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America First, Fallout Later

Feb 22, 2019 William L. Silber

When assessing Donald Trump's place in the US political pantheon, few would put him anywhere near Franklin Delano Roosevelt. Yet by pursuing a narrowly focused domestic agenda with little mind to the international implications, Trump is emulating one of FDR's most egregious political mistakes.

NEW YORK – Like a sunbather bent on improving his tan, US President Donald Trump's policy of always putting "America first" entails long-term costs that could easily outweigh the short-term benefits. Economic nationalism and protectionism may produce immediate industrial gains in some sectors, but they can also lead to bad outcomes that go well beyond trading partners' predictable retaliation.

A lesson from US President Franklin Delano Roosevelt's New Deal programs in the 1930s helps to drive the point home. As with Trump today, part of Roosevelt's strategy for boosting the US economy effectively singled out China. Examining that precedent closely reveals that when US policies are formulated with a view to the domestic context and pay little mind to international implications, the consequences can be disastrous.

Bullion in a China Shop

In December 1934, FDR's Secretary of the Treasury, Henry Morgenthau, confessed to his friend William C. Bullitt, the US Ambassador to the Soviet Union, that "I was on the payroll of the Japanese [and] I've been earning my pay." A disturbing statement by itself, Morgenthau's intimation would seem all the worse for coming just a few years after Japan's invasion of the Chinese province of Manchuria. But, of course, Morgenthau was not literally on Japan's payroll. What he meant is that he might as well have been, having implemented a policy that left China vulnerable to Japanese aggression.

Six months earlier, FDR had signed the US Silver Purchase Act of 1934, which proposed that 25% of US monetary reserves comprise silver, thereby enhancing the metal's role in US finance. With significant support from US senators representing Western mining states, the legislation's stated purpose was to jumpstart the domestic economy in the midst of the Great Depression. To that end, Morgenthau directed the Treasury to start buying up silver; within a year, the price of silver in world markets had doubled.

At the time, China was on the silver standard, and as the price of silver increased, so, too, did the value of the yuan, thereby curtailing Chinese exports and bringing on a recession. Making matters worse, smugglers, encouraged by the sudden price increase, began shipping silver from Shanghai to London, depleting Chinese bank reserves and making credit scarce.

As China's economic troubles mounted, Morgenthau began to worry that Japan would capitalize on its giant neighbor's financial weakness to advance its own territorial ambitions in the Far East. His fears were justified. The Roosevelt administration's silver policy not only kneecapped China, but also tipped the domestic balance of power in Japan away from the diplomats and toward the country's increasingly ill-disciplined military. The result, just three years later, was the Second Sino-Japanese War, which led to mass atrocities against the Chinese civilian population.

Silver-Tongued Senators

The Silver Purchase Act was actually the second phase of FDR's silver program. Earlier, in December 1933, he had issued an executive order directing the Treasury to pay $0.64 per ounce for domestically mined silver. Given that the prevailing market price was around $0.43 per ounce, the policy amounted to a massive subsidy for the industry.

Like Trump's obsession with coal and heavy industry, FDR's apparent love affair with silver was wholly due to domestic politics. His program was designed to secure the loyalty of the 14 US senators representing seven Western mining states: Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, and Utah. FDR lavished special treatment on one in particular, Senator Key Pittman of Nevada, who was not just the leader of the congressional silver bloc, but also president pro tempore of the Senate and chairman of the Committee on Foreign Relations. Pittman had earned the president's favor by delivering the silver bloc's support for one of the administration's earliest legislative initiatives to combat the Depression, the Agricultural Adjustment Act, which passed the Senate in April 1933.

FDR would go on to repay Pittman in installments. First, he appointed the "Silver State Senator" to the committee representing the US at the June 1933 World Monetary and Economic Conference in London, where delegations from 66 countries gathered for six weeks to discuss financial solutions to the Depression. While there, Pittman sponsored a resolution to increase the role of silver in monetary reserves, and FDR followed up by signing the December 1933 executive order subsidizing US domestic production of the metal.

Pittman celebrated the executive order as a "Christmas present." But soon enough, he was busy securing another payoff from the White House. Pittman and his silver bloc negotiated and shepherded through Congress the Silver Purchase Act that would weigh so heavily on Morgenthau's conscience.

Earlier in the year, Senator Burton Wheeler of Montana, a silver-bloc extremist, had suggested openly that a sharp increase in silver prices would be akin to "putting a tariff wall against China." So it is not as though Morgenthau and FDR were unaware of the bill's international economic implications. They simply refused to let those implications interfere with its passage.

China's Test of Metal

When US policies started driving up silver prices in the second half of 1934, Chinese officials responded with formal protests. In October, Chinese Finance Minister H.H. Kung wrote to US Secretary of State Cordell Hull to point out that the US program threatened "a potentially serious monetary situation resulting from the present rise in the price and the drain of silver." But Hull decided to soft-pedal Kung's plea for "American cooperation to prevent a further rise in the price."

Morgenthau, however, was beginning to worry. And on February 17, 1935, a second plea from Kung arrived at the White House, confirming his fears. Morgenthau's friend Bullitt, who had a personal relationship with FDR, delivered the message from the Chinese finance minister directly. The Chinese ambassador to the US had shown him a cable from Kung, which, he intimated, "he did not feel he could show the State Department." To err on the safe side, he asked Bullitt to get the information to the president himself. As Morgenthau noted in his diary, "This procedure seemed most irregular and I should think would be frowned upon by Hull." That was probably the understatement of the year.

In the cable, Kung reported that Japan had offered a "large loan" in the name of "so-called economic cooperation which amounts to economic domination particularly [in] North China." Moreover, as a candied carrot from Japan's diplomats to render China more compliant, Japan would help make "joint representations against American silver policy."

FDR thanked Bullitt for the information, but waited until the following day to discuss it at lunch with Hull and Morgenthau. He told Hull all about his conversation with Bullitt the previous night, perhaps to take the secretary of state down a peg. And while this delighted Morgenthau, who considered Hull too soft on Japan, FDR then came to a mystifying conclusion. "In view of the information that Bullitt has brought us," he said, "I am now convinced that I am right that somehow or other our silver policy is hurting Japan." The president then nodded toward Morgenthau and said, "I have told this to Henry and other people but nobody seems to know why it should hurt Japan, but I maintain that it does."

Of course, the reason nobody seemed to understand FDR's argument is that it made no sense. The Chinese yuan was pegged to silver in the same way the US dollar had been tied to gold. By definition, if silver increased in value, the yuan would strengthen against other currencies, Chinese goods would cost more to Americans and Europeans, sales abroad would fall, and unemployment in China's export industries would rise.

None of this was a secret. As the Princeton University economist Richard A. Lester concluded at the time, "An increase in the value of silver … would blight [China's] commerce." And as China experts like Sir Arthur Salter, the former head of the League of Nations economic and finance section, explained, China had escaped the worst of the early Depression years precisely because its currency was pegged to silver, which declined in price between 1929 and 1932, thus preventing deflation.

FDR's delusion owed much to his having given Pittman the final say over all things silver. When Pittman heard that Kung's brother-in-law, former Chinese Finance Minister T.V. Soong, might visit the US, he told Morgenthau, "It should be understood that he is not coming here to discuss our silver policy." Morgenthau duly delivered Pittman's message to FDR, and the president concluded that it would be "much better that Soong did not come."

From Carats to Sticks

The US government's silver-buying program continued to drive up prices in 1935. Between the start of the year and April, the price of silver increased from $0.55 per ounce to a peak of $0.81 per ounce. This further enhanced FDR's reputation among the silver bloc, but forced China off the silver standard altogether. On November 3, 1935, Kung announced that all Chinese citizens must deliver silver yuan to the Central Bank in exchange for new banknotes, which would be backed only by the government's creditworthiness. The new fiat currency, he explained, was made necessary by "the rapid rise in the price of world silver," which had led to "severe internal deflation, growing unemployment, [and] widespread bankruptcies" across China.

To be sure, many countries can survive currency crises, as Britain did after leaving the gold standard in 1931. But China was confronting both Mao Zedong's communist insurgency and Japan's military expansionism. It needed monetary stability. And as the economist George Roberts of the National City Bank of New York (now Citibank) warned, "China in her present state of economic development, with a large part of the population accustomed to the use of hard money, is poorly adapted to a managed currency."

After abandoning silver, China no longer needed Japanese diplomats to help make "joint representations against American silver policy." But this further shifted the balance of power in Japan from the Foreign Office to the War Department. Anticipating this, the US Ambassador to China, Nelson Johnson, had noted in an earlier telegram to Hull that the Japanese military "have been skeptical of the efficiency of the Japanese Foreign Office policy," and "would be content to watch only for a limited time the direction of Japanese policy in China by Japanese civilians."

Two days after China's adoption of fiat currency, the front page of one newspaper led with the headline "China's Money Plan Angers Japanese," and a story focused on Japanese bankers who had been taken completely by surprise. Similarly, an editorial in the Tokyo daily *Nichi Nichi Shimbun* accused China of demonstrating "complete insincerity" by leaving the silver standard.

But Japanese bankers were the least of China's worries. According to a headline in *The New York Times* the next day, "China Threatened by Japanese Anew: Wrathful over Nanking's New Monetary Plan, War Minister Says Army Is Ready to Act." The story went on to report that "Japan may be ready to replace Foreign Minister Koki Hirota's 'negative' policy of a conciliatory attitude toward Nanking by the army's positive policy of forming a North China bloc to allow Tokyo to achieve its aims."

Then, on November 22, less than three weeks after China left the silver standard, Japanese War Minister Yoshiyuki Kawashima and Hirota faced off in a cabinet debate over how best to subjugate China's five northern provinces, including the key cities of Tientsin and Peiping. Five days later, everyone knew who had prevailed. “Japanese March Into North China; Seize Rail Centre,” reported one front-page story, “3,000 move southward … after taking the railway station … [they] took over the Chinese military telephone lines.”

A Tarnished Legacy

Japanese imperial aggression began well before the Silver Purchase Act of 1934. But the US silver-buying program played a decisive role in strengthening the Japanese military’s hand in Tokyo, and in weakening China to the point that it was forced off the silver standard. Japan invaded China proper in mid-1937, at which point Johnson wrote, “My opinion [is] that the Japanese military faction is forcing Japan along a road of compulsory piecemeal domination of China.” The long Sino-Japanese battle would escalate and spill over globally during World War II. Looking back, it seems likely that a robust China with its ancient silver heritage intact would have been less vulnerable to Japanese aggression, especially if Japan’s Foreign Office had not been neutered so early in the conflict.

FDR ignored the silver program’s destructive effects in China because he was focused on retaining the loyalty of 14 senators. In the end, his domestic political agenda fostered Japanese aggression in the Far East, and led to the loss of millions of lives.

When US presidents (and their congressional enablers) pursue “America first” policies without thinking about the long-term consequences (or after dismissing them), the results can be devastating. Today, we should all be worried about Trump’s singular focus on his base in a few key battleground states. Attempts to win over blue-collar voters in Ohio, Michigan, Pennsylvania, and Wisconsin could well lead to disruptions on a global scale. Unfortunately, we will not know that until it is too late.

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