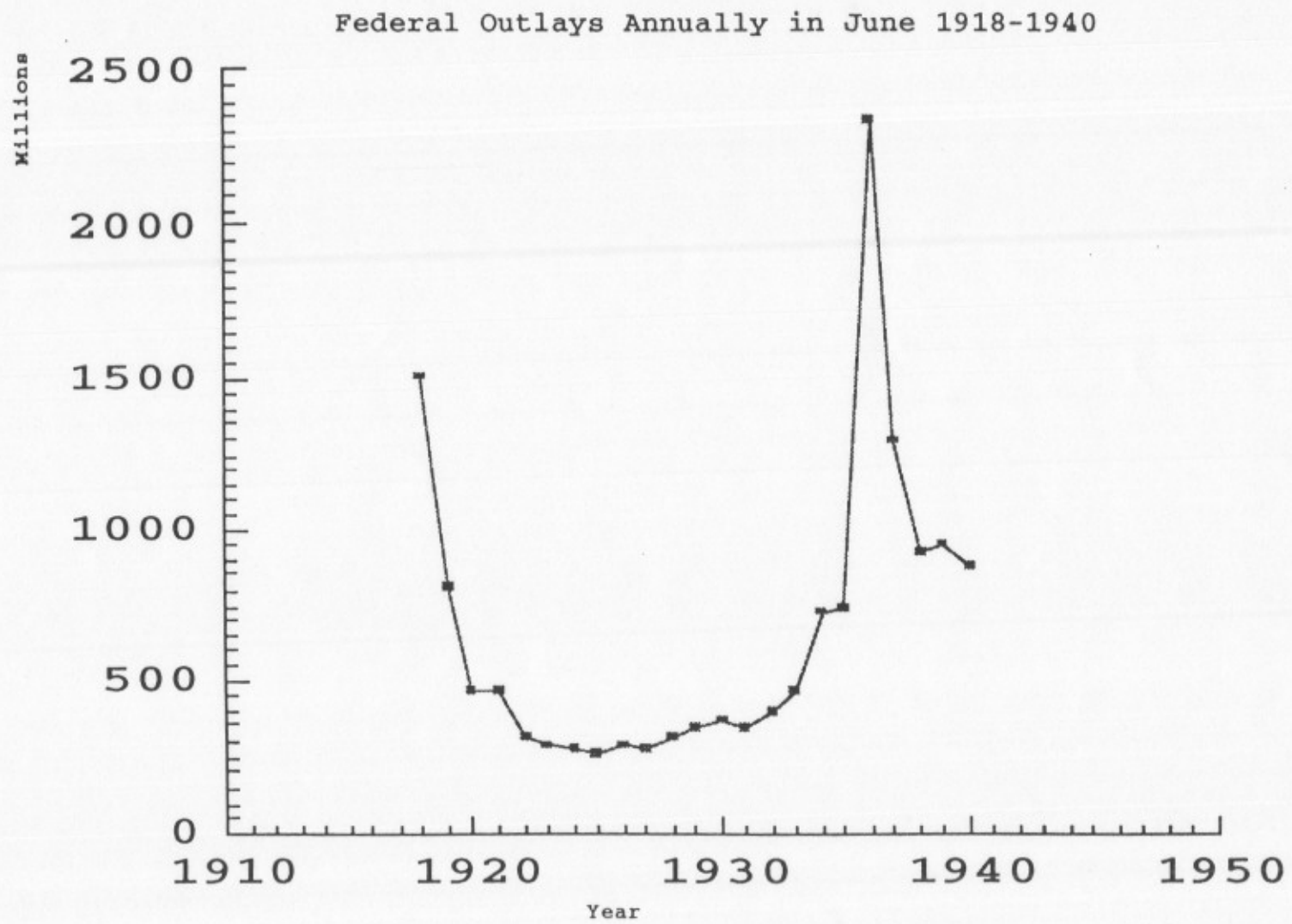


FIG. 2

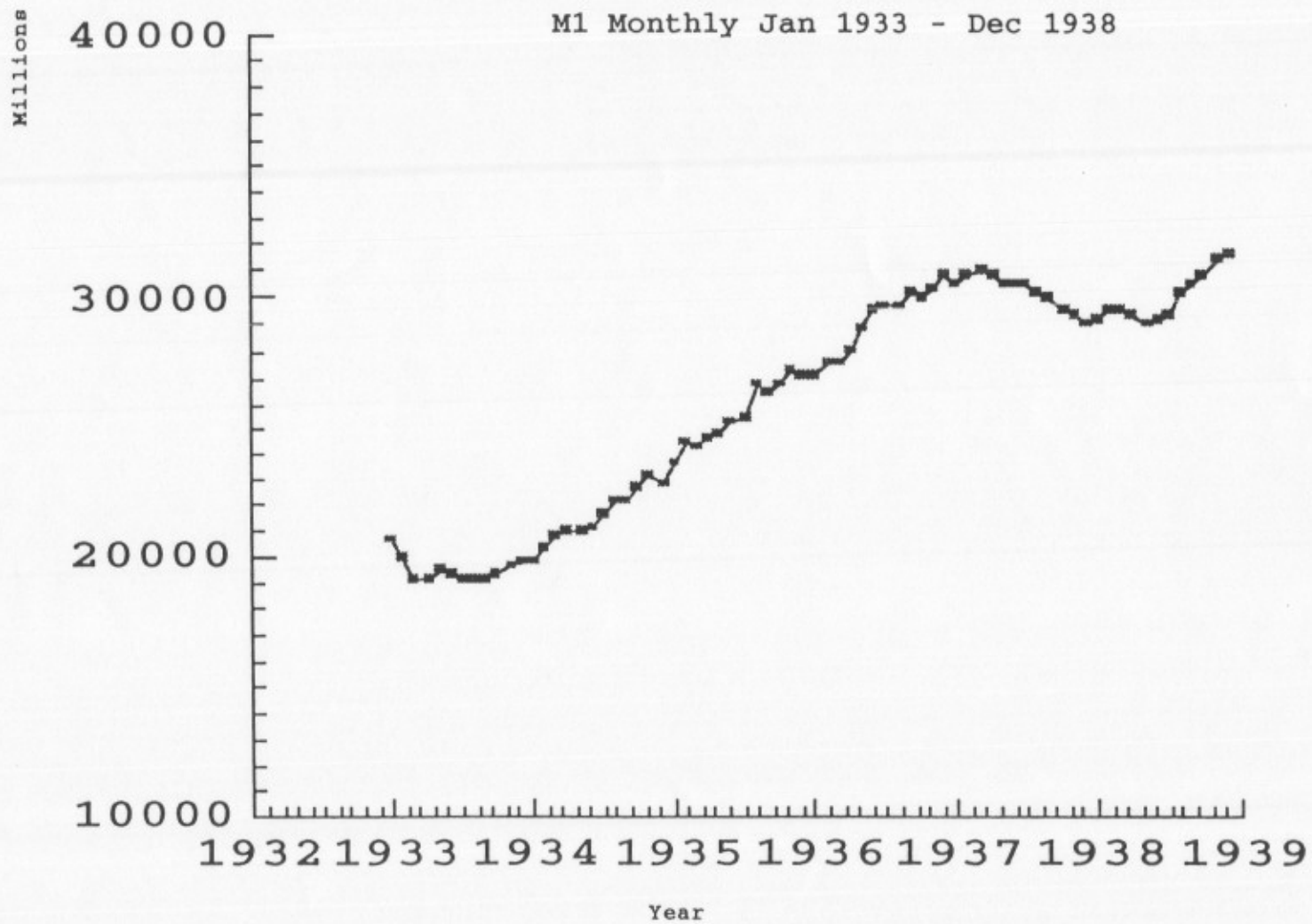


Fig 3

FRB Production Index Monthly Jan 1933 - Dec 1938

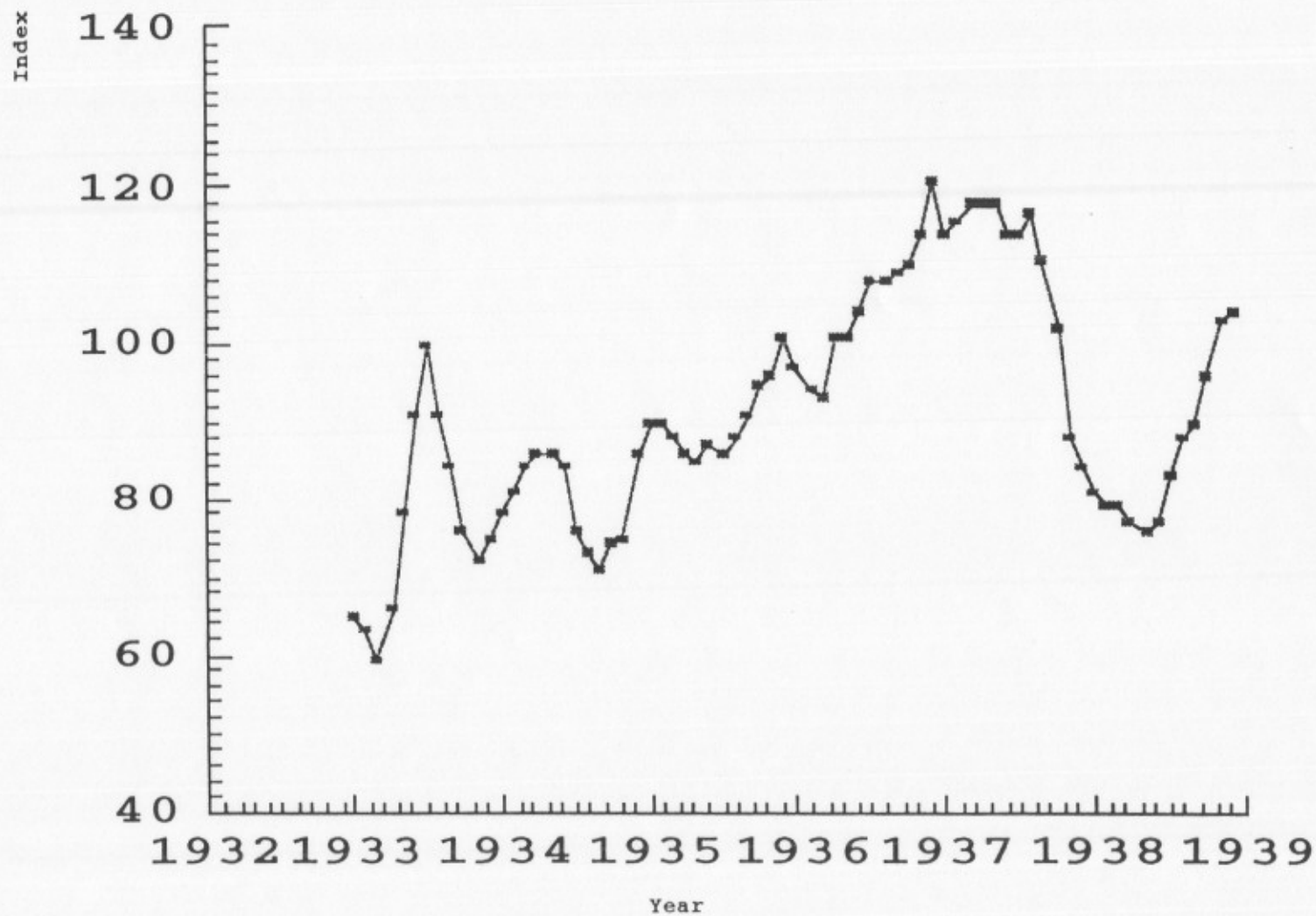


FIG 4

Wholesale Price Index Monthly Jan 1933 - Dec 1938

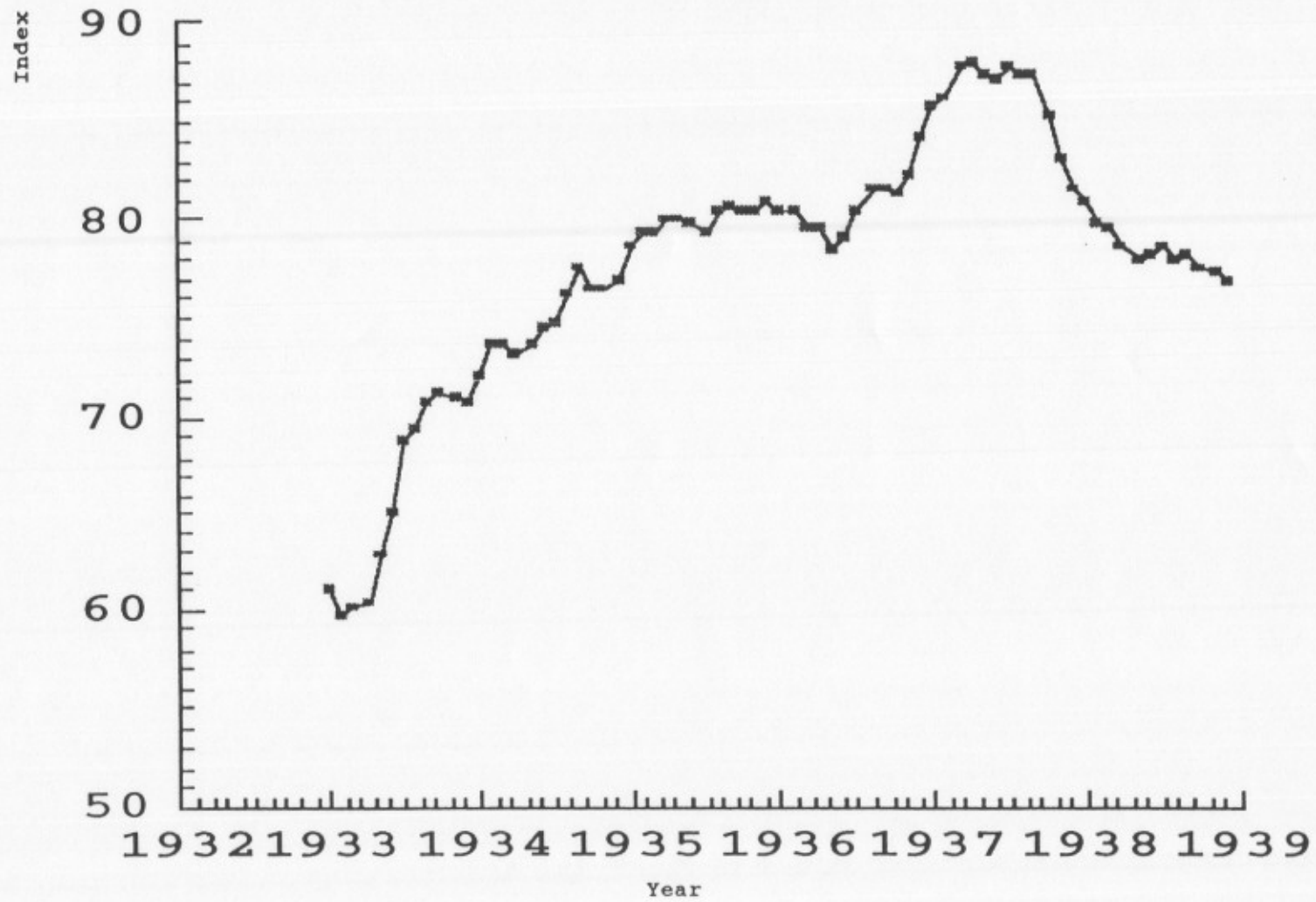


FIG 5

FRB Production & M1 Monthly Jan 1936-Dec 1939

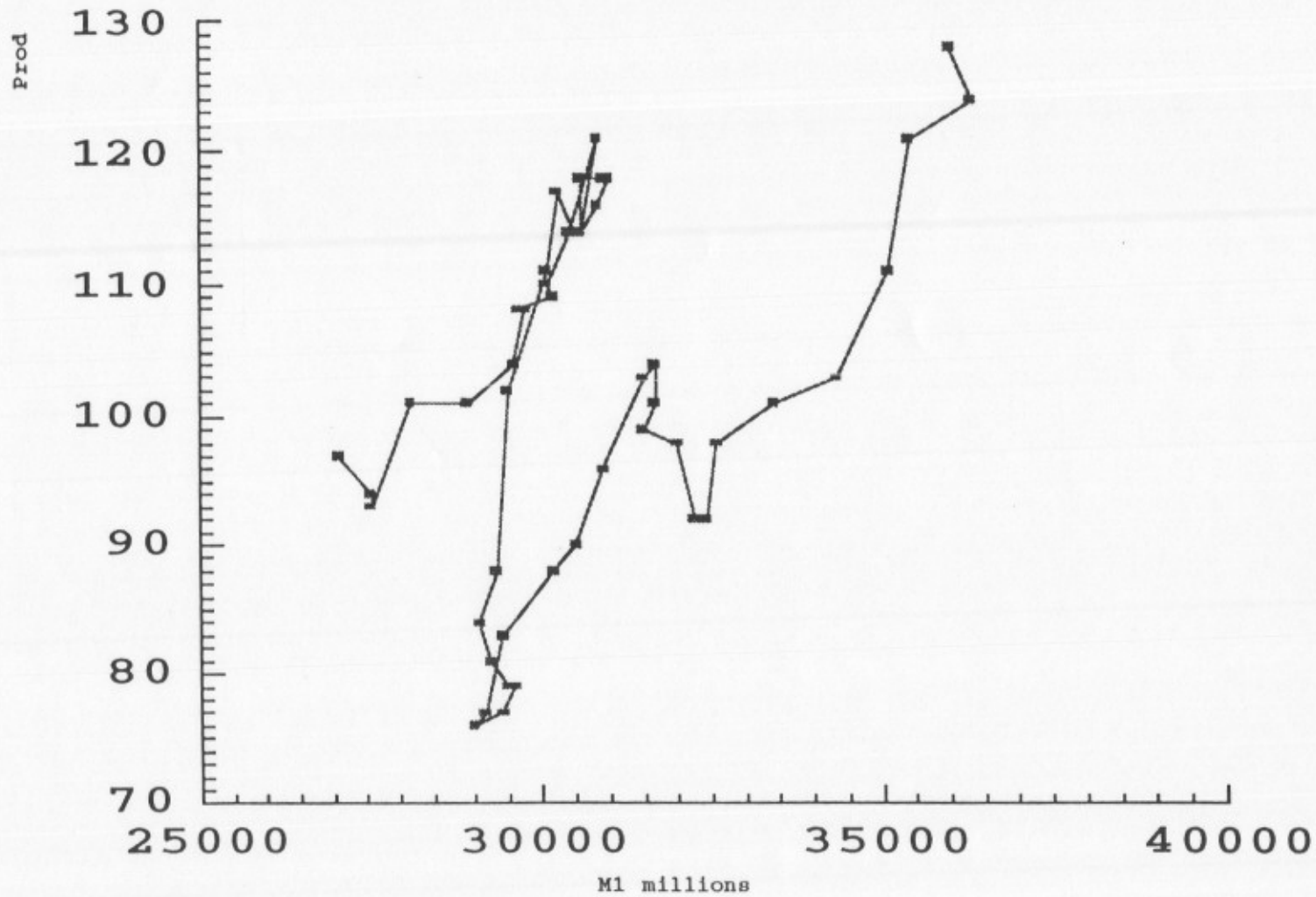


Fig 6

rise of 12.2 percent from 90 in January to 101 in December. The spectacular rise in 1936 coincides with the veterans' bonus. In January, the Index stood at 97 and by December it had risen to 121, an increase of nearly 25 percent. Since the veterans knew the terms of their bonuses including how much each would receive as early as the end of January 1936, it is safe to conclude that this anticipated windfall helped the robust expansion of the economy in 1936. Production remained high until August 1937. Moreover, the veterans' redemptions in June 1937 were 45 percent of the level in the preceding June.⁴ However, the deficit was smaller in June 1937 relative to the preceding year. In June 1936, Federal expenditures were \$2.3 billion and the deficit was \$1.8 billion. Because some redemptions to the veterans were paid in July, note that the total Federal expenditures in June and July 1936 were \$2.75 billions and the deficit for the two months summed to \$1.925 billions. In June 1937, Federal outlays were \$1.3 billion of which \$463.5 millions went for the veterans' redemptions. However, the Federal deficit in June 1937 was \$432 million, only 23.9 percent of the in June 1936 deficit.⁵ The smaller deficit of June 1937 had a commensurably weaker effect. By September 1937, the economy was descending again into depression. Recovery did not begin until May 1938.¹

Some claim that the Social Security program was a drag on the economy (see note 4). This program began in January 1937. From 1937 to 1949 the social security tax rate on taxable earnings was two percent, one percent paid by employees and one percent paid by employers. The collections and disbursements on behalf of social security are both included in Firestone's figures through 1939 (p. 82). The social security levy applied only to the first \$3,000 of taxable earnings and only 60 percent of all workers were liable for the tax. The average earnings of those liable for the tax was not much over \$2,000 so the amount paid per worker was about \$20. For these reasons the negative impact of this tax on the economy should not be overblown.

The regression relating the change in annual consumption to the Federal deficit is pertinent to estimate the effect of the veterans' bonuses on consumption. In 1936, the bonus raised the deficit by 1.033 billion. The regression says this raised consumption by 3.19 billion (1.033×3.088), that is over 50 percent of the actual increase of consumption which was 6.2 billion. In 1937, veterans redeemed 0.389 billion, the deficit was higher by this amount and this raised consumption expenditures in 1937 by 1.2 billion, which is over 25 percent of the actual rise in consumption.

⁴ Romer (1992, p. 705) says "In 1936 a large bonus had been paid to veterans of World War I. In 1937, not only was there no payment of this kind, but social security taxes also were collected for the first time." This is inaccurate. Veterans did receive payments in 1937. The redemptions by the veterans in June 1937 were \$463.5 millions, about 45 percent of the amount paid from June 15, 1936 to July 31, 1936.

⁵ In June 1936, demand deposits were \$24.4 billion and time deposits were \$13.7 billion. In June 1937, these were \$25.1 billion and \$14.6 billion, an increase of nearly \$1.6 billion. A quantity theorist would derive scant support from the relation between production and M1 monthly for the period January 1936 to December 1939.

Figure 5 shows that the Wholesale Price Index (WPI) moved in tandem with production. During the 36 months from January 1936 to December 1938, the adjusted R^2 between the WPI and the production index is 0.475. The surge of prices continued until the middle of 1937 and then declined with the relapse into the 1937-1938 Depression.

Monthly figures on consumer spending are not available. The Federal Reserve Board's Index of Department Store Sales is available monthly and can provide another measure of the effect on consumers of the veteran's bonus. These figures are available starting in January 1923. The most prominent feature of department store sales is seasonality. Sales in December are usually 50 percent above November sales. A secondary peak occurs around Easter and a slump during the summer. Nevertheless it would be misleading to use seasonally adjusted figures owing to the tremendous drop of sales from 1932-1935. It is better to compare the figures for the same month across years and thereby avoid distortions from a mechanical adjustment for seasonality. Consider the FRB Index of Department Store Sales deflated by the Wholesale Price Index. Begin with Figure 7 for January's. The peak occurs in January 1931 and the trough in January 1935. There is a steady rise for all the January's through 1939. Figure 8 shows deflated sales during June's. Like January, there is a big increase from 1935 to 1936. The 1937-38 depression is plainly visible in the June figures. The most dramatic picture is for December. The severity of the Great Depression can be judged by the singular fact that from 1932 to 1935, December sales were below November sales. Figure 9 shows the spectacular rise in deflated department store sales from 1935 to 1936. The 1937 slump appears only in the shape of a leveling off in December 1937 compared to the preceding year. Thereafter, December sales in 1938 and 1939 rose.

The conclusion is plain. The veterans' bonus brought a large measure of recovery to the economy although it was financed by Federal borrowing from the public that did not change the money supply.

Historical Note

Perhaps one reason for the neglect by economists of the veterans' bonus arises from the Treasury's cryptic description. The following is the most direct available statement by the Treasury.

"Adjusted service bonds amounting to \$141,000,000 on the basis of daily Treasury statement, unrevised, were issued during the year [fiscal 1937] making a total of \$1,809,000,000 of such bonds issued since June 15, 1936. Redemptions during the year [fiscal 1937] amounted to \$696,000,000 compared with redemptions of \$724,000,000 during [fiscal] 1936, leaving \$389,000,000 of adjusted service bonds outstanding as of June 30, 1937." (Treasury Report for Fiscal Year Ending June 30, 1937, p. 16). Assume the Treasury refers to years consistently so that a year means a fiscal year. The fiscal year 1936 begins on July 1, 1935 and ends on June 30, 1936. Likewise, fiscal 1937 begins July 1, 1936 and ends on June 30, 1937. The bonds were

Jan's Deflated Dept Store Sales

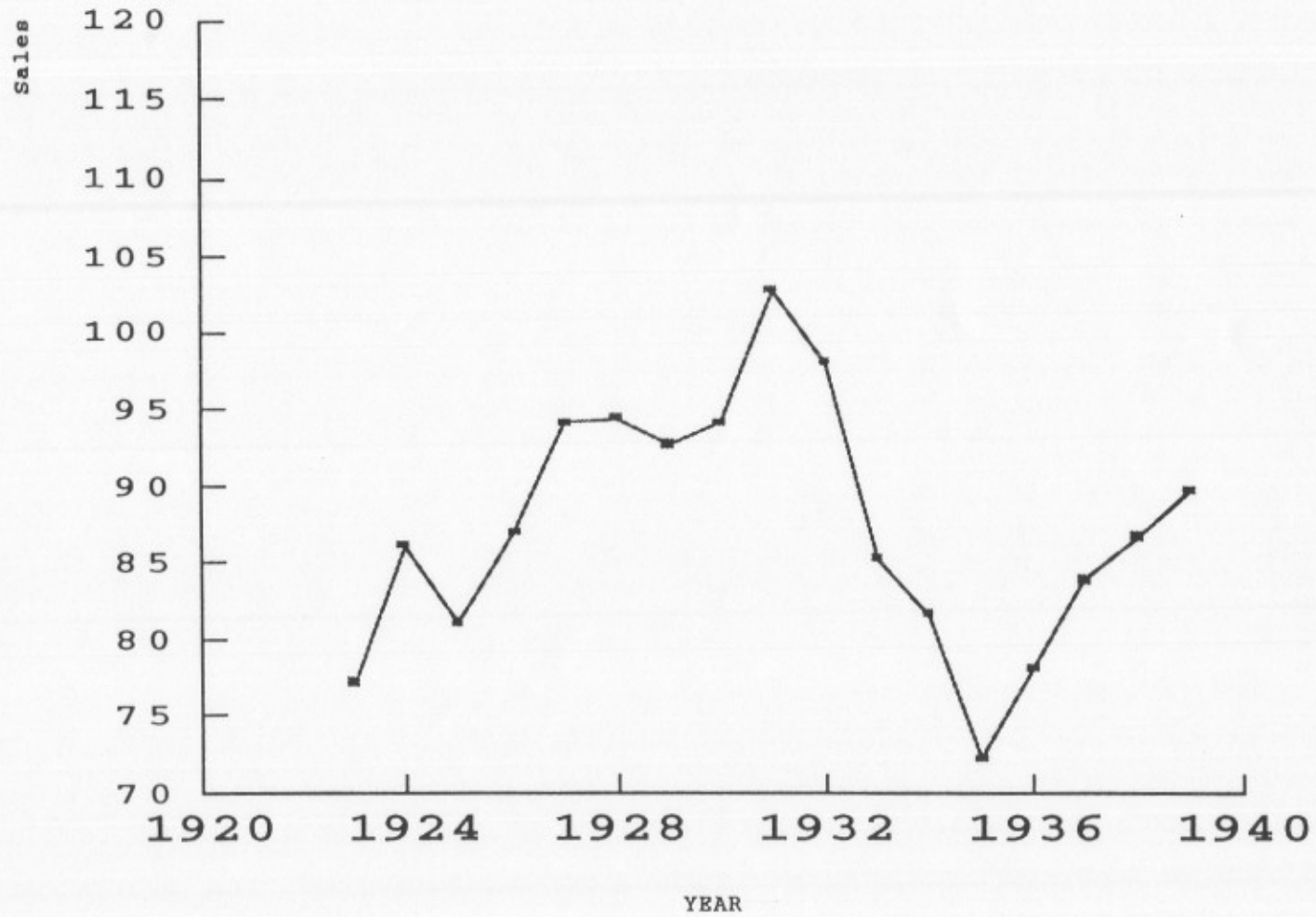


Fig 7

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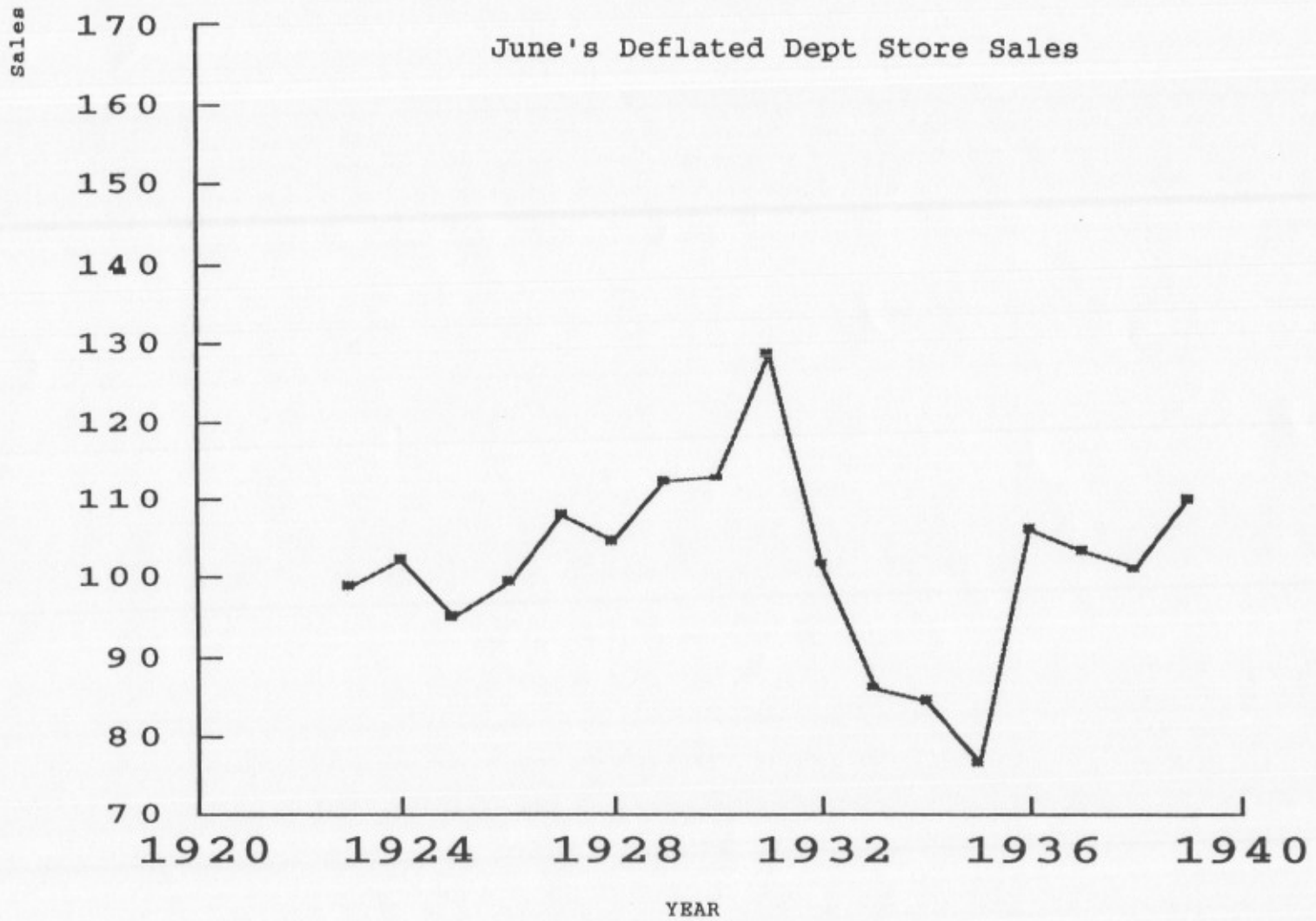


FIG 8



FIG 9

\$800.6 million redeemed in cash during the 2 week period June 15, to June 30, 1936. This extraordinary phenomenon goes without comment in the Treasury Reports. Evidence to support my interpretation is Firestone's figure for the Federal deficit during June 1936. It is \$1,807.3 million. The deficit the month before is \$301.7 million and the month after is \$118.2 million.

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