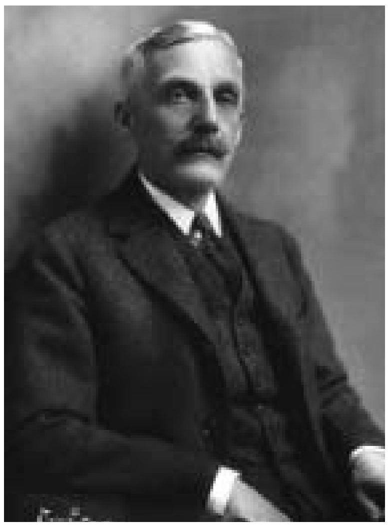
Andrew Mellon: The Entrepreneur as Politician

BY BURTON FOLSOM, JR.

Rarely do spectacular entrepreneurs leave their realm of business for the political arena. One exception is Andrew Mellon, the third-wealthiest American of his era, who left a dazzling career in American industry to become secretary of treasury under Presidents Warren Harding, Calvin Coolidge, and Herbert Hoover.

Mellon established his career in Pittsburgh as a successful banker—always on the lookout for profitable innovations to back. His investments in Gulf Oil challenged the legendary John D. Rockefeller, and Mellon's establishment of Alcoa introduced lightweight aluminum as a significant industrial metal.

Should Mellon have given up running these and other profitable ventures in 1921 to work under President Harding, a career politician who had little understanding of economics? Mellon hesitated. But when Harding persisted, Mellon joined the president's cabinet. At age 65, Mellon had experienced a full career in business; his country, which was in economic chaos after World War I, had 11.7 percent unemployment and needed his financial guidance.



Andrew Mellon

Confronting Crises

As treasury secretary Mellon confronted three major crises: a spiraling national debt, near confiscatory tax rates, and the repayment of large loans owed the United States by most European nations.

The soaring national debt required immediate attention. During the 140 years from the American Revolution to 1916, the United States had accumulated a national debt just over $1.2 billion. But during World War I the debt had skyrocketed to more than $24 billion. The annual interest payments alone exceeded the entire national debt before the war.

The U.S. tax system, which generated the revenue to pay the debt, was in disarray. Under President Woodrow Wilson, Harding's predecessor, the income tax had become part of American life. Wilson started with a top marginal rate of 7 percent, but he argued that the war required a drastic rise in taxes. Congress agreed, and by 1920, Wilson's last full year in office, the top rate reached 73 percent. Tax avoidance was rampant, and the annual revenue did not offset expenses.

Finally, the debts that the European allies owed the United States for food and materials during the war were over $10 billion. Britain and France, which owed the most, were balking at repayment.

Few secretaries of the treasury have ever encountered such formidable problems, and Harding (who died in 1923) and Coolidge relied on Mellon for financial advice. Mellon's attack on the debt was twofold. First, he renegotiated almost one-third of the debt at lower interest rates; second, he helped chop federal spending from $6.5 billion in 1921 to $3.5 billion in 1926. Coolidge, in particular, obliged by vetoing special-interest legislation—a bill to give a bonus to veterans and another to subsidize wheat and cotton farmers.

Mellon was not always consistent in his free-market arguments. He supported high tariffs for many products, but he recognized that a "subsidy can be paid only by taking money out of the pockets of all the people in order that it shall find its way back into the pockets of some of the people."

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Mellon, meanwhile, did his part to promote thrift. He cut staff at the Treasury Department, and he reduced the size of America's paper money; the smaller bills were more durable and saved ink and paper.

The slashing of the tax rates, however, was where Mellon did his most good. He carefully studied the effects of confiscatory rates and concluded that most wealthy Americans were avoiding payment of taxes by exploiting tax loopholes—foreign investments, the buying and selling of art and coins, and the purchase of tax-exempt bonds.

Why not, Mellon argued, cut the top rate from 73 to 25 percent? In fact, why not chop all rates by the same proportion? That idea—which would be called the Mellon Plan—would not only encourage the rich to invest in the American economy, it might actually generate more revenue. "It seems difficult for some to understand," he wrote, "that high rates of taxation do not necessarily mean large revenue to the Government, and that more revenue may often be obtained by lower rates."

Coolidge fully backed the Mellon Plan, and Congress passed it in stages during the 1920s. Cutting both federal spending and tax rates across the board worked wonders for the American economy. American businessmen plowed capital into radios, cars, refrigerators, vacuum cleaners, telephones, and a variety of new inventions from the air conditioner to the zipper. Entrepreneurs knew they would be able to keep most of what they invested, and the American economy grew rapidly during the 1920s.

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Measuring Misery

One measure of prosperity is the misery index, which combines unemployment and inflation. During Coolidge's six years as president, his misery index was 4.3 percent—the lowest of any president during the twentieth century. Unemployment, which had stood at 11.7 percent in 1921, was slashed to 3.3 percent from 1923 to 1929. What's more, Mellon was correct on the effects of the tax-rate cuts—revenue from income taxes steadily increased from $719 million in 1921 to over $1 billion by 1929. Finally, the United States had budget surpluses every year of Coolidge's presidency, which cut about one-fourth of the national debt.

On the issue of the Allied loans, Mellon was less successful. When the Europeans refused to begin payments on their debts, Mellon substantially lowered the interest rates on the loans and gave the Europeans 62 years to repay. At first, they agreed, and even began making small payments, but only Finland paid off its entire debt. The other countries eventually asked for a moratorium on payments, and then abandoned their debts entirely.

Oddly, the Allies had one good argument for reneging on their debts. In 1930, when the United States passed the Smoot-Hawley Tariff, the highest in American history, Europeans asked how they could repay their loans when the United States was refusing to accept their imports? Hoover ultimately appointed Mellon as ambassador to England—in part to nudge the British into honoring their debt commitment—but with the Great Depression under way, even Mellon's powers of persuasion failed to move the British.

By 1933, with the arrival of Franklin Roosevelt and the New Dealers, the times had changed for Mellon. Hoover had raised the top marginal income tax rate to 63 percent, and Roosevelt hiked it to 79 percent in 1935. Moreover, Roosevelt played politics and pressured the IRS to assess Mellon a $3 million fine for tax evasion. Mellon gladly went to court and was vindicated of all charges of wrongdoing. David Blair, the former commissioner of internal revenue, called the tax investigation "unwarranted abuse by high officials of the government."

Mellon, despite the trumped-up charges, always focused optimistically on the art of the possible. Before his death in 1937 he donated his superb art collection to the United States. In doing so, he wanted to avoid all federal expense, so he built the National Gallery of Art in Washington, D. C., to house the paintings and then donated all of it to his country. When Mellon went to Washington, he changed it more than it changed him. FEE