BUREAU OF BUSINESS RESEARCH
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Bulletin No. 54

A BALANCE SHEET OF THE NATION'S ECONOMY

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Comptroller, A. E. Staley Mfg. Company

Published by the University of Illinois, Urbana
1936
PREFACE

The scientific analysis of economic statistics and the careful preparation of accounting data of course antedate the World War. But that period of intense activity and long-felt results gave a new stimulus to the previously slow development of both statistics and accounting as scientific instrumentalities. Two technics have grown up, as it were, side by side, yet without much interchange. But accountants are coming to realize that their art is, in some respects, purely a statistical operation, that of recording and classifying data, and that most of the items reported in the financial statements constitute data for statistical series of very great importance. Economic statisticians on their side are becoming aware of the rich data-source which lies undeveloped in accounting.

When an economist who teaches statistics and a certified public accountant who lives his accounting as the comptroller of a large enterprise are closely associated for some time, it is not unlikely that, sooner or later, these developments will enter into their discussions, and that presently the possible union of statistics and accounting for certain purposes will suggest itself. Out of such discussions comes the present sketch of an area wherein the union of these two technics may easily establish a new high-water mark in the development of both fields of study.

Accountants will recognize the arrangement of the data in the proposed "National Balance Sheet and Income Statement" as the familiar working papers for compactly expressing the opening balance sheet, the closing balance sheet, and the interim transactions that explain the changes revealed. Statisticians will recognize the data used as drawn from familiar statistical sources with considerable freedom. The insufficiency of present-day statistical sources for any such comprehensive purpose will be made evident in the text.

Perhaps the time will soon come when national statistics may be assembled for the specific purpose of a coordinated display of the state of the nation; perhaps we are even now on the verge of a period of better understanding and mutually profitable interchange of ideas by accountants, statisticians, and economists. If this brief preliminary survey of the possibilities shall be even a small stimulus toward the accomplishment of such ends, the authors will feel amply repaid.

Throughout the study the term "Economic Planning" has been avoided because it has so many possible meanings. In its stead, the
words "Economic Coordination" and "Economic Proportionality" have been employed. In this way it is hoped to avoid possible confusion of thought.

We wish to acknowledge our indebtedness to the Bureau staff for their help in editing the manuscript.

FRANK G. DICKINSON
FRANZY EAKIN

September, 1936.
TABLE OF CONTENTS

I. Economic Coordination . . . . . . . . . . . . . 7

II. A National Balance Sheet. . . . . . . . . . . 9

III. An Experimental Sample . . . . . . . . . . . 12

IV. Sources . . . . . . . . . . . . . . . . . . . . . . . 26

V. Explanation of Items in Balance Sheet and Income Statement . . . . . . . . . . . . . . . . . . . 27
I. ECONOMIC COORDINATION

The course of economic history does not run smoothly, nor does it show a series of close-set peaks and valleys of action and reaction. There are variations and changes, some sharp and noticeable, many only slowly manifesting themselves. When, for any reason—severe depressions, extensive wars, or the like—the variations are swift and violent, there are troubled times because innumerable established relationships are then disrupted. The effects of changed conditions upon different individuals and interests are bound to be unequal, and the reactions or rebounds that follow are in turn varied. Things get out of balance; a relative equilibrium once disturbed is difficult to restore, yet the restoration of a workable degree of coordination is vital.

Experienced business men have long been learning the lessons of preparedness—that is, lessons in looking ahead for such poor clues to the future as our intelligence has been able to discern. Financial and economic statistical data and the technics of statistical analysis have vastly extended the business man's vision of the distant horizon. Great developments in accounting, such as cost finding and budgeting, have deepened the business man's understanding of the interaction of details germane to his economic and financial affairs. Out of the combination of these two he has built a technic of planned coordination, which, imperfect—even deceptive at times—though it be, still constitutes a far more effective approach to the solution of administrative problems than business men have ever had before.

The question then appears: Cannot something of this same technic be used as an approach to our national problems? Troubled times are national as well as individual; the need for some vision of distant horizons is the same; definite goals must be selected in both cases and coordination sought in an effort to regain an acceptable degree of equilibrium and a sound inner proportionality. Cannot the technics of the statistician and the accountant be combined in the national interest as effectively as in the interest of individual business enterprises?

Specifically, is it not possible to obtain and organize statistics of national income, costs, wealth, debts, etc., according to the technic of working papers and consolidated balance sheets by which accountants combine widely scattered data into compact schedules? It should be just as feasible to view the total national wealth as the wealth of an individual at two different dates; it should be possible to organize
sources of data in such a manner that the net increase or decrease in national wealth between the two dates could be broken down into analytical, enlightening details, as is done by a business enterprise for its wealth changes.
II. A NATIONAL BALANCE SHEET

In a specific business enterprise one can turn to records of past events—sales, purchases, equipment, employment, prices—to get a picture of the status of that enterprise and prepare plans for the future. If consolidated statements, schedules, and accounts are available for all the members of a trade association, business men can use such statements as an aid in formulating their future program for the entire industry and the role that the individual companies will play. Unfortunately business men do not also have a national balance sheet and income statement to guide them in their enterprise and judgment.

This study advocates the development of account-statistics for all economic activities in the United States in order that it may be possible to view business activity in full perspective—a hazy view, perhaps, but properly proportioned.¹

The National Balance Sheet and Income Statement herein presented is scarcely more than a pro forma statement. Each figure must be accurate in order to present a current estimate of the net worth

¹The nearest approximation to a national balance sheet that has come to our attention is shown in the tables on pages 10, 11, 15, and 199 of Robert R. Doane’s The Measurement of American Wealth. In these tables, a reasonably accurate statement is made of the items of “real” or tangible wealth. The statements of the items of “liquid” and “negative” wealth are incomplete and suggest that the author’s concepts and understanding of these phases of wealth are inadequate. Furthermore, no serious attempt is made to portray the means by which changes occur in the balance-sheet amounts from time to time, nor are the elements of wealth related to the production and consumption or saving of income.

The net worth stated in the National Balance Sheet and Income Statement that is presented in this bulletin is substantially larger than any published estimates of national wealth. This is accounted for by reason of the failure of other estimators to include in their calculations the full amounts or valuations of “liquid” wealth which they deducted as “negative” wealth. Few, if any, of the estimators of national wealth have attempted to include all the elements of “liquid” and “negative” wealth.

The need for a national balance sheet has been presented in recent articles by George N. Peek, although his main interest has been in the recording and summarizing of the international position of a nation resulting from transactions in international trade and finance.


9
of the entire national economy. Each item is important enough to warrant careful calculation.

Even if all the figures used in this national summary had been taken from the works of outstanding authorities on these items, the composite result would have been questionable because of overlapping concepts and conflicting definitions. Furthermore, it has been necessary to make estimates for various items not previously calculated; some of the estimates are scarcely more than guesses. The major purpose is to develop a concept and to strive for a reasonable degree of accuracy in the figures used to illustrate this concept. It would be confusing to include a lengthy appraisal of the methods here used and of the figures of other students whose results were employed. If more than one estimate was available, the one used herein was selected usually because the concept employed fitted the accounts best. It is not intended at this time to defend the adequacy of either the estimates made or the selection of figures from previously published sources; the desire is rather to suggest a research program.

The National Balance Sheet and Income Statement provides an accounting tool especially useful to those interested in the development of economic statistics by governments, private agencies, and individuals. A large mass of information has been compiled on many of these items, but there has been no device for testing their unity or completeness. The use of a national balance sheet and income statement constitutes a unique method of presenting these figures for a large number of separate items in a form that reveals changes in the individual items, as well as increases and decreases in the net worth of our economy from year to year. The gaps which have been found in the information indicate some of the important types and kinds of economic statistics that such agencies should supply in the future.

It is reasonable to suggest that the several fact-gathering agencies of the federal government could use this accounting device as one measure of the adequacy of federal business statistics now being collected. It affords an important test of unity and completeness; it discloses some very important relationships between items; it reveals the "state of the nation" at a glance, as well as many important factual changes that have taken place during the year.

There should be separate balance sheets, income statements, cost accounts, and special schedules for every industry or economic group; in fact, these data for the several important groups should be compiled first and later combined and consolidated into the one national state-
ment. This process of building up a larger and ever larger picture by combining the statements of the separate industries would utilize most of the economic statistics now available as well as new types and kinds of information.

The chief value of such a master check-list would not be to belittle fact-gathering surveys but rather to reveal clearly the wide gaps in our present knowledge of the totality of economic activity. This master check-list would show the need for expanding our information rather than prove an argument against present or proposed statistical research projects.

One of the inherent difficulties faced in the project was the general question of segregating the governmental items from the private or non-governmental. The balance sheet and income statement for all local, state, and federal government economic operations should be shown separately and in a consolidated form; these governmental accounts should be classified into producer and consumer accounts according to the nature of the economic activities. So desirable a treatment of public or governmental accounts is far beyond the limited scope of this study. Governmental items have therefore been recorded in both consumers’ and producers’ accounts, according to the apparent character of such governmental economic operations. The careful preparation of a national balance sheet and income statement of all governmental economic activities with the necessary supporting accounts and schedules for the current year (1936) would be a large research undertaking.
III. AN EXPERIMENTAL SAMPLE

The following pages are, for the most part, devoted to an illustration of a balance sheet and income statement for the nation. The purpose is to show the feasibility of the idea and to provide a procedure so that the way will be paved for more accurate and useful statements in the future.

The year 1929 has been selected for demonstration because the available data for that year are greater than for any subsequent year. Extensive use has been made of secondary sources in which the primary data have been summarized; summaries for more recent years will doubtless appear later. The considerable expansion of various special types of data—e.g., income and sales tax returns—during the past two years offered strong inducements to use 1934 or 1935. The amount of census data available for the closing year of the last decade, however, was the determining factor in the selection of 1929 as the most feasible year for the present use.

As shown by the accompanying statement, there are four distinct divisions or parts in this Balance Sheet and Income Statement of the nation. The first pair of columns shows a balance sheet or inventory of our economy for the end of 1928. The second pair of columns gives a record of the transactions of the entire year of 1929 shown as debits and credits. The third pair of columns shows the sources of the incomes during the twelve months and the disposition of those incomes. The last pair of columns is a balance sheet or inventory of the economy for the end of 1929. The plan of this summary statement is to show the assets and net worth at the end of the preceding year and at the end of the current year, together with the transactions during the year which account for the changes. The changes in net worth are recapitulated in summary form in a footnote at the bottom of the table on pages 14 and 15.

The net worth item is the end figure of the calculations. The present usage of this accounting term roughly coincides with the concept of national wealth. It is the balancing item and its accuracy depends upon the accuracy of all the items which it balances; a net worth of $568.7 billions for December 31, 1928 and $583.9 billions for December 31, 1929 are balancing figures and not estimates of national wealth previously published. The totals of $1063.7 billions for the first pair of columns, as well as the totals of the second and fourth

*Another statement, identical in data and form, but with items cross-referenced, is presented on pages 28 and 29.*
pairs, in general, have little meaning. The third pair of columns, however, shows a national income of $82.1 billions, plus $0.1 billion, the net change in the volume of money in circulation.

There are both debit and credit entries for most of the transactions during the year; that is, there are sales and purchases, costs and incomes, payables and receivables, deposits and withdrawals, exports and imports, etc. The debit and credit for many items are almost equal; the difference is usually the same as the difference between the balance-sheet item at the beginning and at the end of the year. For example, the amount of gold, silver, minor coins, and currency in the banks was $3.7 billions on December 31, 1928 and $4.1 billions on the last day of 1929; this increase of $0.4 billion is exactly equal to the excess of the transactions debit of $11.6 billions over the transactions credit of $11.2 billions. Not all the transactions entries are of this type; they will be given further attention.

The income and disposition columns reveal the distribution of the national income of $82.2 billions for the year 1929; for example, $4.9 billions was devoted to land improvements, new buildings, and equipment and $1.8 billions to additions to inventories—all items in producers' wealth.

As shown in the analysis at the bottom of the statement, the net worth of our national economy increased $15.2 billions during 1929; $6.7 billions was the net addition to our supply of capital goods (gross of $11.1 billions less $4.4 billions consumed in production); $1.5 billions the net addition to consumption goods ($8.0 billions gross less $6.5 billions durable goods consumed); $0.3 billion increase in investments abroad; $0.3 billion increase in our stocks of gold and silver; the final $6.4 billions of the increase in net worth was due to price changes.

This Balance Sheet and Income Statement has been prepared from the viewpoint of the nation's economy; in that sense the viewpoint is neither that of business nor government but rather that of the totality of the economic activities of all the persons composing a single nation. These items may be thought of as expressive of the means by which income is produced, distributed, and consumed; these transactions account for all the changes which occur in wealth from one year to another.

The term "wealth" has a rather definite meaning in economic discussions. In its primary and classic use it has reference to the physical goods which serve to satisfy the wants of man and which are of such limited quantity and such a nature that man may assert owner-
### NATIONAL BALANCE SHEET AND INCOME STATEMENT FOR THE YEAR 1929

**Billions of Dollars**

<table>
<thead>
<tr>
<th>Accounts</th>
<th>Balance Sheet Beginning of Year</th>
<th>Transactions</th>
<th>Income and Disposition</th>
<th>Balance Sheet End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>debit</td>
<td>credit</td>
<td>debit</td>
<td>credit</td>
</tr>
<tr>
<td><strong>WEALTH</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Producers</strong>: (not including bankers)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lands</td>
<td>325.0</td>
<td></td>
<td>53.1</td>
<td>45.0</td>
</tr>
<tr>
<td>Buildings and equipment</td>
<td></td>
<td></td>
<td>199.8</td>
<td>198.0</td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Consumers</strong>:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lands</td>
<td>36.2</td>
<td></td>
<td>11.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Buildings and equipment</td>
<td>53.0</td>
<td></td>
<td>6.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Chattels</td>
<td>76.9</td>
<td></td>
<td>4.5</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>International</strong>:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables and equities owned</td>
<td>18.6</td>
<td></td>
<td>6.3</td>
<td>6.0</td>
</tr>
<tr>
<td>Payables and equities sold</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Banking</strong>:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold, silver, minor coins</td>
<td>3.7</td>
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<td>11.6</td>
<td>11.2</td>
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<tr>
<td>Currency</td>
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<td></td>
<td>189.1</td>
<td>189.6</td>
</tr>
<tr>
<td>Loans and other receivables</td>
<td>63.2</td>
<td></td>
<td>935.1</td>
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<tr>
<td>Deposits and other payables</td>
<td>59.0</td>
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<td>935.1</td>
<td>935.0</td>
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<tr>
<td>Tangible property</td>
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<td></td>
<td>935.1</td>
<td>935.0</td>
</tr>
<tr>
<td>Capital stock</td>
<td>3.9</td>
<td></td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Surplus</td>
<td>6.2</td>
<td></td>
<td>.6</td>
<td>.5</td>
</tr>
<tr>
<td><strong>Credits</strong>:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money in circulation</td>
<td>4.8</td>
<td></td>
<td>33.4</td>
<td>33.5</td>
</tr>
<tr>
<td>Receivables</td>
<td>188.7</td>
<td></td>
<td>267.8</td>
<td>261.9</td>
</tr>
<tr>
<td>Investments</td>
<td>243.1</td>
<td></td>
<td>272.9</td>
<td>271.5</td>
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<tr>
<td>Payables</td>
<td>265.0</td>
<td></td>
<td>253.1</td>
<td>256.0</td>
</tr>
<tr>
<td>Corporate stocks outstanding</td>
<td>106.1</td>
<td></td>
<td>269.0</td>
<td>272.7</td>
</tr>
<tr>
<td>Corporate surplus</td>
<td>54.8</td>
<td></td>
<td>.3</td>
<td></td>
</tr>
</tbody>
</table>

**PRODUCTION AND CONSUMPTION**

**Business Units:**

Sales: 115.4
Purchases: 199.8
Salaries and wages: 53.5
Depreciation and depletion: 4.4
NATIONAL BALANCE SHEET AND INCOME STATEMENT FOR THE YEAR 1929 (Concluded)

Billions of Dollars

<table>
<thead>
<tr>
<th>Accounts</th>
<th>Balance Sheet Beginning of Year</th>
<th>Transactions</th>
<th>Income and Disposition</th>
<th>Balance Sheet End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>debit</td>
<td>credit</td>
<td>debit</td>
<td>credit</td>
</tr>
<tr>
<td>Business Units: (Concluded)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td></td>
<td></td>
<td>6.5</td>
<td>8.3</td>
</tr>
<tr>
<td>Rents and royalties</td>
<td></td>
<td></td>
<td>4.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td>7.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Withdrawals</td>
<td></td>
<td></td>
<td>12.9</td>
<td></td>
</tr>
<tr>
<td>Net increase value retained in business units</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Income:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td></td>
<td></td>
<td>53.5</td>
<td></td>
</tr>
<tr>
<td>Rents and royalties</td>
<td></td>
<td></td>
<td>4.9</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td>5.9</td>
<td></td>
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<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Withdrawals</td>
<td></td>
<td></td>
<td>12.9</td>
<td></td>
</tr>
<tr>
<td>Foreign</td>
<td></td>
<td></td>
<td>.3</td>
<td></td>
</tr>
<tr>
<td>Capital gains</td>
<td></td>
<td></td>
<td>6.4</td>
<td></td>
</tr>
<tr>
<td>Consumption:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td></td>
<td></td>
<td>19.8</td>
<td></td>
</tr>
<tr>
<td>Home</td>
<td></td>
<td></td>
<td>21.5</td>
<td></td>
</tr>
<tr>
<td>Attire</td>
<td></td>
<td></td>
<td>11.1</td>
<td></td>
</tr>
<tr>
<td>Other living</td>
<td></td>
<td></td>
<td>17.4</td>
<td></td>
</tr>
<tr>
<td>Depreciation and obsolescence</td>
<td></td>
<td></td>
<td>6.5</td>
<td></td>
</tr>
<tr>
<td>Net Worth</td>
<td></td>
<td></td>
<td>568.7</td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>1063.7</td>
<td>1063.7</td>
<td>2802.1</td>
<td>2802.1</td>
</tr>
</tbody>
</table>

Analysis of Changes in Net Worth

Add: 568.7

Additions to capital goods 11.1
Less: Capital goods consumed in production 4.4 6.7
Additions to consumption goods 8.0
Less: Permanent consumption goods consumed 6.5 1.5
Increase in investments abroad .3
Discoveries and imports of gold and silver .5
Advances in values due to price changes 6.4 15.2
Balance end of year 568.7

Note A: The amounts stated for balance sheets, income, and disposition are based upon data believed to be reasonably accurate. The amounts stated for transactions are estimated from data contained in certain incomplete tabulations.

Note B: All the amounts stated are subject to revision as further research work is completed.
ship of them. This primary and classic meaning does not necessarily include the idea of valuation in terms of dollars or any other monetary unit. With the development of our elaborate and intricate economic systems there have developed methods of valuation of these items of physical wealth; these valuations are expressed in terms of dollars and other monetary units. In the National Balance Sheet and Income Statement these valuations of physical wealth are stated in Items 1 to 5, 7, 9, 10, and in the corresponding items in the other sections of the Balance Sheet. (See pages 28 and 29 for numbering of items.)

Concurrent with the development of the idea of valuation in terms of monetary units, certain other concepts of wealth came into being. These concepts are "liquid" wealth and "negative" wealth, and, from the standpoint of a national economy, the additional concept of "international" wealth.

Liquid wealth refers to the claims of persons against other persons when such claims are to be paid in monetary units, physical wealth, or services to be performed. In the National Balance Sheet and Income Statement, Items 8, 11, and 12, and the corresponding items are measurements of this kind of wealth.

Negative wealth is the opposite of liquid wealth. It is expressive of the liabilities of persons to other persons, which liabilities are to be liquidated by payment of the monetary units, goods or services. Items 13 to 18 and the corresponding items are expressive of the amounts of such negative wealth.

In a world economy the totals of liquid and negative wealth are always equal in amount. In a national economy there may be some difference; but such a difference is a portion of the international wealth item. International wealth has meaning only as it relates to a national economy or to some phase of a national economy. It expresses both receivable and payable claims of persons (and government) of one national economy to persons (and government) of other national economies. It is possible for the concept of international wealth also to include elements of real or physical wealth. In the National Balance Sheet and Income Statement, Item 6 and the corresponding items are expressive of this kind of wealth. The estimates employed for international, liquid, and negative wealth do not always conform to the concepts as stated. Further research will permit the reclassification of certain elements of these estimates, so that the economic Balance Sheet and Income Statement of the nation will tend to record measurements in accordance with the concepts presented. Investigations of these elements suggest that in both a national and a world economy
the actual measurements of these four kinds of wealth do conform to these concepts.

The net income produced should be understood to be the value that is placed upon the net quantity of goods and services that is produced by all the citizens of an economy. Income paid out is the net amount paid by all business units for wages and other costs incurred in the production of goods and services. It also includes the amount of dividends and distributions of profits that are paid by business units to individuals. Income received by individuals is the same in amount as income paid out, but represents the receipts by the individuals rather than the disbursements by the business units.

Income produced and income paid out are seldom, if ever, equal in amount in any period of time. The difference between these two totals is the amount which is retained by business or which is disbursed by it in excess of the values of goods and services which it has produced. 3

Income consumed by individuals is the value of the portion of income produced that is used by individuals in the satisfaction of their wants. Income saved is the difference between the income produced and the income consumed by individuals.

These concepts may not be so complete as they should be; it is likely that the measurements stated in the National Balance Sheet and Income Statement are not in exact conformity with these concepts. It is quite possible that further research along the lines here indicated will clarify the concepts used and will also make possible more accurate measurements and statements of amounts.

The term "Transactions," the caption of the second pair of columns in the exhibit, includes all dealings involving the transfer of values between persons—the purchases and sales of goods and services, and the claims receivable and liabilities payable that arise out of these transactions. Furthermore, it includes all settlements, regardless of how made, between persons for their purchases, sales, receivables, and payables, and any adjustments of values whether they arise from reappraisals, depreciation, depletion, losses, or other causes. The Balance Sheet and Income Statement, as a whole, is a summary designed to reveal the action of the causes of economic activities and the relationships of changes in any of these activities to changes in other activities.

The Balance Sheet and Income Statement of the nation is an

3For a more detailed explanation of these terms see National Income, 1929-32, Senate Document No. 124, 73rd Congress, 2d Session.
adaptation of the form of the working balance sheets and income statements generally used by the accountant. As the statement is here presented, the accountant may criticize it because a departure from strict accounting practice has been introduced to a limited extent in the columns captioned "Income and Disposition." The departure was made in order to keep the statement relatively simple, and at the same time to reveal the relationships between income produced, income received, income consumed, and income saved. Strict accounting practice would suggest introducing another pair of columns into this statement that would show the eliminations that were made in reducing certain items in the transactions columns to the proper amounts for the purpose stated above.

The sources of the figures employed in the balance sheet and income statement that were taken from published estimates and a brief explanation of estimates which were made for the remaining items are given on page 27 et seq. In this way details are kept from interfering with the explanation of the figures and their concepts, as well as with the possible utility of an accurate balance sheet and income statement. No statements for particular industries and economic groups, cost analyses, or detailed schedules are included because there is reasonably complete material for so few. Furthermore, the preparation of all or a considerable portion of such tables would require a large staff for clerical and statistical assistance. A separate set of records and ac-

The following eliminations, in journal entry form, were made in order to reduce the amounts in the Income and Disposition columns to net balances.

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Producers (except bankers)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lands, buildings, and equipment-price changes</td>
<td></td>
<td>3.2</td>
</tr>
<tr>
<td><strong>Consumers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>Price changes</td>
<td></td>
<td>3.3</td>
</tr>
<tr>
<td>Chattels</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td>Price changes</td>
<td>.1</td>
<td></td>
</tr>
<tr>
<td><strong>Individuals</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rents and royalties</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Capital gain</td>
<td>6.4</td>
<td></td>
</tr>
<tr>
<td><strong>Consumption</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home</td>
<td></td>
<td>2.0</td>
</tr>
<tr>
<td>Other living</td>
<td></td>
<td>1.0</td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td>6.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>16.0</td>
<td>16.0</td>
</tr>
</tbody>
</table>
counts for all governmental activity would be very valuable for improving the data; unquestionably the federal government—perhaps state and local units also—has played an increasingly important role in the sum total of all transactions during recent years.

Every gainfully employed person makes decisions which influence in some degree the course of economic events; a seemingly unimportant choice, such as a young person’s decision to become a mechanic or a stenographer instead of a farmer or a clerk, makes its small imprint upon future business activity. Those who employ only one worker influence the turn of events. The large corporations give much direction to economic affairs through their production, purchases, sales, finance, and labor policies. Each person, as well as each group, therefore, has some influence on the wealth-getting and wealth-using activities of mankind.

It is a source of never-ending wonder to observers of economic affairs that out of this maelstrom of competition, this vast working army with many captains and majors but no general, this following of primitive urges to secure comfort and prestige—that out of these should emerge an economic system or an economic order. We often wonder why the merchant has the things we find that we wish to buy, even articles produced in a foreign land; we did not tell him what to obtain for us.

Economic coordination within a nation involves some preconceived notion of the course which future economic events should follow for the general welfare and of the existence of ways and means of so directing events that they will follow this course. It is good for men to dream and plan for the future of their economy. There is nothing dangerous in attempts at economic coordination except that “directing” may become “forcing.”

A corporation must look ahead because it sells in the future many goods and services completed in the present, or at least produced from facilities now made available. Every business man has to be a business forecaster whether he wants to or not. He must try to push back the veil that conceals the unknown future ahead, looking meanwhile at what lies in the past for possible clues.

How does a corporation do its planning? At the outset the executives study the accounting records, the balance sheet, the income and loss statement, the cost studies, and the various schedules. Shall a new product be added? Is the probable margin between price and cost sufficient to justify the use of funds which might be devoted to other purposes? Shall plant and equipment be increased?
By analogy, there comes the suggestion that similar accounting devices could be used to portray the current state of our entire national economy. Armed with such information, presented in familiar forms, the business man should be better able to plan his own operations intelligently and in keeping with the nation's business. With such information, local, state, and federal officials would have the ideal of a well-proportioned economy always before their minds.

The people of a nation can not know too much about their economic affairs. Long and careful research into the nature and problems of our economic system must lie at the foundation of this knowledge and the policies which grow out of it. The development of adequate national balance sheets, income statements, schedules, and accounts, covering each economic group and the entire economy should be a major item in every program for the accumulation of that knowledge which is a sine qua non of adequate economic coordination and sound economic proportionality.

Most of the present day economic principles, theories, and laws have been developed by a long list of scholars during the past two centuries. These men approached the study of economics from a background of philosophy, history, and kindred subjects. The doctrines they have enunciated and the laws they have formulated and explained have been based almost entirely upon deductive reasoning. The origin of such principles does not warrant criticism of the men who formulated them. But it should be frankly recognized that factual materials concerning the operations of a complicated economic system were lacking.

These writers tried to establish an explanation of the functioning of the whole economic system without the benefit of a factual picture of the system which they were attempting to describe. They were handicapped, furthermore, by the tardy development of accounting and by the absence of comprehensive statements summarizing the affairs of individual enterprises and groups of business enterprises. Accounting has been considered by many of them as too detailed and practical for their consideration.

The formulation of a balance sheet and income statement of the nation's economy with supporting schedules and accounts would constitute an important foundation of fact upon which to build a structure of economic principles; such summary statements would also offer a check upon the operation of economic principles previously formulated. At the very least, such statements would afford many useful illustrations of economic truths.
It is often said that the distribution of income and the cost of production are, for the most part, two sides of the same concept. Upon examination of the balance sheet it is found that the elements of business cost, business income, and individual income are in balance: that is, items for salaries and wages, taxes, rents and royalties, interest, dividends, and withdrawals total $92.0 billions (Items 37, 39, 40, 41, 42, 43, and $1.8 billions of Item 47); the income Items (67, 68, 69, 89, 90, 91, 92, and 93) also total $92.0 billions. A further illustration of the value of this way of presenting "the state of the nation" is seen in its application to social insurance plans. The only real security for the gainfully employed population obviously lies in having sufficient current national income from a productive capacity sufficiently active to produce the volume of national income that would be required.

Another illustration of the value of such a national balance sheet and income statement will be evident in any consideration of the economic implications of savings. The amount of savings of any economy can be represented only in wealth itself. Bank deposits are considered assets by their owners; but these deposits are also liabilities of the banks. The National Balance Sheet and Income Statement can be used to clarify the confusing and conflicting economic theories concerning the possibility of investments exceeding savings, or *vice versa*, during the several phases of the business cycle. Accounts receivable and investments of all types are considered assets by their owners; yet these same items are also liabilities for those persons in the economy who owe them. The sums of all these types of asset and liability in an economy are always equal. To illustrate, the total of Items 8, 11, and 12 is $495.0 billions; the total of the credit or liability Items 13, 14, 15, 16, 17, and 18 is also $495.0 billions. The difficulty with the traditional approaches to the problem of spending and saving, investments, and debts is that the approach has been made from the standpoint of either debtor or creditor and not from the viewpoint of the whole economy.

The National Balance Sheet and Income Statement has at least two more educational uses: it presents a new way of recording economic history; it will facilitate the education of business men because accounting is their language.

Much of the confusion encountered by the thoughtful college student in his first course in economics is attributable to the inability of his instructor to present a panoramic view or a comprehensive picture of the entire system of wealth-getting and wealth-using activities of his country. The writers of textbooks for these students find
it difficult, if not impossible, to present such a perspective. The Balance Sheet and Income Statement should be of real assistance in formal education in the preparation of subject matter for courses in economics. It will certainly demonstrate that cost and income are two sides of the same picture; this feature alone will greatly help in the study of proposed reforms.

Statisticians have been quick to use data derived from the accountant's records in the measurement of wealth, income, and fluctuations in business activity. Unfortunately these statisticians have neglected to adopt the coordinated summarizing devices of the accountant—balance sheet, income statement, etc.—in attempting to condense their figures into summaries, tables, and charts. Accounting offers not only the figures but also the concepts that will add to the clarity of statistical summaries prepared for business people and governmental officials.

Students of quantitative economics will always dream of the day when they will be able to measure the totality of economic progress; the more conservative leaders are inclined to agree with the theoretical economists that it will always remain a dream until someone invents a measuring rod for the final utility of consumption, the ultimate reality of economic experience. Those who continue to hope will welcome a device borrowed from the accountants and will explore its possibilities in trying to present the changing picture of economic life.

The difficulty of securing reasonably satisfactory estimates of many of the 119 items here used will perhaps be advanced as a reason for doubting the value of research along these lines. It is admitted that several different estimates—for example, the value of inventories—have been made which do not agree; this same lack of agreement is apparent in the available estimates of the value of all lands, buildings, and equipment. These differences arise both from the samples used and from differences in ideas on valuation. Although larger samples are being used, the matter of valuation will continue to be a stumbling block in the way of statistical agreement, especially in periods of violent price fluctuations. What is the total value of our railroads or of our public utilities? Judicial determination of the rights of equity and lien holders in businesses affected with a public interest introduces considerations that make the valuation of utility property more difficult than the appraisal of other lands, buildings, and equipment not owned by regulated public monopolies.

Other difficulties will arise in extending such research. How can a satisfactory figure for obsolescence and depreciation of consumers
goods and producers' durable goods be calculated. Every accountant knows that any figure for depreciation and obsolescence involves either an arbitrary use of averages or a forecast of the unknown future lifetime of an asset, or both. Our national balance sheet items could be at least as reliable as the allowances for these two items made by the accountants of business establishments. Few critics would condemn the proposal on this ground alone; planning ahead in business has been effectively done even though some accounting terms are subject to somewhat different interpretations by equally qualified men. In fact, the use of accounting devices seems capable of bringing economic coordination down to earth, where deficiencies in the factual information will be revealed. A frank recognition of the inexactness of many of the accounts and concepts used in preparing a national balance sheet and allied statements would also have its usefulness.

Great progress has been made in the measurement of national income and its disposition. The technic has been improved and the supporting sample enlarged; hence the resulting estimates are more reliable. The items appearing in the third pair of columns have been taken from such studies. These columns will continue to present more reliable figures than the first two (assets and liabilities) as long as our estimates of national income continue to be more reliable than similar estimates of national wealth.

Let us suppose that these difficult and baffling statistical obstacles will yield to patient and extensive research, and that the educational, business, and governmental uses of such national financial statements will justify the expenditure of a large sum in an expanded statistical and accounting research program. What else can be said for the undertaking?

It seems reasonable to suppose that this type of information would enable business and governmental leaders to see the need for changes that should be urged from time to time in our economic and political structure in order that grave problems may be solved before the situation gets out of hand. The repeal of laws and the enactment of laws could thus be better fitted to our changing national, state, and local needs.

In the past and present, business executives have studied such data as have been available to them with a view to planning their

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Footnote:

4Solomon Fabricant, Measures of Capital Consumption, 1919-1933. Bulletin No. 60, National Bureau of Economic Research, June 30, 1936. This bulletin arrived too late to be used in making these estimates.
individual business in such a way that it will balance with the activities of other business establishments. Their purpose in planning is to attain a continuous and growing prosperity for their individual businesses. If their information were more adequate they would be better able to accomplish this result and in their individual accomplishments would realize for the economy as a whole a healthy expansion. Unfortunately the data that have hitherto been available and the explanations of the operations of the economy based upon these data have been so inadequate that individual business men in their planning have not attained the sound proportionality they sought. The failure of the business men to attain this balance has been among the major reasons for the periods of crises and depressions.

This notion of proportionality is evidenced in the attempt of the head of every business to maintain a balanced relationship between the several products which he produces and between his product or products and the products of others. This process also manifests itself in the substitution by the consumer of another product for the one that he formerly purchased. It is only a short step from this concept of balance between the different phases of one business to a balance between all the productive efforts in our economy. It may be truly said that no business plans for a depression; rather it directs its main efforts toward a continuing increase in the production and sale of all its products. It seems reasonable that, if the individual business man (particularly the small business man) had adequate information as to the operation of the whole economy, he would be more nearly able always to maintain his business in a state of balanced growth, or to adjust his business more rapidly to the new conditions created by any major economic, social, or political upheaval, such as war, for example. This statement does not imply that it will ever be possible in any kind of relationship between business men themselves, and between them and government as representing the consumers and investors, to achieve and maintain a perfect adjustment between all the units which make up the economy; but few would deny that further progress can be made along these lines.

The greatest problem faced by any business in attempting to expand its operations is to discover and measure the ability and desire of consumers to buy its products. If balance sheets and income statements with accompanying schedules and accounts could be developed for each industry, a considerable number of the business errors resulting from such lack of knowledge could be avoided. Very little
comprehensive information of this sort is today available; that which is available is not assembled in such form as to aid the business man in his planning problems.

Armed with the records of their own business enterprise and further implemented with a clear concept of the place of that enterprise in the whole national economy as revealed by a national balance sheet and income statement, each economic unit could more effectively plan production, sales, and expansion. Until this larger picture of the structure and function of the whole economy is available, business executives, labor leaders, merchants, farmers, mining operators, and governmental officials will continue to make errors that are due to the lack of such knowledge.
IV. SOURCES

Anyone interested in attempting to verify or check the amounts stated in the exhibit presented herein, or in expanding or extending the work here begun, will find much useful information and data in the following secondary sources.


George N. Peek, “In and Out” (Saturday Evening Post, May 16, 23, and 30, and June 6, 13, and 20, 1936).

Those who are interested in primary sources will find many excellent references in the works named. However, particular reference is made to the following publications of several departments of the federal government.

Statistics of Income
Reports of the Comptroller of the Currency
Census of Retail Distribution
Census of Wholesale Distribution
Census of the Construction Industry
Census of Manufactures
Agricultural Yearbook

Treasury Department
Treasury Department
Bureau of the Census
Bureau of the Census
Bureau of the Census
Department of Agriculture
V. EXPLANATION OF ITEMS IN BALANCE SHEET AND INCOME STATEMENT

Computation of Items

Items 1 to 5 and 95 to 99 were computed from estimates published in Doane's *The Measurement of American Wealth*. As these estimates do not conform exactly to the concepts of the study, adjustments were made.

Items 6, 25, 54, 81, 100, and 107 were computed from estimates by George N. Peek.

Items 7 to 10, 13 to 15, 28, 82, 87, 101 to 104, and 108 to 110 were computed from reports of the Comptroller of the Currency.

Items 11, 12, 16 to 18, 105, 106, and 111 to 113 were estimated from data contained in Doane's *The Measurement of American Wealth, Statistics of Income*, and other sources.

Items 19 and 114 are sums of the "real" and "international" wealth of the economy.

Items 20 to 24, 26, 27, 29 to 36, 49 to 53, and 55 to 66 were computed and estimated from data published by the Bureau of the Census, the Department of Agriculture, the Comptroller of the Currency, the Treasury Department, and *The Measurement of American Wealth*. For several of the items the information available was limited and incomplete. In such cases estimates were made of the probable volume of transactions, using the ratios derived from business experience. It is recognized that further studies may arrive at amounts substantially different from those stated.

Items 37, 39 to 47, 67 to 76, 83 to 86, and 88 to 94 were computed from estimates contained in *America's Capacity to Consume* and in *National Income, 1929-32*.

Item 38 is from *Statistics of Income*.

Items 77 to 80, 115, and 116 are estimates based on data contained in publications of the Bureau of the Census. These derived items may be subject to error both as to classifications and amounts.

Description of Items

Item 1—Current valuation of all lands, buildings, equipment, and other means of production. It includes government-owned lands, buildings, etc., that are used to produce goods or services for consumption. Some of these are capital buildings, postoffices, public utilities, etc. The tangible wealth of bankers might have been included here; it has been omitted in order to include it in the banking section of the statement, so that the nature of banking and its function in the national economy might be more accurately portrayed.

Item 20—Current valuation of all purchases and other acquirements, such as by gift, mortgage, inheritance, etc., of the elements of wealth included in Item 1. This amount also includes new constructions, additions, and improvements. Furthermore, it includes any increases in valuations as a result of reappraisals, etc.

Item 49—All sales and other dispositions of the elements of wealth included in Item 1. Herein are included losses by fire, wind, accident, etc., and reductions in valuation as a result of depreciation, depletion, obsolescence, and reappraisals.

Items 20 and 49—Taken together, these items reveal all the changes which occur during the year in the valuations, changes in ownership of real wealth, increases and losses in capital goods (except banking), however caused. These items, when properly analyzed, probably afford a better understanding of the changes in capital goods than can be acquired by any other means.
### NATIONAL BALANCE SHEET AND INCOME STATEMENT FOR THE YEAR 1929

**Billions of Dollars**  
*(Reference Numbers in Parentheses)*

<table>
<thead>
<tr>
<th>Accounts</th>
<th>Balance Sheet Beginning of Year</th>
<th>Transactions</th>
<th>Income and Disposition</th>
<th>Balance Sheet End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>debit</td>
<td>credit</td>
<td>debit</td>
<td>credit</td>
</tr>
<tr>
<td><strong>WEALTH</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Producers': (not including bankers)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lands</td>
<td>325.0(1)</td>
<td>…………</td>
<td>53.1(20)</td>
<td>45.0(49)</td>
</tr>
<tr>
<td>Buildings and equipment</td>
<td>48.3(2)</td>
<td>…………</td>
<td>198.6(21)</td>
<td>198.0(50)</td>
</tr>
<tr>
<td>Inventories</td>
<td>…………</td>
<td></td>
<td>36.5(3)</td>
<td>…………</td>
</tr>
<tr>
<td><strong>Consumers':</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lands</td>
<td>36.5(3)</td>
<td>…………</td>
<td>6.7(23)</td>
<td>…………</td>
</tr>
<tr>
<td>Buildings and equipment</td>
<td>76.0(5)</td>
<td>…………</td>
<td>4.5(24)</td>
<td>…………</td>
</tr>
<tr>
<td>Chattels</td>
<td>…………</td>
<td></td>
<td>…………</td>
<td></td>
</tr>
<tr>
<td><strong>International:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables and equities owned</td>
<td>18.6(6)</td>
<td>…………</td>
<td>6.3(25)</td>
<td>…………</td>
</tr>
<tr>
<td>Payables and equities sold</td>
<td>…………</td>
<td></td>
<td>…………</td>
<td></td>
</tr>
<tr>
<td><strong>Banking:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold, silver, minor coins</td>
<td>3.7(7)</td>
<td>…………</td>
<td>11.6(26)</td>
<td>…………</td>
</tr>
<tr>
<td>Currency</td>
<td>…………</td>
<td></td>
<td>189.1(27)</td>
<td>…………</td>
</tr>
<tr>
<td>Loans and other receivables</td>
<td>63.2(8)</td>
<td>…………</td>
<td>935.1(28)</td>
<td>…………</td>
</tr>
<tr>
<td>Deposits and other payables</td>
<td>…………</td>
<td></td>
<td>2.2(9)</td>
<td>…………</td>
</tr>
<tr>
<td>Tangible property</td>
<td>…………</td>
<td></td>
<td>6.6(15)</td>
<td>…………</td>
</tr>
<tr>
<td><strong>Credits:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money in circulation</td>
<td>4.8(10)</td>
<td>…………</td>
<td>33.4(31)</td>
<td>…………</td>
</tr>
<tr>
<td>Receivables</td>
<td>188.7(11)</td>
<td>…………</td>
<td>267.8(32)</td>
<td>…………</td>
</tr>
<tr>
<td>Investments</td>
<td>243.1(12)</td>
<td>…………</td>
<td>272.9(33)</td>
<td>…………</td>
</tr>
<tr>
<td>Payables</td>
<td>…………</td>
<td></td>
<td>263.8(34)</td>
<td>…………</td>
</tr>
<tr>
<td>Corporate stocks outstanding</td>
<td>106.1(14)</td>
<td>…………</td>
<td>106.0(35)</td>
<td>…………</td>
</tr>
<tr>
<td>Corporate surplus</td>
<td>54.8(18)</td>
<td>…………</td>
<td>3.1(85)</td>
<td>…………</td>
</tr>
</tbody>
</table>

**PRODUCTION AND CONSUMPTION**

**Business Units:**

<table>
<thead>
<tr>
<th>Sales</th>
<th>Purchases</th>
<th>Salaries and wages</th>
<th>Depreciation and depletion</th>
<th>Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>…………</td>
<td>115.4(56)</td>
<td>…………</td>
<td>4.4(38)</td>
<td>6.5(99)</td>
</tr>
<tr>
<td>…………</td>
<td>53.5(37)</td>
<td>…………</td>
<td>3.1(85)</td>
<td>…………</td>
</tr>
<tr>
<td>…………</td>
<td>4.4(38)</td>
<td>…………</td>
<td>3.1(85)</td>
<td>…………</td>
</tr>
<tr>
<td>…………</td>
<td>6.5(99)</td>
<td>…………</td>
<td>3.1(85)</td>
<td>…………</td>
</tr>
</tbody>
</table>
### NATIONAL BALANCE SHEET AND INCOME STATEMENT FOR THE YEAR 1929 (Concluded)

**Billions of Dollars**

(Reference Numbers in Parentheses)

<table>
<thead>
<tr>
<th>Accounts</th>
<th>Balance Sheet Beginning of Year</th>
<th>Transactions</th>
<th>Income and Disposition</th>
<th>Balance Sheet End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>debit</td>
<td>credit</td>
<td>debit</td>
<td>credit</td>
</tr>
<tr>
<td>Business Units: (Concluded)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rents and royalties</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withdrawals</td>
<td>12.9(43)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net increase value retained in business units</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td></td>
<td></td>
<td>53.5(70)</td>
<td></td>
</tr>
<tr>
<td>Rents and royalties</td>
<td></td>
<td></td>
<td>4.9(71)</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td>5.0(72)</td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td>6.0(73)</td>
<td></td>
</tr>
<tr>
<td>Withdrawals</td>
<td></td>
<td></td>
<td>12.9(74)</td>
<td></td>
</tr>
<tr>
<td>Foreign</td>
<td></td>
<td></td>
<td>3.7(75)</td>
<td></td>
</tr>
<tr>
<td>Capital gain</td>
<td></td>
<td></td>
<td>6.4(76)</td>
<td></td>
</tr>
<tr>
<td>Consumption:</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Food</td>
<td></td>
<td></td>
<td>19.8(44)</td>
<td></td>
</tr>
<tr>
<td>Home</td>
<td></td>
<td></td>
<td>21.5(45)</td>
<td></td>
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<tr>
<td>Attire</td>
<td></td>
<td></td>
<td>11.1(46)</td>
<td></td>
</tr>
<tr>
<td>Other living</td>
<td></td>
<td></td>
<td>17.4(47)</td>
<td></td>
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<tr>
<td>Depreciation and obsolescence</td>
<td></td>
<td></td>
<td>6.5(48)</td>
<td></td>
</tr>
<tr>
<td>Net Worth</td>
<td></td>
<td></td>
<td>568.7(19)</td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>1063.7</td>
<td>1063.7</td>
<td>2802.1</td>
<td>2802.1</td>
</tr>
</tbody>
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**ANALYSIS OF CHANGES IN NET WORTH**

Balance beginning of period: 568.7(19)

| Add: | | | | | | | | |
| ------- | | | | | | | | |
| Additions to capital goods | 11.1(115) | | | | | | | |
| Loss: Capital goods consumed in production | 4.4(38) | 6.7(117) | | | | | | |
| Additions to consumption goods | 8.0(116) | | | | | | | |
| Loss: Permanent consumption goods consumed | 6.5(48) | 1.5(118) | | | | | | |
| Increase in investments abroad | 3.1(81) | | | | | | | |
| Discoveries and imports of gold and silver | 3.4(82) | | | | | | | |
| Advances in values due to price changes | 6.4(76) | | | | | | | |
| Balance end of year | | | | | | | | |

Balance end of year: 583.9(114)

**Note A:** The amounts stated for balance sheets, income, and disposition are based upon data believed to be reasonably accurate. The amounts stated for transactions are estimated from data contained in certain completed tabulations.

**Note B:** All the amounts stated are subject to revision as further research work is completed.
Item 77—This item purports to state the amount of current savings out of income which was added to capital goods.

Item 95—This is the same as Item 1 except that it is the valuation at the end of the year instead of the beginning of the year. The ending figure reflects changes due to transactions during the year.

Items 1, 20, 49, 77, and 95—These should be separated into their component parts, such as land, buildings, and equipment. The data at hand were inadequate for such a separation, however useful such an illustration might be.

Item 2—Valuation of inventories of producers, and also consumers' goods in the hands of manufacturers, wholesalers, retailers, and other business units holding the goods for processing or for sale.

Item 21—The debit entry for inventories shows the total purchases by all business units of goods for processing and sale. This amount is equal to Item 66. It is considerably in excess of the value of the national income, for the reason that goods are transferred between business units several times before they are completed and disposed of to consumers or to producers of capital goods.

Item 50—This credit to inventories represents the sale of goods and services by all business units to other business units or to consumers. The comments on Item 21 should be considered in conjunction with this item.

Items 21, 50—These figures in the National Balance Sheet and Income Statements do not measure inventories in the full concept of that term.

Item 78—The amount of the current year's income that was saved and invested in increased stocks of goods.

Item 96—Valuation of the same class of goods as defined for Item 2, except that it is for the end of the year instead of the beginning.

Items 3, 4, 8—Valuation as of the beginning of the year of all lands owned by government, associations, and individuals for the purpose of consumption by individuals. The idea of consumption as here used means use for homes, recreation, etc.

Items 22, 23, 24—Current valuation of all purchases and other acquirements of lands, buildings, equipment, and chattels for the purpose of consumption as defined in Items 3 and 4. These items include improvements, such as landscaping, roads, fertilization, sewers, etc. They also include any increases in valuations for any reason whatsoever.

Items 51, 52, 53—These items express the valuation of all sales and other disposals of consumers' lands, buildings, equipment, and chattels. They include depletion, losses, and reductions in valuations.

Items 97, 98, 99—Valuation of consumers' lands, buildings, equipment, and chattels at the end of the year.

Items 79, 80—Amount of current year's savings invested in consumers' lands, buildings, equipment, and chattels.

Items 23, 24, 52, and 53—The amounts stated for these items appear to the writers to be considerably less than they should be. Inadequacy of data and classifications of some transactions in Items 20, 49, 22, and 51 may account for the understatement of these amounts.

Item 6—This is a statement of the net amount of two distinctly different classes of accounts. The first class is composed of all holdings of foreign properties and equities and of all loans and receivables due from foreign governments and citizens. The second class comprises all properties and equities owned by foreigners and all loans and other payables due to foreign governments and citizens. Data are not available which would permit the segregation of these different classes of "real," "liquid," and "negative" wealth.
Item 25—Amount of all exports, remittances, and payments to foreigners. This also includes the purchase of any foreign properties (except such as are imported) and equities. Increases in valuation of foreign properties and equities owned are included herein.

Item 54—Valuation of all imports, receipts, and payments from foreigners. Sales of properties (except such as are exported) and equities to foreigners and decreases in valuation of foreign properties and equities are here included.

Items 25 and 54—It should be noted that dissimilar transactions are included in each of the items. If Item 6 were separated into its component parts, these accounts could be classified properly.

Item 87—Net amount of the current year’s savings invested in foreign properties and equities, and payment on debts due foreigners.

Items 100 and 107—End-of-the-year valuations of the elements of wealth defined for Item 6. Item 100 states the valuation of the first class there defined and Item 107 states the valuation of the second class. The data used separated these items as of the end of the year but not as of the beginning of the year.

Item 7—Valuation of gold, silver, minor coins, and currency held by the banks as of the beginning of the year.

Item 26—Amount of money, as defined by Item 7, deposited in banks during the year.

Item 55—Amount of money, as defined by Item 7, withdrawn from the banks during the year.

Item 82—Amount of the current year’s savings invested in money. This item should be considered in conjunction with Item 87. The net increase in these two items is $0.3 billion, which is the difference between the $0.4 billion increase of moneys in the banking system and the decrease of $0.1 billion of moneys in the credit system. Accounting procedure requires that both these accounts appear rather than the difference or net increase. This increase is the value of “hard moneys” added to the stocks of the national economy. This increase could arise from importations, new discoveries, and coinage of money from gold, silver, and other monetary stocks previously held by persons or corporations not included in banking.

Item 101—Valuation of money, as defined in Item 7, as of the end of the year.

Item 8—Amount of loans and other receivables held by the banks as of the beginning of the year.

Item 27—Amount of loans made by the banks and of securities and investments other than real property purchased by the banks during the year.

Item 56—Amount of loans paid to the banks and of securities sold by the banks from their portfolios during the year.

Item 102—Amount of loans and other receivables held by the banks as of the end of the year.

Item 13—Amount of deposits and other liabilities of the banks as of the beginning of the year.

Item 28—Total amount of all debits by the banks to deposits and other liability accounts. This item should represent all payments made by the persons of the economy when such payments are made by checks, drafts, or any similar negotiable instruments drawn on a banking institution.

Item 57—Total amount of all credits made by banking institutions to their liability accounts.

Items 28 and 57—These amounts are considerably less than a complete tabulation of the transactions would reveal.
Item 108—Amount of deposits and other liabilities of the banks as of the end of the year.

Item 9—Amount of real estate, buildings, and other tangible equipment owned by the banks as of the beginning of the year.

Item 103—Amount of real estate, buildings, and other tangible equipment owned by the banks as of the end of the year.

Comment: In the transactions column there should be recorded the amount of sales, purchases and other transactions related to the tangible properties owned by the banks. No data were found from which to formulate an estimate of this item; therefore, it has been omitted. It is obvious that if amounts were to appear in the debit and credit columns, they would balance in this year, since the opening and closing balances were the same.

Item 14—Amount of capital stock of banks outstanding as of the beginning of the year.

Item 29—Amount of purchases, retirements, and cancellations of bank stock during the year.

Item 58—Amount of new issues, sales, and increases of bank stock during the year.

Item 109—Amount of bank stock outstanding at the end of the year.

Item 15—Net worth of the banks in excess of their capital stock as of the beginning of the year.

Item 30—Dividend payments, losses, and other decreases in surplus accounts during the year.

Item 59—Profits, gains, and other increases in surplus accounts during the year.

Item 110—Net worth of the banks at the end of the year in excess of the stock outstanding.

Item 10—Amount of money in the hands of the public and outside the banking system as of the beginning of the year.

Item 31—Receipts of money from the banks and payments in cash made between the persons of the economy during the year.

Item 60—Deposits of money in the banks and receipts of money by persons during the year.

Item 87—Decrease in money held outside the banking system during the year.

Comment: Pertaining to Item 82 above.

Item 104—Amount of money held outside the banking system as of the end of the year.

Item 11—Valuation of all receivables due to persons of the economy as of the beginning of the year. (Receivables in the nature of open accounts.)

Item 32—Amount of accounts opened during the year.

Item 61—Amount of payments and other liquidations of receivables during the year.

Item 105—Amount of all receivables in the nature of open accounts due to persons of the economy as of the end of the year.

Item 12—Amount of all stocks, bonds, mortgages, and other evidences of indebtedness owned or held outside the banking system by persons of the economy as of the beginning of the year.

Item 33—All issuance and other increases of the securities defined in Item 12 during the year.

Item 62—All payments and other liquidations of the securities defined in Item 12 during the year.

Item 106—Amount of all stocks, bonds, mortgages, and other evidences of indebtedness owned or held outside the banking system by persons of the economy as of the end of the year.
Item 16—Amount of all open accounts, loans, and other payments due by persons of the economy (except banking) as of the beginning of the year.

Item 34—All payments and other liquidations of the liabilities defined in Item 16 during the year.

Item 63—All issuance and other increases of the liabilities defined in Item 16 during the year.

Item 111—Amount of all open accounts, loans, and other payments due by persons of the economy (except banking) as of the end of the year.

Item 17—Amount of stocks of all corporations (except banks) as of the beginning of the year.

Item 35—Amount of purchases, retirements, and other decreases of corporate capital stock (except banking) during the year.

Item 64—Amount of all issuance, sales, and other increases of corporate stock (except banking) during the year.

Items 35 and 64—The definition and amounts stated for these two items may not conform to the best concepts which should be used. It might be reasonable to include the amount of purchase and sales of corporate capital stock in Items 33 and 62.

Item 112—Amount of stocks of all corporations (except banks) as of the end of the year.

Item 18—Net worth of corporations (except banks) in excess of their capital stock as of the beginning of the year.

Item 65—Net increase in net worth of corporations (except banks) during the year.

Comment: Item 65 should not be a net figure. An amount should be stated in the debit column to express the dividends paid by the corporations (except banks), losses, and other reductions in their net worth. An amount should be stated in the credit column which would include all profits, gains, and other increases in corporate surplus during the year. Inadequacy of data compelled this to be stated as a net figure.

Item 113—Net worth of corporations (except banks) in excess of their capital stock as of the end of the year.

Item 19—Net worth or total value of all items of “real” wealth including net international claims. The amount, $568.7 billions, is the sum of Items 1 to 7, 9, and 10. It will be noted that the items of liquid wealth expressed in Items 8, 11, and 12 are exactly balanced and offset by the items of "negative" wealth, 13 to 18.

Item 114—Net worth, or total value, of all items of “real” wealth including net international claims as of the end of the year.

Item 66—Amount of all sales of goods and services made by business units. This definition is subject to the qualification that taxes received by governments, rents, royalties, and interest received by business units are not included. These items are 67, 68, and 69.

Item 36—Purchases by business units of goods and services produced by other business units.

Item 37—Amount of wages and salaries paid to individuals and business units.

Item 38—Depreciation and depletion of producers' goods used in production.

Item 39—Amount of taxes paid by business units.

Item 67—Taxes collected by all forms of federal, state, and local governments.

Item 40—Amount of rents and royalties paid by business units.

Item 68—Amount of rents and royalties received by business units.

Item 41—Amount of interest paid by business units.

Item 69—Amount of interest received by business units.
Item 42—Dividends paid by business units to individuals.
Comment: This item should be stated at a larger amount and be offset in the credit column to show the amount of dividends received by business units. Six billion dollars is the amount paid to individuals.

Item 43—Withdrawals by individuals from the business units owned and controlled by them other than withdrawals for purposes of salaries or wages.

Item 70—Amount of wages and salaries received by individuals from business units, including withdrawals for purposes of salaries or wages.

Item 71—Amount of rents and royalties received by individuals from business units, and the amount received by individuals from other individuals as rents on consumers' goods.

Item 72—Interest received by individuals from business units and from other individuals as interest on loans for the purpose of owning consumers' goods.

Item 73—Dividends received by individuals from business units.

Item 74—Withdrawals by individuals from businesses owned or controlled by them other than withdrawals for purpose of salary or wages.

Item 75—Net gain to individuals as a result of international trade and settlements.

Item 76—Speculative profit received by individuals as a result of their sales and transactions in "real" and "liquid" wealth.

Item 44—Expenditures of individuals for food.

Item 45—Expenditures of individuals for the purpose of maintaining homes.
This item includes the rents paid by individuals to other individuals.

Item 46—Purchases of clothing and similar items by individuals.

Item 47—All other purchases and expenditures of individuals for consumption goods. This includes the amount of interest paid by individuals to other individuals in connection with loans for the purpose of owning consumers' goods.

Item 48—Depreciation of consumers' goods as defined in Items 3, 4, and 5.

Item 88—Excess of income produced by business units over the income paid out to individuals.

Item 89—Amount of wages and salaries received by individuals from business units.

Item 90—Amount of rents and royalties received by individuals from business units.

Item 91—Interest received by individuals from business units.

Items 90 and 91—These items do not include the amount of rents and interest received from other individuals in payment of the use of consumers' goods or loans for purpose of owning consumers' goods. In accordance with the concept used here, payments between individuals for and in connection with consumers' goods add nothing to the national income. They only serve the purpose of further distributing the shares among the individuals.

Item 92—Dividends received by individuals from business units.

Item 93—Withdrawals by individuals from businesses owned or controlled by them, other than withdrawals for purposes of salaries or wages.

Item 94—Net gain accruing to individuals as a result of international trade and settlements.

Item 83—Expenditures of individuals for food.

Item 84—Expenditures of individuals for maintenance of homes.

Item 85—Expenditures of individuals for clothing and similar items.

Item 86—All other purchases and expenditures of individuals for consumption goods.
Items 84 and 86—These items do not include payments made by individuals to other individuals for purposes of rents or interest in connection with the use or ownership of consumers' goods. See comments on Items 90 and 91.

Item 115—Total amount of constructions, replacements, and other additions to the physical elements of producers' wealth.

Item 116—Total amount of constructions, replacements, and other additions to the physical elements of consumers' wealth—the sum of Items 79 and 80.

Item 117—Net amount of increase in producers' goods.

Item 118—Net amount of increase in consumers' goods.

Item 119—Net increase during the year in the total stated wealth of the economy.
Business Recovery and Government Policy
-National and International-

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
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Business Recovery
and Government Policy
-National and International

An Address by
WINTHROP W. ALDRICH
Chairman Board of Directors
THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at the
Thirty-ninth Annual Dinner of the
ILLINOIS MANUFACTURERS' ASSOCIATION

on the Evening of Tuesday, December 8, 1936
AT CHICAGO, ILLINOIS
Business Recovery
and Government Policy
-National and International-

I appreciate greatly the honor of being invited to be one of the speakers this evening. I am very happy to have the opportunity of discussing with so representative a group of business executives some of the problems which confront the business men of America at the present time. I say "the business men of America" rather than "American business" because I am conscious of the fact that it is a mistake to think of business as an entity—as something which is able to think and act as a unit, and which is capable of adopting a policy and carrying it out. It is true that business men, through organizations such as yours, can do very effective work in considering questions affecting the interests of their group or the interests of the country as a whole. It is also true that such organizations can assist greatly in the creation of public opinion and the formulation of policy. But the execution of any program which may be adopted, in its application to any particular plant or company, must of necessity be left to the initiative and judgment of the individual executive in charge.

A few days ago, at the annual banquet of the Chamber of Commerce of New York, I took occasion to comment on certain aspects of the recent election as they affect the business men of the country. In the course of my address I stated that it seemed to me that the election had pro-
found social implications, both in its causes and perhaps in its consequences. An unmistakable ground swell swept across the country which was not limited to any section, class or occupation. The result was the American reflection of a world-wide movement that the war and its consequences greatly stimulated, the movement yielding up of some of the individual’s freedom to act in return for increased security. I pointed out that if we wished to avoid the dangers inherent in centralized authority or prescriptive regulation, every man in a responsible position must study and restudy his decisions and guide his actions according to his best estimate of the public good. I also expressed the opinion that business men should coöperate fully with the Government not only by assisting in the development and carrying out of its general policies, but also by presenting clearly and vigorously such objections as may exist to legislation enacted or under consideration by Congress.

Tonight I would like to refer to certain difficulties which confront us as to the solution of which I believe the American business man may be helpful to the Administration, either through his individual action or through coöperation in the formulation of policy.

The Problem of Unemployment

The first of these is the situation created by the large body of unemployed. Unemployment is at the same time the most distressing symptom of the depression and the most difficult and pressing problem with which the country is faced today. The superficial and easy approach to this problem at the present time is to say that the depression is practically over, business is again prosperous, and therefore business should immediately step forward and furnish reëmployment for the great numbers of people still on the
relief rolls. Of course the zeal of business men to accomplish everything possible along this line should be encouraged, but it seems to me that a word of warning is in order so that false hopes will not be created in the public mind.

Unemployment is of many kinds. There is agricultural unemployment, caused primarily by the loss of our foreign markets and secondarily by crop restrictions and other artificial remedies adopted to compensate us for the loss of such markets. There is unemployment in the transportation field, such as the railroads and shipping, caused to no small degree by reduced shipments of farm products. There is unemployment in the building trades, caused by overbuilding during boom times. There are also great numbers of unemployed who never have been connected with industry, such as professional men, artists and persons engaged in the service occupations. No one of these groups can find reemployment through the efforts of business men alone, and as to some of them the business man cannot be of any direct assistance. It has been stated on good authority that in many lines of industry—such as, for example, the automotive industry—employment is greater today than it was in 1929. In such lines substantial additional employment is hardly to be expected immediately.

An Authoritative Survey Is Needed

I do not know, and I do not believe that anyone knows, how many of the present body of unemployed can be absorbed into industry and business in the near future. But I am sure that before any intelligent coördinated effort can be made on the part of business men to reduce the total number of unemployed, an authoritative study must be made concerning the former occupations of those
who are now on the relief rolls, and concerning the comparative amount of unemployment which exists at the present time in agriculture, transportation, the professions, the service groups, and in various lines of industry. Why such a study has not been made before this is difficult to understand. Many business men have been urging it for years.

What we, as business men, need to know before making a definite commitment as to what we can do, is what the recipients of relief were doing before they became unemployed, and what chance there is of finding or creating jobs for them in industry and business to replace those they have lost. Here is the most important problem before the country today. It has been with us since 1929, and yet I know of no information available to the general public, no census, survey, enquiry or report, made on a nation-wide scale, which would assist in the formation of an intelligent judgment as to how or where the recipients of relief can best be given reemployment. I suggest that we should all urge the necessity for making such a study at the earliest possible moment by the Federal Government. Once the results of this study are available, business can go forward more intelligently to do its part in bearing its share of the burden.

The reemployment by business and industry of such portion of the unemployed as can be so absorbed is a primary duty of business men today. But in order that they may have the confidence necessary to accomplish this result, they must, I believe, feel reasonably sure that certain elements of uncertainty and difficulty which exist in the general situation will be eliminated or minimized.
The Money Market

We have had now, for several years, a very unusual situation in the money market. The banking community has grown accustomed to two billion dollars or more of excess reserves and to a rapid expansion of bank credit as banks have bought Government securities, giving their deposit liabilities in exchange. But, despite the great plethora of available funds, business men and private borrowers generally have shown great prudence with respect to increasing their debts. Commercial borrowing and borrowing against stock market collateral have changed very little, though there has been, I am glad to say, an upward trend in commercial borrowing during the last year. The rapid utilization of excess reserves which we saw between 1922 and 1929 by private borrowers and through new security issues has not been repeated in 1933-36.

The Money Situation and the Business Outlook

I have no predictions to make with respect to either the time or manner in which we shall experience the deferred consequences of the great changes which we have made in our money and credit situation. But I do want to sum up some of the factors involved and to draw some practical conclusions as to policy. First, let me say that the potentialities of a great increase in the use of bank deposits in the purchase of investments of various kinds, particularly equities and real estate, are not confined to the further expansion of bank credit that is possible on the basis of our existing excess reserves. There exists today a great volume of idle deposits in the hands both of business corporations and of private investors who, not seeing satisfactory use to make of their funds, have allowed them to accumulate.
You do not need additional expansion of bank credit to set these funds in motion. They are already there waiting. Growing confidence could lead easily to a stampede in buying on the part of investors. They would not usually buy commodities. They would be more likely to buy stocks and real estate.

As far as commodities are concerned, the possibility of an early sharp rise in prices does not seem so imminent. The obvious view with respect to agricultural prices would seem to be that we are more likely to have normal crops than very short crops. This would tend to prevent any runaway in agricultural prices, and could even lead to sharp declines unless, meanwhile, we get our agricultural export markets back. And the possibility of a great rise in the prices of manufactured goods would seem to be precluded as long as the volume of unemployment is as great as it is, and we have as much unused capacity as we have.

On the other hand, we have today labor shortages in certain lines, notably in skilled mechanics. This is particularly manifest in the machine tools industry, but it appears in many places. Comparatively few apprentices have been trained in recent years. In many industries, years of depression have led to great reductions in the number of skilled men available, and many such men have shifted to other occupations. Bottle necks in particular industries as regards the labor supply could, with increasing demand, bring about sharp price rises for special things. Further, when we talk about capacity, we must recognize that we have allowed a great deal of obsolescence to take place, and that we have, in many cases, allowed equipment to run down. Capacity may not be as great as we think, and additional demand for finished goods might lead to a very sudden increase in the de-
mand for new equipment. Moreover, the possibility of a move by the public utilities in making a long-deferred expansion would seem to wait only for a better understanding between the public utilities and the Administration, with some evidence that this may be achieved sooner than many expect.

I think that those who would expect factors such as I have just mentioned to bring about a boom, progressing for several years, in which there would come a great rise in the commodity price level and in the values of real estate and equities, may well be disappointed. I believe that too many things would get out of balance quickly for such a boom to go very far without a setback. And I am sure, in any case, that it is very desirable that no violent boom should come. I believe that a rise in the average of commodity prices in which some groups rose very fast while others trailed badly, would contain in it the seeds of disaster. A world-wide rise in commodity prices such as we had from 1896 to 1913, moving rather steadily but not so much in any one year as to upset the relations of different industries, is another story. But nothing but calamity could come from a spectacular boom accompanied by rapidly rising prices of particular commodities in the United States alone.

I repeat that I make no prediction, as to the time or the manner in which the potentialities of our excessive bank expansion will finally be felt, nor as to when and how the reduction of the gold content of the dollar will ultimately manifest itself.

As to the latter, I should not expect anything like a rise in prices proportional to the debasement to take place for a long time, because I think that the world-wide debasement of currencies has shaken men's faith in the future
of paper money to such an extent that the demand for gold for hoarding has greatly increased and that as a result the value of gold itself has risen greatly. Governments and central banks will have to reestablish the confidence which they have shaken before gold loses this recent gain in value, and this will take many years. But the potentialities of excessive bank credit at some time in the future are ominous, and I believe that we ought to move further in these quiet times toward getting control of the credit situation.

**The Methods of Control**

The Federal Reserve authorities have manifested definite concern with respect to the great volume of excess reserves, and have already taken one important step to reduce them. I refer to their action, announced on July 14 and effective August 16 of this year, raising the reserve requirements of member banks by 50 per cent. The subject is again under discussion and there is rather widespread expectation of further action on their part.

I believe that the reserve requirements should again be raised by an equal amount to the full limit allowed by the law, an action which would reduce excess reserves (taking the figures of December 2) from 2 billions 210 millions to 688 millions. Reserve requirements were, I believe, put much too low in 1917, with the result that both the expansion of credit and the contraction of credit on the basis of increases or decreases in the volume of bank reserves moved too rapidly. I trust that the Federal Reserve authorities will in the near future raise reserve requirements to the full limit allowed by the law and then leave them unchanged, certainly for many years. I am assuming, in saying this, that excess reserves are still widely diffused among the individual banks
of the country, as proved to be true when the August increase was made in reserve requirements. The Federal Reserve authorities will, of course, inform themselves with respect to this before they act, as they did last time. We ought to use the method of increasing reserve requirements as the first resort rather than the last resort, because, in a time when a real tightening of the money market is called for by a boom, there will be a large number of individual banks which will not have excess reserves even though excess reserves in the aggregate may be large. We could then use the more familiar methods of control through Federal Reserve open market operations and discount rate increases. These methods affect first the great money markets and the liquid banks, whereas the method of raising reserve requirements affects all banks, both those which are liquid and those which are not.

Reducing the excess reserves to 688 million dollars by the suggested increase in reserve requirements would still leave a very great excess and would still leave a very easy money market. We should then, however, be in a position to act effectively with the older methods when a further reduction of excess reserves is compelled by boom symptoms.

**Credit and Debt**

Our last great boom was characterized by a very excessive expansion of bank credit and other credit, which means it was characterized by a very excessive creation of debt. Credit is the other name for debt. We call it credit in boom times and we call it debt when depressions come. We praise credit in the boom and we denounce debt in the depression. If we could learn to use periods of active business in such a way as to pay off debt instead of in-
creasing it, we should have gone very far toward solving one of the greatest problems of prosperity and depression.

Now, the financial technique for doing this exists and is well understood. It is to be found in using part of the profits in good times to pay off debt and to increase business assets instead of paying all profits out as dividends. It is to be found in issuing stocks wherever possible instead of bonds, and, for unincorporated businesses, it is to be found in getting proprietors' capital, instead of borrowed money, wherever possible and in throwing profits back into the business and expanding surplus, whether by increase of business assets or by debt reduction.

It is to be found, moreover, in a realization that capital gains made in good times should be conserved to offset capital losses that come in bad times; and that it is good for the country that this should be done. A boom in which corporations pay out all their profits as dividends and in which capital gains are spent as income or are taken in income taxes by the Government, is a boom that is sure to end in greater disaster than any we have yet known.

**Tax Policy and the Use of Capital**

In this connection, I hope that it may be possible for the Administration in Washington to reconsider a number of things in our existing tax structure. It is not a good thing for the country that men of large fortune should feel obliged to carry millions of dollars of idle bank deposits because at the time of their death their estates will be subject to taxes running up as high as 70 per cent or more, and must, therefore, be held highly liquid. It is not a good thing for the country that men of substantial incomes should feel driven to purchase tax exempt Government, State and municipal bonds instead of investing
their funds in active industry. It seems clear to me that we have gone much too far in tax rates in the higher brackets, from the standpoint of industry and the growth of capital in the country. Men of large and substantial fortunes are men who can afford to take risks which men with modest fortunes cannot take in the financing of new inventions and in the development of new industries. The small investor, unable to diversify adequately, must "play safe," and should buy only seasoned securities. There is today a great scarcity of venturesome capital, and we should modify our tax system to the extent that it is necessary to permit capital to become venturesome again.

Tax Policy and Capital Accumulation

The tax on corporate savings, passed at the last session of Congress, if long continued, will create a very serious problem. In almost every bank in the country, this tax is today the subject of discussion between corporate borrowers and bank credit officials. Both realize the importance of retaining part of the profits of the enterprise for expansion and the importance of building up surpluses as a safety factor in case a new depression should come, and both realize that, even apart from a general business reaction, individual lines of business and individual corporations are continually having vicissitudes, and need an anchor to windward. A tax running up to 27 per cent on retained profits which does not have to be paid if the profits are all paid out makes it terribly difficult for corporate management to follow the course of wisdom with regard to these matters.

Even if one grants that there may be merit in the idea of forcing full distribution of profits in bad times so that stockholders may spend and, by spending, help to bring
about good business—a notion which I do not myself accept—certainly one would hesitate to accept the theory that this should be done in boom times and at all stages of the business cycle. The general theory of those who wish, by increasing the volume of money and credit and intensifying their velocity, to bring about prosperity, requires that these things should be curbed when the pace gets too fast; and this particular law, unlike other devices connected with the idea of forcing the pace of prosperity, works only one way. Granted that it might have been useful in 1933 or 1934, it came too late to be useful in 1936 and it can be definitely and gravely harmful in 1937 and 1938. Already it has led to the reduction of lines of credit to some corporations and already it has operated to check expansion of plant and equipment in others. Its general effect is to retard the growth of capital and particularly that form of growth of capital which does not involve a corresponding growth of debt.

On the other hand, I want to say that I sympathize with the Administration’s desire to prevent the use of corporations as a means of tax evasion by very wealthy individuals. I believe it ought not to be an exceedingly difficult matter to make a very clear discrimination between the retention of profits for that purpose and the retention of profits to meet the needs of the corporation itself. Section 102 of the Revenue Act of 1936 strengthens section 104 of the 1928 and 1932 acts, which was aimed at the use of corporations for this type of tax evasion. I think the business community would do both itself and the Government a service if it studied this section with a view to helping to make it more efficient, and if it presented its suggestions for making it more efficient, at the same time that it presents its argument against the retained profits tax as such.
Capital Gains Tax

With respect to the capital gains tax, I think that there is an extraordinary unanimity of financial opinion that it has no place in the general income tax system, and that, if kept at all, it ought to be put into a separate category at a very much lower rate than the rates of the higher brackets. We know that it exaggerates stock market booms. We know that it immobilizes large blocks of securities. A man who ought to shift from one thing to another, who ought to sell as a stock goes too high, simply does nothing, because, if he sells, the Government will take the major part of his profit. Moreover, the tax on capital gains, at the exceedingly high rates of income taxes, means that the tax is a tax on capital, one which forces the dissipation of capital when we look at it from the standpoint of the country as a whole. From the standpoint of the man who pays the tax, it is merely turning over part of the profit to the Government. But, viewed from the standpoint of the country, the capital gain is part of the price which the seller of a security or a piece of real estate has received from the buyer. The buyer has paid this either entirely from his own capital or in part with his own capital and in part with capital borrowed from other people, or with funds borrowed from a bank. It is these funds which are turned over as taxes to the Government, which spends them for current running expenses. This results clearly in the dissipation of capital.

The Reserve Fund of The Federal Social Security Act

I said in my address before the Chamber of Commerce of New York that the objections many of us have expressed to legislative measures undertaken for social betterment have been directed against methods of oper-
ation rather than broad basic principles. The plan in the Federal Social Security Act for the accumulation of a huge reserve fund in the form of Government debt is a case in point. Most of us agree with the objectives of the Act, but we should be derelict in our duty as citizens if we did not point out that this reserve fund threatens the whole future stability of the plan itself. With that in mind, I wish to emphasize that, whatever else may or may not be done in connection with amending the Federal Social Security Act, the reserve fund feature should be promptly dropped and the system should be placed on a current cost basis. Unless this is done, dissipation of savings through increased and unnecessary Governmental expenditures is going to be the almost automatic consequence of the reserve fund provision. This reserve fund is to be invested in Government securities solely. If all of it were used in buying existing Government obligations in the hands of the public and thus returning funds to the general capital market, it might add to the capital of the country. In actual practice, however, a large part of it is to be “invested” in special new obligations of the United States Government bearing 3 per cent interest, which means that no real investment is made at all, because the money still remains in the general fund of the Treasury, available for Congressional appropriation for any purpose whatsoever. On the basis of the present prices of Government bonds, this procedure must immediately begin, because there are no Government bonds yielding as much as 3 per cent, and, therefore, all of the fund must be put into the special 3 per cent obligations. I discussed this matter at length, together with other features of the Federal Social Security Act, in an address which I made at the University of Virginia last
July, and I venture to refer to what I there said for a more extended discussion of this problem.

**Our International Policy**

Political decisions are not always matters of choice, once other decisions have been made. Economic conditions often control political decisions. Once a given line is started, it leads, by economic rather than by political logic, to unexpected things. We saw this in connection with the A.A.A. Voluntary control of crops proved inadequate and we turned to the Bankhead Bill, putting a tax on cotton ginning. Land withdrawn from cotton and other export crops was turned to the growing of potatoes, and we passed the Potato Control Act.

On the other hand, the active development of business which has followed the abandonment of N.R.A. has greatly lessened the demand for measures of the N.R.A. type. One restriction calls for another restriction, and one measure enlarging freedom encourages the development of other measures enlarging freedom. In this great depression, a multitude of different policies, often contradictory, have claimed attention; some we would all approve and as to the wisdom of others many of us have had serious doubts.

But there is one line of policy which the Administration has been taking which seems to me so thoroughly wholesome and sound and so tremendously important, both in itself and in its general implications, that I think there is nothing which the business community can do that would accomplish more toward straightening out the grave problems that we still face than to get vigorously and wholeheartedly behind it. I refer to the policy of
building up our foreign trade through the reduction of tariffs and the removal of trade restrictions.

**Tariff Policy and Our Creditor Position**

The record of the United States since the War with respect to the protective tariff has not been intelligent. The War had brought about an immense shift in our international balances. Whereas we had been a debtor nation prior to the War, during that period we became a creditor nation on a great scale. Whereas we had had an export surplus before the War, as we sent out goods to foreign countries in paying interest on our debts, it became our natural function after the war, as a creditor nation, to receive an import surplus as debtor countries sent goods to us, sold the goods here, and turned over the money received, in payment of interest and amortization, to the American people and the American Government. This is the way a creditor country receives payment. An import surplus in no way harms a creditor country. It does not diminish the ability of the creditor country to buy and consume its own products, because the process of payment involves a corresponding increase of money income for the creditor country. England, France, Germany, The Netherlands and Switzerland in the days before the War used regularly to receive more goods than they sent out. They were creditor countries, capitalist countries, which, like an individual capitalist, could afford to consume more than they produced by their own labor. We should not have raised our tariffs following the War, but we did. We raised them in 1921 and 1922.

Our export trade, especially in farm products, would have gone to pieces very soon as a result of these tariff increases, but for the fact that we offset the high tariffs, especially after early 1924, by a second unsound policy, that of
artificial cheap money through Federal Reserve Bank action, making possible gigantic foreign loans, which continued to take the exports out, even though imports in adequate quantity were not received to offset them. And when the great credit expansion could no longer continue to offset trade barriers, the prices of the international staples crumbled, in the winter of 1929-30, and our agricultural problem became increasingly desperate. And then we committed the incredible folly of raising the tariffs still higher in 1930.

With high and rising trade barriers, export industries in every country in the world were greatly depressed. Unemployment in the export industries became widespread and, for every country in the world, there was created the problem either of restoring the export trade or of shifting great bodies of people from producing for export to producing for the domestic market—and meanwhile feeding them. There came also a great collapse of international credits, and great losses on foreign bonds. If foreign debtors could not pay with goods, they could not pay at all.

If goods could not move in the world, there was not enough gold in the debtor countries to pay their debts, and country after country abandoned the gold standard and saw its currency depreciate, while other debtor countries maintained a nominal parity of their currencies, but only by exchange restrictions which still further stifled foreign trade. A world which had been adjusted to a large international trade found itself cut up into almost watertight compartments, each of which, lacking the balancing influence of the others, was out of balance. And then, each country strove desperately, by a multitude of unsound internal devices, to try to bring about some kind of internal balance by means of regimentation, curtailment of pro-
duction in export lines, and the use of public credit to fill in gaps in the productive and financial system.

**Foreign Trade and the Federal Budget**

I believe that the business and financial community as a whole should get vigorously behind the Administration in its efforts to restore international trade. The advantages of such a course are manifold and not the least of these is in connection with the Federal budget. Speaking before the World Trade Luncheon, under the auspices of the Merchants Association of New York, on May 22 of this year, with respect to this point I said:

"One highly important point to take into account in deciding between the policy of economic self-sufficiency and the policy of the restoration of foreign trade is that the policy of economic self-sufficiency, even to the extent that we are now practicing it, imposes an immense burden upon the Federal budget. In view of the unbalance as between agriculture on the one hand and manufacturing on the other, the Government is undertaking to give to the farmers as compensation for their lost export trade many hundreds of millions of dollars a year, and additional vast sums are being spent by the Government in relief for the displaced tenant farmers, share croppers and farm laborers.

"An adequate restoration of foreign trade would make a bigger contribution to the balance of the Federal budget than any other single measure. Let us consider the following important items on both sides of the income and outgo ledger. (1) The tariff used to be our most important source of Federal revenue. We received in the fiscal year 1935 only 8½ per cent
of our revenues from it. In that fiscal year customs receipts were 343 millions of dollars. Most of the goods that come in today come in on the free list. A great number of our tariff rates are so high as to be virtually, if not absolutely, prohibitive rates, stopping imports. The Government, however, collects customs duties only on goods that come in, not on those that are kept out. Lower tariff rates on many items would bring in very much more revenue and still leave a great deal of protection. We could easily get $300,000,000 a year additional revenue from the tariff by lowering rates. (2) Further, if we allow foreign countries to send goods to us instead of requiring gold, we should be able to collect something on inter-allied debts; not the three hundred odd millions of dollars a year that the contracts call for, but, let us say, 75 to 125 millions a year. (3) On the side of outgo, we could save the vast sums which we have been paying the farmers in benefits and other payments, since, if they had their foreign market restored, the reason for these payments would be gone. In the fiscal year 1935 these payments, including administrative expenses, totaled $712,000,000, not counting the advances of the Farm Credit Administration, which were $125,000,000, or the relief expenditures of the Department of Agriculture amounting to $81,000,000. (4) And if we had a normal market for agricultural goods and full production in agriculture, the Federal Government would no longer need to spend vast sums in relief among the now idle tenant farmers and the farm laborers.

"I raise the question as to whether there is any other way in which we could so painlessly contribute far over a billion dollars to the Federal budget."
Tariffs and Wages

There are those who fear the effect of tariff reductions upon wages and employment in manufacturing in this country. We have long been indoctrinated with many fallacies with respect to the protective tariffs. There are many sound arguments for protective tariffs—arguments which before the War had greater validity than they have today. The infant industries argument, properly applied, was sound. The diversification of industries argument was sound in the earlier days.

But I find almost no one among the economists who believes that protective tariffs are responsible for wages or for standard of life if you look beyond a few special groups of laborers. The law of wages rather is that, when population is scarce and natural resources and capital are relatively abundant, you will have high wages, tariff or no tariff; and that, when natural resources and capital are scarce, and labor relatively abundant, you will have low wages, tariff or no tariff.

And in the present situation we must recognize that with the great unbalance between export industries and domestic industries, a policy of removing trade restrictions and lowering tariffs will mean better business and wages than will exist if this is permitted to continue.

I would say to those who are fearful of the effect of reasonable foreign competition on our manufacturing industry and our manufacturing labor, that competition of foreign goods cannot possibly be as severe as the competition that is inevitable if we remain with the enormous body of idle agricultural labor which has been created since early 1933. What are these people to do if their export market is not restored and if they do not come back into full agricultural production? Most of them
are on relief today — W. P. A. work or other relief. We cannot look forward to this as a permanent thing. They must be reabsorbed into the general body of our economic life. If a foreign market cannot be found for the agricultural production, what are they to do? Some have gone into dairying, creating new difficulties for existing dairy producers. Many more, in one way or another, will go into manufacturing. Some will come to the great cities. Others will stay where they are and factories will go out to them. New England textiles already know what it means to have new Southern factories established with new equipment and with lower wage scales. Many other manufacturing lines will face the same internal competition unless these people speedily get back into their accustomed work.

Efforts may be made by means analogous to the N.R.A. to limit competition from the West and the South in manufacturing lines. But by what right and on what possible basis? Tariffs among the States we cannot have and should not have. We have avoided some of the worst things that Europe faces today by having a great free trade area within our own borders. A re-balancing of some sort must come. Efforts to force wage scales in the Southern and Western communities to the level of those in the North and the East if enforced would merely perpetuate the unemployment. The factories would not go to the West and the South if that were done, but the people would remain unemployed and would drift northward and eastward. Those who oppose internal regimentation and N.R.A. devices would do very well to avert this problem by getting behind the programme of lowering the tariffs on manufactured goods so as to permit a sufficient volume of imports of manufactured goods to take out, at good prices, an adequate volume of farm
exports, and let our farming population once more engage in full production.

_**A Commendable Move Toward Currency Stability**_

There is a related policy of the Administration, which centers in the Treasury, though apparently involving also cooperation from the Department of State, which we ought also to commend and to support. I refer to the concerted action of our Government and the British and French Governments in preventing a chaos in the foreign exchanges when France, The Netherlands, Switzerland and Italy broke away from their established gold parities a few weeks ago. A great deal of difficulty was averted by this cooperation, and the foundation was laid for much better things, though, in my judgment, the task will not be completed until definite gold contents are established for these foreign currencies, and until each country takes care of its own currency on sound gold standard lines.

In this connection, I call especial attention to the fact that both France and Italy lowered their tariffs at the same time that they let the values of their currencies sink. This is one of the most hopeful indications of returning world sanity that we have had in a long time. And I would emphasize that the ability of the world to restore stable international exchange rates and fixed gold parities is enormously increased if tariffs and other trade barriers are reduced and goods can move adequately in making international payments instead of having the whole burden thrown on gold.

_Trade, Peace and Freedom_

And the final and most emphatic reason why those of us who believe in free enterprise, in individual liberty, and the preservation of chartered Constitutional rights,
should work earnestly for the rapid extension of the foreign trade policy of the Administration is that this is the great road toward world peace. A world in which the nations are trading is a world in which the peoples are working. Desperate peoples, deprived of trade, feel driven to fight for their outlets and to fight for sources of food and raw materials or other things which they need but cannot afford to buy. A world in which war and rumors of war bring fear to the masses of men is a world in which governments grow very strong and individuals surrender liberties, hoping thereby to gain security. A peaceful, hopeful world is a world in which men value liberty and opportunity and defend their liberties and extend them.
The Reciprocal Tariff Policy
and the
Proposed Government Spending
Programme

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
The Reciprocal Tariff Policy
and the
Proposed Government Spending Programme

An Address by

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at the Annual Dinner Meeting of
the American Section of the
INTERNATIONAL CHAMBER OF COMMERCE
in the Mayflower Hotel
Washington, D. C.

on Monday, May 2, 1938
<table>
<thead>
<tr>
<th>The Reciprocal Tariff Policy</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Proposed Spending Programme</td>
<td>4</td>
</tr>
<tr>
<td>What Will It Cost?</td>
<td>5</td>
</tr>
<tr>
<td>Some Dangers Involved</td>
<td>6</td>
</tr>
<tr>
<td>The Theory of the Spending Policy: Consumer Purchasing Power</td>
<td>7</td>
</tr>
<tr>
<td>The Theory of Karl Marx</td>
<td>9</td>
</tr>
<tr>
<td>Purchasing Power Grows out of Production</td>
<td>10</td>
</tr>
<tr>
<td>The Fallacy of &quot;Over-saving&quot;</td>
<td>11</td>
</tr>
<tr>
<td>For Five Years We Have Proceeded on this Fallacy</td>
<td>12</td>
</tr>
<tr>
<td>Extent of Impairment of Business Capital</td>
<td>13</td>
</tr>
<tr>
<td>Prolonged Depression in Capital Goods Industries</td>
<td>14</td>
</tr>
<tr>
<td>The Treasury's Gold Supply and the Problem of Excess Reserves</td>
<td>15</td>
</tr>
<tr>
<td>Assets as an Offset to Borrowing</td>
<td>18</td>
</tr>
<tr>
<td>The Pace Has Been too Fast</td>
<td>19</td>
</tr>
</tbody>
</table>
The Reciprocal Tariff Policy and the Proposed Government Spending Programme

The Reciprocal Tariff Policy

It gives me particular pleasure to have the opportunity of addressing the International Chamber of Commerce tonight because as I understand it the primary function of the International Chamber is to encourage and foster foreign trade. And, as I have said many times recently, I believe that the re-establishment of our foreign trade if it could be accomplished would do more than any other single thing toward restoring the balance of our economic life. In saying this I do not mean to minimize the importance of our internal trade. Indeed, it is impossible in the last analysis to separate the foreign and internal trade from each other in considering what can be done to ameliorate the existing economic situation.

As far as our foreign trade is concerned, it seems to me that the President's programme of reciprocal tariff reduction being carried forward by Secretary Hull is of the first importance. Adequately accomplished, this programme will restore economic balance between particular industries and between agriculture on the one hand and manufacturing on the other. It will make unnecessary the continued regimentation of agriculture and the proposed further regimentation of industry and labor, designed to meet the problem of a large body of displaced agricultural labor (particularly in the South) which is seeking employment at low wages in manufacturing. The restoration of balance among our industries and between agriculture and manufacturing and the protection of our economic freedom would constitute one of the greatest contributions to sound prosperity which could be made. This programme will, moreover, contribute largely to the prosperity of the
other nations of the world, and with improvement in the economic conditions of foreign nations our own markets will be broadened and our own industrial life strengthened and made more secure.

In addition to this, the adequate restoration of international trade through the carrying out of the programme of reciprocal tariff reduction would relieve the existing pressure on government finances in virtually every country in the world. Men who were formerly engaged in producing for the export market are either being supported in idleness out of the public treasury or have been set to work at government expense on public works. In Italy and Germany these men have also been set to work at high cost to produce substitutes for goods formerly imported from abroad. Finally, as a result of international ill will, to which the strangulation of foreign trade has been a great contributor, in many countries, including our own, there has been a great increase in national armament. All of these things have meant greatly increased public expenditure and public debt. The successful carrying through of our reciprocal tariff programme, which would set the workers of the world to work in their old occupations, with the workers in one country producing goods to be exchanged for the products of the workers in other countries, would greatly relieve the pressure on public credit and taxpayers in every country, and would contribute greatly to the cause of peace.

But I am sure that it is not necessary for me to argue before this audience that Secretary Hull’s programme is worthy of support.

The Proposed Spending Programme

A subject which concerns us all, even more immediately than the reciprocal tariff programme is the programme laid before the country by the President in his radio address on the evening of April 14th. This message outlined a programme of Government spending for relief and public works, for the handling of the Treasury’s gold supply, and for a change in
Federal Reserve policy regarding bank reserves. In the course of his address the President said:

"You may get all kinds of impressions in regard to the total cost of this new program, or in regard to the amount that will be added to the net national debt.

"It is a big program. Last autumn in a sincere effort to bring Government expenditures and Government income into closer balance, the budget I worked out called for sharp decreases in Government spending.

"In the light of present conditions those estimates were far too low. This new program adds $2,062,000,000 to direct Treasury expenditures and another $950,000,000 to Government loans—and the latter sum, because they are loans, will come back to the Treasury in the future.

"The net effect on the debt of the Government is this—between now and July 1, 1939, fifteen months away, the Treasury will have to raise less than a billion and a half dollars of new money.

"Such an addition to the net debt of the United States need not give concern to any citizen. . . ."

What Will It Cost?

Now, it is my belief, first, that any addition to our national debt, which already stands at 37.6 billions of direct debt, with an additional 4.6 billions of Government-guaranteed obligations, should give concern to every citizen. And, second, I must confess my doubts regarding the proposition that the Treasury will have to raise less than fifteen hundred million dollars of new money between now and July 1, 1939. With respect to the effect of the new proposals only, this appears to be true. The two sums mentioned by the President, in the quotation I have just read, total about 3 billion dollars, and he plans to raise 1.4 billions of this by the use of gold now in the hands of the Treasury. This would seem to leave only 1.6 billions for the Treasury to raise by new borrowing, and the Treasury
could doubtless cut this to less than 1.5 billions, by letting the working cash balances go down. But this calculation does not take account of the deficit on the basis of the existing programme of spending.

That deficit, as reported in the Daily Treasury Statement of April 23rd, already stands at $1,213,000,000, with over two months of the fiscal year yet to be completed, and with relief and other expenditure items increasing. Apart from the new proposals, the deficit for the following fiscal year, ending July 1, 1939, can hardly be less than two billions, and may easily be greater, to the extent that the armament expenditures are increased and to the extent that the depression, which has already run four months of the current calendar year, reduces receipts from income taxes from individuals and corporations in the fiscal year 1939.

If to this we add the additional disbursements which the President recommends for the fiscal year 1939, it would appear that the excess of spending over revenues would equal or exceed five billion dollars, and if to this we add substantial disbursements by the Reconstruction Finance Corporation on the basis of the billion and a half authorization recently voted by Congress, the deficit could mount much higher. I should suppose that the additions to the public debt of the United States by July 1, 1939, on the basis of the President's programme, added to existing expenditures, would not be less than three and a half billion dollars, even allowing for the gold which it is planned to use, and, to the extent that the R.F.C. makes advances, the addition to the public debt—either in the form of R.F.C. notes or of Government bonds—would be correspondingly greater. Part of this will be borrowed from the Social Security funds and other trust funds, but it remains debt on which interest must be paid. And I repeat that this prospect should give concern to every citizen. Some day these debts must be paid.

**Some Dangers Involved**

Let me say with all possible emphasis that I am entirely in sympathy with the expenditure of whatever amount may be necessary for the adequate care of those on relief. We should
never forget, however, that from the standpoint of providing food and shelter and the comforts of life for our people, there is nothing of greater importance than the protection of the credit of the Government and the value of our currency. If we lose control of Government spending and wreck the credit of the Government, the currency becomes quickly involved, and, with currency disorder, we face every other kind of disorder and suffering.

The whole programme of social security goes by the board in such a situation. The Federal Government and the States are collecting vast sums of money—the amount is roughly one billion and a half for the fiscal year 1939—from the wages of our people and from the payrolls out of which these wages come, to provide security for our people in their old age, and to provide them with unemployment insurance. We are investing the resultant trust funds in Government bonds, and we are promising to pay them back dollars at a future time. How could we justify the imposition of these current sacrifices upon our people, if the whole thing should collapse in a crash of Government credit and a debauch of the currency? What of the deposits of the people in the savings banks and other banks holding Government securities, if the credit of the Government and the currency are allowed to become involved? Every citizen must be concerned with a situation where, for eight uninterrupted years, the Government of the United States has spent more every year than it has taken in as revenues, has added 21.5 billions to its national debt, and now proposes to go forward with a financial programme which must almost certainly add another 3.5 billions to the national debt in the next fifteen months. Let us face realities now, and let us see if this is the course which we wish to follow, while it is still possible to decide.

The Theory of the Spending Policy: Consumer Purchasing Power

What are the reasons offered for this vast additional spending of borrowed money beyond the amounts necessary for relief?
The President has stated the theory on which the programme is based. It is a very simple theory. In 1929, production exceeded purchasing power. I quote: "... millions of people had been put to work, but the products of their hands had exceeded the purchasing power of their pocketbooks, with the result that huge surpluses, not only of crops but also of buildings and goods of every kind, overhung the market." For 1937, he gives the same basic explanation. I quote: "But the very vigor of the recovery in both durable goods and consumers' goods brought into the picture early in 1937 certain highly undesirable practices, which were, in large part, responsible for the economic decline which began in the later months of that year. Again production outran the ability to buy." Again I quote: "At this immediate time we suffer from a failure of consumer demand."

There are other elements in the President's discussion, but we should concentrate on the fundamental philosophy. This philosophy is based upon the theory that the failure of aggregate consumer purchasing power to keep pace with aggregate production causes crises and depressions. From this the conclusion is drawn that the remedy for depressions is to increase consumer purchasing power by increased Government spending. The corollary is, and this has been much emphasized by the defenders of this doctrine, that the increase in Government expenditures must not be through increased taxes, but rather through increased borrowing, because there is no net addition to purchasing power if the Government merely distributes the proceeds of taxes, whereas if the Government borrows newly created bank credit, it actually increases total purchasing power by its spending.

Now, we have tried this theory before and we are asked to venture great stakes upon it again. It is highly important that we should be sure that the theory is right before we do so. By following this course, we are risking our national solvency, the credit of the Government and the future of the currency. We are facing, therefore, the gravest economic, financial and social convulsions if it turns out that the theory is wrong.
We have already increased our national debt to a dangerously high level in reliance upon this theory in the past five years, with results which have not been reassuring. And, during this time, one element, at least, in the theory has been clearly disproved. I quote: "As citizen income rises, let us not forget that Government expenditures will go down and Government tax receipts will go up." I agree that the past five years reveal that as citizen income rises, Government tax receipts go up. But I submit that we have spent sixteen and a half billions of borrowed money in the process of demonstrating that when our Government proceeds on this theory Government expenditures do not go down as citizen income rises, but, on the contrary Government expenditures continue to rise as citizen income rises. Now, this is costly information. But if we learn the lesson that it teaches and act upon that lesson, it may have been worth acquiring.

The Theory of Karl Marx

I turn now to the central point in the theory. Is the notion that crises are caused by the failure of aggregate consumer power to keep pace with aggregate production a valid one? Is it a notion which is accepted by the most authoritative students of the business cycle? I think the professional economists of the country will bear me out when I say that this is not the case, and when I say rather that it is an idea drawn from the teachings of the socialists. It is the theory of crises presented in crude form by Karl Marx, and subsequently elaborated by later writers influenced by him.

Marx thought only of the buying power of the laborers as he constructed his doctrine. Working people produced more than they received in wages, part of the product which he called "surplus value" going to the owners of land and of capital goods. Workers, therefore, could not buy back all they produced, and periodical gluts of over-production came. Critics of Marx have pointed out that the owners of land and the owners of capital goods are also consumers. The question may be raised as to whether the division of the
products of industry as between laborers and employers is fair. But no argument with regard to the fairness of this division has any bearing upon the question of whether the aggregate buying power is sufficient to purchase all that is produced. Laborers, employers, land owners, retired capitalists, and other recipients of income collectively, together with the Government as tax gatherer, receive all of the income from production and have, therefore, in the aggregate full buying power to buy all that is produced.

Purchasing Power Grows out of Production

The prevailing view among economists is that a general over-production is an impossibility. Buying power grows out of production. One kind of production makes a market for other kinds of production. Automobiles constitute the supply of automobiles, but they also constitute part of the demand for shoes, wheat, cotton goods, sugar, and the other commodities consumed by the men who produce automobiles. Wheat constitutes the supply of wheat coming into the market, but the proceeds of the sale of wheat create income which constitutes demand for automobiles, clothing, food and other commodities which the wheat producers want. As Cairnes puts it, every commodity may be looked upon either as supply or as demand, and, in the aggregate, supply and demand are not merely equal, but they are identical. A general over-production is thus impossible since buying power is increased as production is increased.

What then can be meant by over-production that has a rational meaning? Merely this—that there can be maladjusted production. There can be too much of some things and too little of others produced. There can be over-production in particular lines, but not general over-production. And when discrepancies of this kind come, the products of the particular things that are over-produced may go very low in price, and then the producers in the overdone field find their buying power cut so heavily that they are unable to buy in ordinary volume what other producers are creating, and these have unsold
goods on their hands also. We then have what looks like a
general over-production, though it is noteworthy that in such
a time less is being produced in the aggregate than is ordinarily being produced.

If prices, wage rates and other rates of exchange are left
flexible and free, we usually get out of a trouble of this sort
quickly enough. With free competitive markets, a slight over-
production in a particular line shows itself quickly in falling
prices, and under-production in another line shows itself
quickly in rising prices, and these price changes induce men
to increase production in the line where production is inade-
quate and to diminish production in the line that is being over-
done. New capital goes to the lines where the prices are
rising, and labor shifts from the overdone field where produc-
tion is decreasing to the lines where production is increasing.
If, however, there is interference with the freedom of the
markets, whether by private monopoly or by governmental
policy, readjustments are retarded and periods of depression
are prolonged.

But looking at the thing in terms of aggregate consumer
demand against aggregate production, the doctrine that a
simple failure of consumer demand to keep pace with total
production is the cause of crises has, I believe, no standing
among scientific economists today.

The Fallacy of “Over-saving”

A more sophisticated form of this doctrine, however, has
had greater currency in recent years, though I think that the
weight of economic opinion is clearly against it. It is the
doctrine that although recipients of the larger incomes have
money which they could spend in consumption if they chose,
they do in practice save more than the recipients of the smaller
incomes, and these savings are used in the creation of new
capital equipment rather than in buying consumers’ goods.
This leads to a deficiency in consumer purchasing power on
the one hand, and to increases in goods produced on the other
hand as the new capital equipment comes into use. Crises, according to this theory, would come when over-saving gets too great, and this is supposed by many to have happened in 1928 and 1929.

I shall not pause long for an analysis of this doctrine on theoretical grounds. I shall content myself with the proposition that there has never been an excessive creation of capital out of real saving, whether by individual thrift, or by businesses building up surplus out of profits from production. The trouble in 1928 and 1929 was, I believe, not an excess of real saving, but an excess of bank credit going into capital uses and speculative uses due to the cheap money policies of the Federal Reserve System during the 1920's. When a prolonged period of artificially cheap money generates a volume of bank credit which outruns the needs of commerce and industry and runs over on a great scale into capital and speculative uses, we inevitably lay the foundation for a crisis and depression, because we inevitably create a situation in which debt outruns production.

For Five Years We Have Proceeded on this Fallacy

But I do not need to analyse this doctrine theoretically in view of the clear lesson of the recent years during which we have been acting upon it. The whole course of governmental policy has been directed toward increasing consumer income and diminishing savings for investment purposes, for the creation of new capital, and, indeed, for the maintenance of existing capital. On the one hand we have had our vast relief expenditures, soldiers' bonus payments, agricultural benefits, N.R.A. increases in wage rates, and other policies aimed at the direct increase of consumer demand. And on the other we have had a wide range of policies which inhibit the growth and utilization of capital.

Progressive income taxation running to heights unmatched in any other country has made a startling reduction in the capital created by those in income brackets above fifteen thousand. The undistributed profits tax has dealt a deadly blow to corporate savings. The high taxes, moreover, have created a great shift from investments in industry to investments in non-
productive tax-exempt securities. Moreover, the efficiency of the markets through which investment funds pass from investor to industry has been impaired. The funds available for new capital have been greatly reduced. And the demand for new capital has been greatly restricted by the apprehensions which business men have had regarding the future, so that they have preferred generally to use existing plant and equipment rather than to expand, or even, in many cases, to replace obsolescence. There has been great impairment in the industrial capital of the country in recent years.

Extent of Impairment of Business Capital

I have before me a table, which I shall not read, derived from a study of the National Bureau of Economic Research, published last month, called “National Income and Capital Formation 1919-1935.” This report was prepared under the direction of Dr. Simon Kuznets.

<table>
<thead>
<tr>
<th>Year</th>
<th>Destined for Business Use</th>
<th>Residential Construction</th>
<th>Public</th>
<th>Net Change in claims against Foreign Countries</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1919</td>
<td>4,600</td>
<td>-336</td>
<td>834</td>
<td>2,280</td>
<td>7,378</td>
</tr>
<tr>
<td>1920</td>
<td>5,826</td>
<td>-892</td>
<td>832</td>
<td>1,391</td>
<td>7,157</td>
</tr>
<tr>
<td>1921</td>
<td>-124</td>
<td>345</td>
<td>2,082</td>
<td>613</td>
<td>2,916</td>
</tr>
<tr>
<td>1922</td>
<td>1,258</td>
<td>1,878</td>
<td>1,883</td>
<td>212</td>
<td>5,231</td>
</tr>
<tr>
<td>1923</td>
<td>5,105</td>
<td>2,273</td>
<td>1,586</td>
<td>-74</td>
<td>8,890</td>
</tr>
<tr>
<td>1924</td>
<td>1,367</td>
<td>2,544</td>
<td>1,834</td>
<td>433</td>
<td>6,178</td>
</tr>
<tr>
<td>1925</td>
<td>4,926</td>
<td>3,079</td>
<td>1,766</td>
<td>394</td>
<td>10,165</td>
</tr>
<tr>
<td>1926</td>
<td>4,635</td>
<td>2,518</td>
<td>1,889</td>
<td>42</td>
<td>9,084</td>
</tr>
<tr>
<td>1927</td>
<td>4,345</td>
<td>2,182</td>
<td>1,980</td>
<td>605</td>
<td>9,112</td>
</tr>
<tr>
<td>1928</td>
<td>3,300</td>
<td>1,854</td>
<td>2,051</td>
<td>943</td>
<td>8,148</td>
</tr>
<tr>
<td>1929</td>
<td>6,752</td>
<td>530</td>
<td>2,471</td>
<td>312</td>
<td>10,065</td>
</tr>
<tr>
<td>1930</td>
<td>1,460</td>
<td>-646</td>
<td>2,801</td>
<td>409</td>
<td>4,024</td>
</tr>
<tr>
<td>Total 1919-1930</td>
<td>43,450</td>
<td>15,329</td>
<td>22,009</td>
<td>7,560</td>
<td>88,348</td>
</tr>
<tr>
<td>1931</td>
<td>-1,899</td>
<td>-984</td>
<td>2,099</td>
<td>426</td>
<td>-358</td>
</tr>
<tr>
<td>1932</td>
<td>-5,865</td>
<td>-1,867</td>
<td>1,798</td>
<td>59</td>
<td>-5,875</td>
</tr>
<tr>
<td>1933</td>
<td>-4,160</td>
<td>-1,899</td>
<td>1,322</td>
<td>431</td>
<td>-4,306</td>
</tr>
<tr>
<td>1934</td>
<td>-3,487</td>
<td>-1,839</td>
<td>2,899</td>
<td>-1,104</td>
<td>-3,531</td>
</tr>
<tr>
<td>1935</td>
<td>-596</td>
<td>-1,209</td>
<td>3,574</td>
<td>-2,226</td>
<td>-457</td>
</tr>
<tr>
<td>Total 1931-1935</td>
<td>-16,007</td>
<td>-7,798</td>
<td>11,692</td>
<td>-2,414</td>
<td>-14,527</td>
</tr>
<tr>
<td>Grand Total</td>
<td>27,443</td>
<td>7,531</td>
<td>33,701</td>
<td>5,146</td>
<td>73,821</td>
</tr>
<tr>
<td>Annual Average</td>
<td>1,614.3</td>
<td>443</td>
<td>1,982.4</td>
<td>302.7</td>
<td>4,342.4</td>
</tr>
</tbody>
</table>
The table shows that for every year from 1919 to 1930 there was a great increase in capital for business uses, with the exception of the year 1921, when there was a small deficiency. The total increase in business capital for these years was forty-three and a half billion dollars. In contrast, for every year from 1931 to 1935 inclusive, business capital declined, with a total loss for these years of sixteen billions. For the year 1933, the table shows a decline in business capital of $4,160,000,000; 1934, $3,487,000,000; 1935, $596,000,000. I think that 1936 and 1937 would show some net addition to business capital, but not nearly enough. For capital embodied in residential construction, every year since 1929 shows a decline, the aggregate decline from 1931 to 1935 being $7,798,000,000. The arrearage in maintenance of residential construction is very great.

Prolonged Depression in Capital Goods Industries

The net result of these governmental policies has been that, for the whole period 1933 to 1938, our industrial activity has been very one-sided. We have had some prolonged periods of great activity in industries producing to meet immediate consumers' demand. We have had no period of adequate activity in the industries, including construction, producing long-time producers' goods. Until the middle of 1936, in fact, there was great depression in most of the industries producing capital goods. From the middle of 1936 through September of 1937, there was strong revival in many of the capital goods industries, but, through the whole of the period, construction remained deeply depressed.

If the theory that a failure of consumers' demand is responsible for business reaction is correct, then we should expect this to reveal itself by a falling off of retail trade as the first step in a business reaction. Moreover, we should expect the first step of business revival to manifest itself in an increase of retail trade. Now, in fact, we do not find either of these things. We find, on the contrary, retail trade to be the steadiest
sector of all trade. We find retail sales lagging behind production both on the downturn and on the upturn. A study in the *Harvard Review of Economic Statistics*, of February, 1937 (page 17) says: "The lag on the downturn in 1920 and on the upturn in 1921 and after 1933 was quite pronounced. Particularly noteworthy was the almost complete absence of a drop in retail sales during the recessions of 1923-24 and 1926-27." I may add that, in the current business reaction, we find retail demand holding strong for many weeks after the sharp reaction had come in industry.

The greatest variations in volume of production come the further we get away from the consumer. It is the industries supplying capital goods rather than the industries supplying consumers' goods which show the largest variations in volume as between prosperous and bad times. Moreover, we find the greatest price variations, in general, the further we get away from the consumer. Raw materials fluctuate more than finished goods at wholesale, and wholesale prices fluctuate more than retail prices. It is strange that a theory of the business cycle should have been developed which centers about the steadiest of all the elements in the business situation.

I believe that I have shown that the over-production theory of crises is not justified either in the form in which Karl Marx presents it or in the more sophisticated form in which it is found in the works of some of the later economic writers. Certainly we cannot find justification for the theory in the actual facts of the current depression. This being so, I earnestly submit that we should not add additional billions to our already excessive public debt for the purpose of increasing consumer purchasing power.

The Treasury's Gold Supply and the Problem of Excess Reserves

I would like to say a few words with regard to the decision of the Administration to use $1,400,000,000 of gold in the Treasury as a substitute for an equal amount of borrowing,
and the related decision to reduce member bank reserve requirements in such a way as to increase excess reserves by $750,000,000. The matter is technical and difficult to discuss with brevity. The purpose of the use of the gold is partly to reduce Government borrowing. The purpose of the two moves together is clearly to increase excess reserves in the banks, with the thought that this will make credit more abundant and facilitate business revival. The immediate consequences of these moves on the part of the Administration and the Board of Governors of the Federal Reserve System will, I believe, be negligible. The member banks of the Federal Reserve System already had $1,700,000,000 of excess reserves before these two operations were undertaken. Interest rates were already extremely low. Almost every bank in the country was looking in every direction for sound opportunities to lend or invest. Competition among banks was keen for loans and investments. I believe that it is fair to say that there was no practical restriction to bank expansion in the reserve situation as it stood before these measures were undertaken. Moreover, the expansion of bank credit which had already taken place had led to the creation of a great volume of idle deposits in banks subject to immediate check which investors and others could and would use the moment they saw a profitable opportunity to justify the investment of their money. In banks all over the country there was and is an altogether unprecedented volume of deposits held by people who ordinarily would not be holding large amounts of money in banks. Once the way is clear and once these funds begin to move, the problem will not be one of the encouragement of further expansion of bank credit, but rather of holding down a dangerous boom.

The Federal Reserve System had been awake to this possibility before the increases which were ordered by the Board of Governors in reserve requirements. Excess reserves had risen as high as $3,300,000,000. This was recognized as ominous. Past experience had shown that in order to get an effective control of bank expansion it was necessary to have excess reserves under $100,000,000.
Wishing, no doubt, to get closer to a position where it could control the situation, the Board of Governors, by successive increases in reserve requirements, culminating in the increase of May 1, 1937, had reduced the total of excess reserves to about $700,000,000. This still imposed no limitation on the growth of bank credit and left a great margin for expansion. Between that time and the time when these new decisions were made, excess reserves had risen to over $1,700,000,000.

Now the Administration has suddenly created a situation where $1,400,000,000 more of reserve money will eventually be thrown into bank reserves and has reduced reserve requirements by $750,000,000. Allowing for the increased deposits which this action will create, we may estimate that this adds nearly $2,000,000,000 to excess reserves, and that when the process is completed excess reserves will stand at about $3,700,000,000. This is in effect throwing away all the brakes.

It is apparently done on the theory that the last increase of reserve requirements by the Board of Governors—namely, that which took place on May 1, 1937—had restricted bank credit and is partly responsible for the current depression. I believe that this view can be demonstrated to be erroneous. The commercial loans of banks rose steadily while the reserve requirements were being raised and for a substantial time thereafter. The volume of new security issues, which had been very low in the first quarter of 1936, rose steadily as the reserve requirements were being raised, and continued to rise steadily in 1937 along with the increase in reserve requirements, and for three months after the increase was completed. Then the volume of new issues dropped sharply, not because of any shortage of bank accommodation, but because of the stock market break which began in August of 1937 and because of the ensuing business troubles.

If the country gets the impression that such mild financial measures as the Board of Governors made use of in 1936 and 1937 are responsible for the current business depression, we shall never regain any kind of control of the credit situa-
tion and our next credit boom will make the excesses of 1929 look very mild. And if we establish the tradition that with every business reaction it is necessary for us to proceed with heavy governmental expenditure, adding tremendously to public debt, we shall never regain control of our public finances. Both in policy regarding public spending and borrowing and in policy regarding excess reserves we appear to be throwing away all safeguards, removing all brakes, and heading for disaster.

**Assets as an Offset to Borrowing**

There is one other feature of the budgetary position of the Federal Government to which I would like to refer. In some quarters the doctrine has been enunciated that the Federal budget is really in balance because assets in the form of bridges and highways, public buildings, parks and other tangible things are being created as offsets to the growth of public debt.

From the beginning of the country down to 1929 the Federal Government hardly ever borrowed for the sake of erecting public works. The one conspicuous exception was the Panama Canal, which was a large undertaking in terms of our Federal budget of that time. In connection with the construction of that canal we authorized bond issues of upwards of $350,000,000, of which we actually issued some $135,000,000, so that even in that case current revenues paid most of the bill. But practically all of the rest of our public works, river and harbor improvements, peacetime naval construction, army posts, coast fortifications, postoffices, public buildings of all kinds, public highways and the like, we paid for out of current revenue, creating assets but not creating debts. This is the sound way to do it. The City of New York, obliged to pay for a new school building every year or two, should pay for it out of current revenue. A small village putting up a school house which it will not need to replace or add to for 25 years or 30 years, will be justified in borrowing in order to prevent too great a jump in tax rates during the year the building is being constructed. A great public building is no asset to the United
States Treasury. It is a liability, because it involves a further annual outlay for maintenance, upkeep and operation. The larger a Government unit, the less justification there is for borrowing for work of this kind.

The Pace Has Been too Fast

In his Message to the Congress the President says, "... that the Congress and the Chief Executive can ill-afford to weaken or destroy great reforms which, during the past five years, have been effected on behalf of the American people," and adds, "... the electorate of America wants no backward steps taken." I am entirely sympathetic with the objectives of many of the reforms to which the President refers. There were abuses in banking and in the security markets. There were abuses in the relations between commercial banking and investment banking.

But I believe that we have gone too far in important respects in the effort to correct abuses in these fields, notably in the regulation of the issue of new securities and in the regulation of the stock market. We have impaired normal functioning in the process of eliminating abnormalities. Our capital market is not functioning adequately.

Moreover, there are other very important instances where even with all sympathy for the objectives, it seems clear to me that we have gone too far or that we have used ill chosen methods. It is one thing to destroy a reform, but it is another thing to re-examine it in the light of its practical workings and to modify it to make it workable.

And I believe that in cases where clear mistakes have been made, as has been shown to be the case with the undistributed profits tax and the high rates in the tax on capital gains, "backward steps" are essential, and frank reversal of policy constitutes progress rather than retrogression.

I might add that reforms which, coming one by one, would be sound and helpful, can generate chaos if they come so quickly
that men cannot adjust themselves to all of them simultaneously. I think that nothing is more needed at the present time than a prolonged period of quiet, not a three to six months' breathing spell, but a two or three years' breathing spell, during which both Government and business can consolidate, modify and assimilate what has already been done, and during which also it will be possible to study quietly the basis of further reform.

One of the most difficult handicaps under which American industry has worked for the past several years has been the immense burden upon the time and energy of business and financial executives in adjusting themselves to the constant shifts of Government policy and attempting to forecast future shifts of policy. A great deal of thought and energy which should have gone into the problems of internal organization of business, of increasing efficiency, of finding markets for goods, of making comprehensive plans for expansion, and of the introduction of new technology, has necessarily gone into the question of what the Government is doing and is going to do.

It is not a wholesome business situation when the head of a factory is obliged to spend more time with his lawyers than he spends with his engineers, his treasurer and his sales manager. The architect is very unlikely to get an audience at all under such conditions. And the blueprint of a new invention, which in quieter times would have a chief executive's eager attention, finds itself covered under on the executive's desk by legal opinions on the consequences of recent legislation and reports on the prospects of proposed legislation. The pace has been too fast. We must pause, consolidate, modify, at points retreat, and adjust ourselves to the whirlwind changes which have already taken place.

If such a period of pause and quiet could be established, we have in the industries producing capital goods and equipment an immensely promising prospect of private spending.

As I have shown before, we have a vast arrearage in the production of capital goods, deferred maintenance, appalling
obsolescence, and a need in many lines for great expansion. If men can look ahead and make far-reaching industrial plans with assurance of stability in Government policy, great capital outlays will inevitably ensue. This will not cost the Government money, but, on the contrary, will create new income out of which the Government will be able to raise additional taxes—which we may devoutly hope will be used to reduce the public debt.
Sweden and the United States

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
Sweden and the United States

An Address by

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at a Banquet tendered to

THEIR ROYAL HIGHNESSES
THE CROWN PRINCE AND THE CROWN PRINCESS
OF SWEDEN

under the auspices of the

NEW SWEDEN TERCENTENARY COMMITTEE
OF NEW YORK CITY

at the Waldorf-Astoria Hotel

on Wednesday, July 6th, 1938
Sweden and the United States

Your Royal Highnesses, your Excellency Governor Lehman, your Honor the Mayor, other distinguished guests, Mr. Chairman, Ladies and Gentlemen:

Since the "Kungsholm" entered the Delaware, on June 27th, we have followed with great interest the newspaper accounts of the many festivities which have taken place in connection with the celebration of the New Sweden Tercentenary. It is a source of very great pleasure to everyone that His Royal Highness, the Crown Prince, has recovered from his recent illness and is able to be present tonight. If I may say so, our admiration has gone out to His Royal Highness, Prince Bertil, for the able and very charming manner in which he has represented his country during the absence of his illustrious father.

It is indeed a most happy occasion when two great democratic nations join together to celebrate the anniversary of an event of such profound significance in the development of an entire continent.

Although the small Swedish colony founded on the shores of the Delaware, in 1638, maintained its independence for only seventeen years, the influence of Sweden in this country has been increasingly important for three hundred years.

Sweden herself, although technically neutral during the War of 1776, was decidedly friendly to our cause, and a number of brilliant young Swedish officers participated in the campaigns of the Revolutionary Army.
Sweden was the first of the neutral countries to recognize the independence of the United States, and was the first nation to conclude a commercial treaty with this country. As early as 1783 Benjamin Franklin negotiated a treaty of “peace, amity and commerce” with Sweden, and this treaty, which contains our first statement of “the most favored nation” principle, became a model for subsequent commercial accords.

The colony of New Sweden was formed by a trading company whose primary purpose was to secure for Sweden a share of the West Indian trade. The original colonists came to seek their fortunes in the new world. During the early years, trading between Sweden and the American colonies was difficult and not particularly profitable, but even after the capture of New Sweden by the Dutch, and the subsequent domination of both by the English, trade continued to increase and the struggling colonies received substantial supplies of much needed raw materials from Sweden during the War for Independence.

Swedish Immigrants in America

After the Revolution, immigration to this country from Sweden was practically negligible until about the year 1840. At that time the tide of immigration began to flow more strongly, and it has continued in substantial volume until very recent years. These new immigrants, like their predecessors, came to America for the purpose of creating new homes and achieving a better economic status for themselves and their families. Almost all of them were farmers. They did not remain along the Atlantic seaboard, but moved westward to the rich farmlands of Illinois, Kansas, Wisconsin, Minnesota and the northwest. Many of them worked on the railroads and roads which were at that time being constructed for the pur-
pose of making possible the development of the territory where they wished to live. Some became lumbermen and others went into skilled crafts, such as furniture making and construction, but the great majority continued to be farmers. Minnesota was especially adapted to development by these active and industrious men. It was not unlike Sweden itself in climate and resources, and large numbers of immigrants settled there.

According to the last census there were over one and one-half million first and second generation Swedes in America in 1930. More than half of these lived in the north central states; namely, Illinois, Minnesota, Michigan and Nebraska. Today Chicago, with its suburbs, is the third largest Swedish city in the world, having two hundred thousand Swedes.

It is not surprising, in view of our intimate relations, that American interest in Swedish institutions and the Swedish way of life has always been keen. In recent years this interest has been greatly stimulated by Sweden’s rapid and almost spectacular economic recovery from the world-wide depression of 1929.

It has often been said that Sweden is the outstanding example of a socialistic country; of a “controlled capitalism”; of a “planned economy” that works. The question is often asked, if Sweden can “manage” her economy so successfully, why can’t the rest of the world do likewise? It is a challenging thought. Volumes have been written on the subject in recent years and these volumes have been avidly read by the American people.

An examination of the facts, however, makes it clear that Sweden’s economic life is not nearly so “controlled” nor so “planned” as most of the protagonists of economic management would have us believe. Perhaps after all they have mistaken the shadow for the substance.
Liberty and Individualism in Sweden

The Swede is essentially an individualist, with great vitality and ability to work. He has a highly developed sense of personal rights, a strong respect for law and order, and an innate love of freedom. The Swedes have been a free people for more than two thousand years. Liberty is a necessity for them; they could never be satisfied with anything else.

Gustavus Adolphus, in laying the plans for the founding of New Sweden declared that the colony should be an asylum for the oppressed of all nations; a free state where all should have equal rights and enjoy to the fullest extent possible the fruits of their own labor.

I have mentioned this traditional love of freedom on the part of all Swedish people, because it is a trait which Americans and Swedes have in common. I have also mentioned it because in view of this national characteristic it is almost impossible to believe that the Swedish people would elect to live in a regimented economy where individual effort and thought are thwarted at every turn by authoritarian decrees and governmental "red tape." A careful analysis of Sweden's so-called "recovery program" corroborates this view. The high level of industrial activity attained by Sweden in recent years has not been due to governmental economic "management," but rather it has been due to dynamic economic forces inherent in an expanding industrial economy. It came as the result of favorable world price movements, of expanding foreign trade, of a rising trend of industrial expansion, and above all, of increasing productivity of labor and capital.

Sweden's Monetary Policy

A fallacy that has wide currency in the United States is the belief that Sweden's enviable prosperity during the
last few years is attributable to her monetary policy. The notion is advanced that Sweden deliberately "went off gold" in order to halt the deflation; that she has successfully stabilized prices; and that as a result the depression has been routed and prosperity recreated. All of these claims are unjustified in the light of actual facts.

In the first place, Sweden did not voluntarily abandon the gold standard; she was forced to suspend gold payments because England did. Swedish bankers tried to secure a stabilization loan in New York just before the krona was severed from its gold base. The loan could not be secured at the time because of the general pressure on the world's money markets.

In the second place, prices were not "stabilized" by these monetary measures. After Sweden abandoned gold, prices of domestic goods, and goods destined for export, continued to fall. The only prices that rose were those of goods imported from gold-standard countries. The apparent stability of the Riksbank's index of consumption during this period was due to the rise in the prices of imported goods which offset the fall in domestic prices. It can hardly be claimed that this was an advantage to the Swedish people, as they had to pay more for the goods they bought while they received less for the goods they sold.

Recovery did not become evident until the middle of 1933, when Swedish exports began to increase. The recovery stimulus thus came not from internal monetary management, but from world demand.

**Pump-priming and Balanced Budgets**

Another misconception prevalent in the United States is that our Government, in recent years, has followed a budgetary policy similar to that of Sweden's. Swedish
fiscal policy has been cited as proof that government pump-priming is an effective yet innocuous sure-cure for depressions.

As a matter of fact very few Swedish economists make the claim that the budgetary deficits were responsible for turning the business tide. It is generally conceded that extraordinary governmental expenditures for public works did not get under way until 1934; but by that time business recovery had already been initiated by the increased foreign demand for Swedish goods and was forging ahead at a rapid pace.

What is even more significant, however, is that the fiscal philosophy that budgetary deficits are good in themselves was never subscribed to in Sweden. The policy of restricting governmental borrowing to the financing of productive enterprises has been a firmly established tradition. As a result, the Swedish nation has never been burdened with a large public debt incurred for non-productive purposes. When the decision was made, therefore, to allow a budgetary deficit for a few years in order to provide the necessary funds for the alleviation of unemployment, it was only with the determined understanding that the budget would be balanced during the ensuing years of prosperity. The loans were short-term loans. It was provided that the government obligations floated in 1933 and 1934 should be repaid within the next seven years.

Since recovery proceeded faster than had been anticipated, the loans were actually repaid within four years. By 1935 the budget was in balance, and by July 1, 1937, final liquidation of the short-term loans was completed. The total budgetary deficits incurred during the four depression years (the fiscal years ending June 30, 1932 to 1935) amounted to 330 million kronor (or $84,150,-
000). More than a third of this amount was covered by surpluses that had accumulated during the two preceding years of prosperity. The remainder has been made up out of Treasury surpluses amassed during the three fiscal years 1936 to 1938, inclusive\(^{(1)}\). Apparently, the ideal of a balanced budget is still in vogue in Sweden.

Swedish pump-priming has differed in yet another respect from ours. Sweden has a healthy fear of inflation—well remembering the devastating effects of post-war experience with a depreciating currency on her close neighbor, Germany. As a result, Sweden has avoided the dangers of bank credit inflation, which come about when bank credit is created in large quantities for the purchase of long-term government obligations.

**Wages, Hours, Prices and Tariffs**

In addition, Sweden's public works program was so planned that it did not compete with private industry for skilled labor, nor prevent the lowering of those wage rates which were found to be too high. Wages on public projects were kept slightly below the levels prevailing in the same locality for the same kind of work.

While speaking of wage rates and labor policy, it is significant that in Sweden the advance in wage rates did not outrun the advance in prices. An index of real wages compiled by the International Labor Office, which relates changes in wage rates to changes in the cost of living, indicates that in 1936 (the latest year for which comparable data are available) real wages per hour in Sweden were 7 per cent above their 1929 level. In the same year, in the United States they were 23 per cent above their

\(^{(1)}\) Annals of the American Academy of Political Science, May, 1938, pp. 34 and 63.
1929 level\(^{(2)}\). May not this disparity have some bearing on the fact that by December of 1937 the index of industrial production in the United States had fallen to a point 30 per cent below its 1929 level, while in Sweden industrial production was 53 per cent above its 1929 average? The relation between these two sets of facts may not be one of cause and effect—but it is hard to believe that the sequence of events was purely coincidental.

It is also of interest to note that in Sweden the prevailing work-week is one of 48 hours. There have been no demands for a 30-hour week, nor even a 40-hour week there. According to one of Sweden’s outstanding economists, "the working people understand that a reduction of the working time would seriously reduce the volume of output and hence the capacity of industries to pay high wages."\(^{(3)}\)

Another vitally important factor that has contributed materially to Sweden’s recent recovery has been her very moderate tariff system. Since Sweden’s exports were in demand and at the same time her imports were varied and obtainable in many places, Sweden could have erected high tariff barriers in order to fortify her industries against the threat of foreign competition without fear of any serious reprisals. But Sweden did not resort to any such short-sighted policy. Realizing that a country must buy in order to sell, Sweden refused to try to palliate her temporary difficulties by trade strangulation.

Partly due to Sweden’s devotion to the principles of international exchange, Swedish prices have been much more flexible than they otherwise might have been. Monopoly prices cannot well be maintained in the face

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\(^{(2)}\) *International Labor Review*, April, 1938, p. 526.

\(^{(3)}\) *Annals of the American Academy of Political Science*, May, 1938, p. 3. Article by Bertil Ohlin.
of international competition. The co-operative movement has also been an important factor in breaking up cartels and trusts which maintained prices at unjustifiably high levels. And here again we run into another popular American illusion. It is usually thought in this country that the co-operatives in Sweden dominate industry and trade, whereas the truth of the matter is that only approximately 10 per cent of all manufacturing and 20 per cent of retail and wholesale trade are carried on through co-operatives\(^4\). Furthermore, the co-operatives are not subsidized by the State, but function on a business basis, paying dividends to their shareholder patrons. This marginal competition from the co-operatives serves to keep prices of goods as low as possible, thus passing along to the consumer the benefits of improved technology and managerial efficiency.

**Sound Basis of Swedish Prosperity**

Time does not permit further amplification of this analysis of the probable causes of Sweden's recent outstanding recovery record. Enough has been said, I believe, to substantiate the conclusion that the principles of economic liberalism are still very much alive in Sweden today. Fundamental economic truths have not been disregarded by either labor, or capital, or the Government.

Sweden, in fashioning her recovery program, did not embrace such panaceas as economic nationalism, inflation or curtailment of production—panaceas which history and experience have proven to be but cruel delusions. The basis of Sweden's prosperity has been international trade and ever-increasing national productivity. That is the real lesson in economics taught by the Swedish "experiment."

\(^4\) "Sweden; the Middle Way," Marquis W. Childs, New Haven, 1936, p. 16.
A Homogeneous Population

But there is also an important political lesson. The Swedish Government is free from many of the political difficulties which handicap our Federal Government when it undertakes to deal in an intimate way with the economic life of the people. Sweden is a small country, with a homogeneous population. Sweden has an area (173,000 square miles) a great deal smaller than that of Texas (266,000 square miles) and a little larger than that of California (158,000 square miles). She has a population of 6,200,000, which is just a little larger than that of California (5,825,000 in our 1930 census). With the exception of about 40,000 people, all the inhabitants of Sweden belong to the same race. The people are almost all of one religion. This racial and religious homogeneity means that many of the conflicts which enter American political life do not exist in Sweden. Where the whole population has so much in common, political differences are much more likely to be upon an intellectual rather than upon an emotional level.

Further, half of the people of Sweden are on farms. There are only three cities with a population of more than 100,000, and the largest of these (Stockholm) has only a few more than half a million. The ancestors of the present population of Sweden for generations have lived together, and have shared a common political and social tradition. It is, therefore, possible to have wiser political planning in connection with economic life in Sweden than would be possible in a country less homogeneous.

Moreover, a small state can work out political control of economic life far better than a vast country can. The Swedish Government and the Swedish Riksdag are as intimately acquainted with the problems of the whole country as the Governor and Legislature of an American
State would be with the State problems, and very much more intimately acquainted with detailed local needs than the ablest Congress and the ablest Federal Administration could possibly be in the United States.

The three small Scandinavian countries, each sovereign and independent, co-operate for certain purposes. During the Great War, it was understood that they worked in concert to protect their neutrality and their neutral rights. But they represent a superb demonstration of the ability of small states to handle the intimate affairs of their own economic life far better than a great central government can do. I would say that one of the most important lessons which we can draw from Swedish experience is that we must protect the powers of our States, and preserve the limitations on the powers of the Federal Government as provided in our Constitution.

**Swedish Contributions to America**

But this consideration of the influence of Sweden as a nation upon our current economic and political thought does not help us to evaluate the tremendous contribution which has been made since the founding of New Sweden by men and women of Swedish origin and descent, to the intellectual, spiritual and material development of this nation. To appreciate fully what they have accomplished through the years in moulding the character and upbuilding the prosperity of important sections of our country, would require an intimate knowledge of the lives of hundreds of thousands of hard-working but inconspicuous individuals, which no one could hope to achieve. To obtain some degree of understanding, however, of the importance of the influence of Sweden in the past upon our culture, one may perhaps be permitted to refer to a few outstanding individuals as typical of the rest. It will
hardly be necessary for me to do more than mention the names of these men and women for you to see why this influence has been so disproportionately great in comparison to the small number of Swedes who have come to our shores.

As one looks backward over the intervening years, what an extraordinarily romantic group one finds to choose from! One hardly knows how to select from such a remarkable assemblage. Tonight I think that I will first remind you of that afternoon in 1850, when Jenny Lind, already known to the music lovers of the world as the "Swedish Nightingale," drove from her steamer to the Irving House, while "handkerchiefs waved from balconies and windows, and flowers rained down on her carriage." Even now our imagination can picture that evening a few days later when, at Castle Garden, she received a tremendous ovation and was acclaimed the greatest artist of her time. One would have thought that never again could such an event be repeated, but it was only a few years later that another great Swedish singer, Christina Nilson, received a similar ovation in old Steinway Hall. The impression which these two beautiful and gifted women made upon our public, not only because of their genius, but by reason of their charm, sweetness and generosity, has lasted undiminished to this day. These great artists were simply the beginning of a long series of singers, musicians and actors and actresses of the stage and screen which Sweden has bestowed upon us to the enrichment of our artistic culture.

To illustrate what Swedish-Americans have accomplished in the field of engineering, I would like to say a few words about one of the most dramatic scenes in our history. Our nation was at war, and a great crisis in the war had arrived. It was in the morning of the ninth of
March, 1862. One of the most powerful squadrons of ships of war this country had ever assembled was lying in Hampton Roads. Unfortunately these ships of war were built of wood and carried the light and somewhat primitive ordnance which had been in use in all the navies of the world up to that time. The day before, the Confederate ironclad "Virginia," reconstructed from the hull of the old United States frigate "Merrimac" and generally known by the latter name, had come out from Norfolk, and impervious to every attack which could be made upon her had sunk or captured two of our finest ships. The only thing which had saved the remainder of the Federal squadron was the coming of night.

It seemed at the time that nothing could prevent the destruction then and there of the sea power of the North. But you all know the story. When the "Merrimac" left her anchorage that morning and approached the Federal ships, there advanced to meet her, from behind the wooden men-of-war, that diminutive "cheesebox on a raft" which had arrived from New York the night before, the Federal ironclad "Monitor." There ensued that encounter which was destined to save control of the seas for the United States Navy, and to change the entire course of naval history. The design of that ship, the revolving turret which carried her guns, the raft-like structure which bore it, and the screw propeller which drove her, were the creations of the genius of a Swedish engineer, John Ericsson, and the new type of heavy guns she carried, which so shattered the armor of the "Merrimac" that she was obliged to withdraw, was designed by another great engineer of Swedish descent, Admiral John Dahlgren of the United States Navy. Other engineers and inventors of Swedish descent have made great contributions to the economic and industrial development of this country. For example, DeLaval and the brothers
Ljungström, of the steam turbine, and Dalen of the automatic beacon, but I do not think it is too much to say that the work of Ericsson and Dahlgren, that morning on the calm waters of Hampton Roads, saved the Union.

Another of the great contributions which have been made to us by the Swedes is in connection with the development of our merchant marine. All of us, especially those who have engaged in the sport of yacht racing, know what splendid sailors the Swedes are, but there is one man who, to my mind, exemplifies better than anyone else these fine qualities of seamanship. In the fall of 1926 the British freighter “Antinoe” was lying disabled in one of the worst gales the North Atlantic has seen in a generation. Her SOS was answered by the “President Roosevelt” of the United States Lines. On her bridge stood an American seaman of Swedish descent, named Captain George Fried. For three days and nights the “President Roosevelt” stood by the “Antinoe,” while her captain used every device known to seamanship to rescue the crew of the freighter. Again and again the “Antinoe” was lost sight of in the mountainous seas and driving rain, and in the darkness of night, and again and again Captain Fried, with inexhaustible skill and tenacity, picked her up. At last the gale abated sufficiently for a boat to be launched and the crew of twenty-five was taken off the sinking vessel.

Captain Fried was given command of a larger ship, the “America,” and only three months later he was again the hero of perhaps the most brilliant rescue ever made at sea. In the midst of a full gale the “America” answered the SOS of the Italian freighter “Florida.” When the “America” arrived on the scene the “Florida” was in a sinking condition and darkness was about to fall, but through his skill in maneuvering his ship Captain Fried
was able to get a boat away which reached the "Florida" and brought back her entire crew of thirty-two before the "Florida" went down. You will remember that on his arrival in New York Captain Fried was presented with a gold medal by the Mayor at City Hall.

I will mention only one other great American of Swedish descent. He is in himself the embodiment of all the virtues which the Swedes have brought to us. The scientific and inventive mind, that indefinable quality which has been referred to as "imaginative realism," the technical and practical skill, the courage, fortitude and tenacity, and the modesty which is characteristic of the race, are all found in him. I refer, of course, to Colonel Charles A. Lindbergh, whose career, I believe, has kindled the imagination of the American people more than that of any other man of our time.

I could speak to you of other soldiers, sailors, doctors, lawyers, writers and educators almost without number, but there come to my mind the words of the Apostle Paul, in the eleventh chapter of the Epistle to the Hebrews, and with these words I will bring to a close an address which has already become too long. After enumerating the fruits of faith in the old time the Apostle says:

"And what shall I more say? for the time would fail me to tell of Gedeon, and of Barak, and of Samson, and of Jephthae; of David also, and Samuel, and of the prophets:

"Who through faith subdued kingdoms, wrought righteousness, obtained promises, stopped the mouths of lions,

"Quenched the violence of fire, escaped the edge of the sword, out of weakness were made strong, waxed valiant in fight, turned to flight the armies of the aliens."
The University as an Instrument of Social Progress

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
The University as an Instrument of Social Progress

An Address by

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

on the Occasion of the Fortieth Anniversary and Dedicatory Exercises of

NORTHEASTERN UNIVERSITY
BOSTON, MASSACHUSETTS

on Monday, October 3, 1938
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The University as an Instrument of Social Progress

I am deeply appreciative of the honor which has been conferred upon me by the invitation to be one of the speakers on the happy occasion of the Fortieth Anniversary of Northeastern University. This anniversary is particularly significant in the history of the University because it has been marked by the completion of the first unit of your comprehensive new building program. I am very happy to have had the opportunity of being present this afternoon at the impressive ceremonies in connection with the dedication of this building, and I was particularly interested in the thoughtful and illuminating address of President Compton on the instruments of social progress, because the subject I would like to discuss with you this evening is the opportunities and responsibilities which today lie before one of the most important of these instruments—the American university.

It may perhaps occur to you that it requires a certain amount of temerity for a banker to appear before a distinguished gathering of scholars such as this with the purpose of considering a topic which involves the whole field of higher education.

I must confess that I would not myself have had the courage to undertake the task if I had not come to the conclusion, after long and serious consideration, that one of the things which is most necessary today for the good of our country is the constant and intimate exchange of
views by business men, bankers and others engaged in the active conduct of our enterprise system on the one hand and the scholars and teachers in our universities on the other, with regard to the infinite variety of questions with which they are mutually concerned. It is indeed my hope that instrumentalities may in the near future be set up in our universities through which such discussions may take place, to the end that the business man may achieve a measure of the objective and scientific point of view of the scholar, and that the scholar and educator may understand more fully the purposes, aspirations and problems of the business man.

The Basic Services of Our Universities

America is distinguished above other countries for the number and the quality of its universities. These universities have received generous support from grants of public funds and through endowments from private sources. The American people depend upon the university, and they have come to look to it, for certain definite services. I think these services may be stated as follows:

First, our universities are repositories or storehouses of learning, where, in libraries and museums, the knowledge and art which mankind has accumulated and created through the centuries are available for study and inspiration.

Second, our universities are centers where scholars and students may gather together for research in every field.

Third, our universities provide education in the professions and in all of the higher fields of learning.

These varied functions of the universities present an infinite variety of opportunities for service, and every one of them is worthy of serious study to make certain
that the methods and techniques being used are the best which can be evolved from time to time to accomplish the desired purpose.

But I am not planning tonight to talk to you about the university as a repository of knowledge or as a place for research, nor to discuss with you the teaching of the exact sciences such as chemistry or mathematics, or of the arts such as architecture and painting, or the teaching of professions such as engineering or medicine or the law. The precise subject which I would like to discuss with you tonight is the opportunity which the American university has, and the obligation which it must accept, of creating a new type of leadership which is essential if we would perpetuate and strengthen the American system of democracy.

Two Systems in the World Today

The nations of the world today are divided into two groups. On the one hand stand the democracies, with their governmental systems based upon the conception of liberty for the individual and equality and fraternity among all citizens, their economic systems based upon free enterprise actuated by the profit motive and operating through free markets; and on the other hand stand the great authoritarian states whose governmental systems are based upon the conception of the supremacy of the state and the absolute regimentation of the individual, whose economic systems are completely planned on the basis of state socialism or state capitalism. There is no possible compromise ultimately between the conceptions underlying the democratic and authoritarian systems.

In the United States we hold tenaciously to the democratic conception. We believe in the liberty of the individual, in the equality of all men before the law, in the essential fraternity of mankind. By these principles we test not only the laws of Congress and the state legisla-
tures, the actions of the federal and state executives, but also the standards of conduct which govern our individual lives. Devotion to these principles lies deep in the heart of every American, and any threat which promises to nullify them arouses uncompromising opposition, provided the threat is recognized and understood.

The fact is, however, that despite the patriotism of the American citizen and his devotion to democracy, collectivist tendencies have been increasing in this country, largely because they have been unnoticed or misunderstood by the majority of our people. Economic and social conditions have been ripe for such a trend. Even now, twenty years after the close of the great war, the nations that were engaged in it have not yet succeeded in clearing away the economic wreckage of those four years of conflict.

**Historical Changes and New Problems**

In America, in addition to the disturbances directly attributable to the war, we have been obliged to face many other economic and social changes which have complicated our readjustment. One of the most striking of these was the disappearance of the old frontier. We have not yet fully accustomed ourselves to getting along without it. The old frontier had served us well for over a century, and provided a ready outlet for those adventurous elements in our population who wanted free scope for their abounding energies. It also opened fresh opportunities for those others who wanted to make a new start. With no frontier, no free land, no boom cities surging upward and outward with the inrush of new inhabitants, we had reached the stage at which development had to come from within. No one knows better than President Compton and none realizes more clearly than this audience, what great things we have achieved in this process of internal development, construction, invention, and
production. It has been a stupendous performance with few counterparts in history. We sometimes lose sight of the magnitude of this performance in the welter of present confusions.

The growth and flowering of America is one of the great sagas of the world. Our ancestors accomplished it under a system of free enterprise, deeply founded in the principles of democracy. This is so much a truism that I fear many of us have taken our freedom for granted and have rested on the easy conviction that liberty in America is so deeply rooted that it cannot be undermined. Is it not true that many of us in these recent years, happily assuming that our liberty is safe, have unconsciously bartered some phase of it for what we conceive to be security? Our ancestors struggled through centuries to achieve our liberties, and for my part I do not believe the people of America will ever consciously surrender them.

Training Men and Women for Democracy

This brings me to that function of the American university which I conceive to be the most vital service it can perform to the people of America at this time and in the years immediately ahead of us. The high function of the American university is to educate men and women for democracy. This means that it must provide its students with the intellectual and spiritual power to guide their own actions and test the actions of their elected governments by the highest standards of democracy.

This educational program has two distinct objectives. The first is the training of the future scholars, professional men and business leaders of the country so that they will have a vivid sense of personal responsibility for the public interest. In this complex world everything a man does necessarily affects, for good or evil, the lives
of those about him, and the more important the position he holds, the greater is this effect. In every field, whether in business, in the professions, or in politics, the price of power is responsibility for the public good.

Much can be said on this purely personal side of a university's training. The instruction which a university gives puts sharp tools in the hands of its graduates. The better they learn to use those tools, the greater the place they can take in the life of the nation. And unhappily, too, the greater the damage they can do to the public good if they have not learned to use their tools wisely.

Horace Mann, whose spirit is still alive in Boston, wrote these words in an eloquent plea for the development of character:

"The experience of the ages that are past, the hopes of the ages that are yet to come, unite their voices in an appeal to us; they implore us to think more of the character of our people than of its numbers; to look upon our vast natural resources, not as tempters to ostentation and pride, but as means to be converted, by the refining alchemy of education, into mental and spiritual treasures—and thus give to the world the example of a nation whose wisdom increases with its prosperity, and whose virtues are equal to its power."

When he wrote those words Horace Mann must have foreseen the vital need we now have for university graduates who are not only good technicians in their chosen fields, but also are deeply conscious of their responsibility for the public good.

The inculcation of a sense of social responsibility is one phase of the double problem of education for leadership in a democracy. The other phase has to do with
giving to such prospective leaders a scholarly understanding of the relations between government and economic life in a democracy.

Private Enterprise Versus Planned Economy

The system of private enterprise is essential to democracy. It is impossible to think of a democratic system which does not provide for individual initiative with its personal rewards and its personal penalties. I am no advocate of the doctrine of *laissez faire*, for after all, that doctrine has not been permitted to operate entirely without controls at any time. I am convinced that the enterprise system, subjected to enlightened controls from within itself, and responsive to the broad demands of the public interest, is inseparable from democracy. Neither can exist without the other.

The enemy of the enterprise system is planned economy, just as the enemy of democracy is authoritarian government. As a matter of fact, and I call to witness the examples of authoritarian governments now operating in the world, a planned economy cannot function except under an authoritarian state. Whether the converse is true, that an authoritarian system cannot function without a planned economy, I do not know; and perhaps the answer is of theoretical interest only. But if by planned economy we mean an economic system subject to control by government down to the smallest detail of economic life, then the examples before us do show that they are inseparable.

Let me go one step further. No planned economy is possible without economic nationalism. One necessarily implies the other. I think you will agree with me, that to identify the economic system of a country with its national government, vastly increases the hazards of war.
If we are to throw the mantle of national dignity around the commercial activities of a country, we cannot avoid investing every international commercial dispute with the sinister aspect of a dispute between the governments of nations. Moreover, since a planned economy exerts its primary and most profound influence within national boundaries, frontiers necessarily assume greatly augmented importance. It is for these reasons, among others, that many believe that planned economy is the handmaiden of war.

Now, between a rigid system of planned economy and the flexible system of free economy such as we had, for example, in the early years of this century, there is a vast field within which controls by government can be exercised. No one will say, I think, that we can turn the calendar back to 1910; and few would say we should turn it back if we could. Times have changed too much, thought has changed too much, the emotions and desires of men have changed too much. If I read the signs of recent times aright, public regulation of private enterprise is not going to be suspended. But is there any reason why we should venture into extensions of public regulation without determining to the best of our technical ability, first, whether it is necessary—that is to say whether the result cannot be achieved by voluntary action—and, second, whether it will work or not, whether it will achieve the social objectives for which it is designed, and especially whether it will be exercised at the cost of our hard won liberty?

A Vital Question Before the People

The most important question before the American people today is this: To what extent is it desirable, in particular fields or more generally, for the government to exercise controls over the enterprise system? It goes
without saying that if the controls are to work to the benefit of the country, the remedies must not be worse than the ills they are designed to correct. It goes without saying, too, that the controls must accomplish their social objective without the sacrifice of essential liberties which are basic to a system of free enterprise operating in response to the profit motive and functioning through free markets. The normal incentives to enterprise and production which have been so long native to our race must not be destroyed, whether by governmental regulations, governmental competition or such unmanageable governmental expenditures as will result in either an impossible tax burden or bankruptcy of the government. Otherwise, as one corrective succeeds another, and remedies are devised to offset the ill effects of other remedies, we gradually are drawn into collectivism, an alien system repugnant to our deepest convictions.

As I have tried to point out to you this evening, the American university can render its greatest service to the American people today if it will turn out prospective leaders with a sense of social responsibility and a discriminating understanding of the relations between government and our economic life. In this connection these words of President Emeritus Lowell are singularly appropriate:

"The great need of the present day is wisdom, the calm, unimpassioned search for enduring truth, not so much concerned with immediate action as with the slow adjustment of human relations. During the World War one thought of the moon shining upon the pale faces of the dead on the battlefield—faces of young men who would have been the thinkers and statesmen of the future, killed by conditions which neither they, nor perhaps anyone else, could have controlled. They are
gone, and how much may have been lost to the world with them we shall never know, for they were among the choicest of their kind.

"Where shall wisdom be found and where is the place of understanding? Surely it should be where the pressure of interests is lowest, where passions should be least inflamed, where men are most free to think and write their own thoughts, where the anxieties of the present do not exclude the contemplation of the past and drawing therefrom a horoscope of the possibilities of the future. These conditions ought to be most nearly fulfilled in our universities, colleges and other seats of higher learning, so far as they are free from political and financial pressure; and in the experience of the writer they are in this country far more free than is sometimes supposed. The cases of interference with the expression of opinion have been rare, and have been met with the kind of protest that shows how rare they are. Such an institution lives not for its day alone, but to train future pilots, and for the light it may give to those who must navigate shoals where others have been wrecked."

**Practical Co-operation Needed**

If the American university is to render the services to which I have referred there must be more direct understanding by the scholar of the day-to-day practical problems of business. Scholarship working through research is already equipped with a vast mass of factual knowledge, but answers to problems of this magnitude are not to be found in statistics or mathematical computations alone. If the answers are to be useful they must be tested by the experience and judgment of men engaged in operating the enterprise system as it exists.
I am a firm believer in this form of co-operation between business, the professions and the university. The practice has already been established in one or two centers. Its success depends upon the quality of mind that each of the participants brings to bear on the questions discussed, his willingness to seek out and consider all of the facts and to test a proposed program by its workability, his sympathy with the aspirations of the people for social betterment, and his devotion to the ideals of democracy.
The Effect of
Easy Money Policies
On
Savings, Savings Institutions, Insurance
Companies, Endowed Institutions
and Commercial Banks

WINTHROP W. ALDRICH
Chairman Board of Directors

THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
The Effect of Easy Money Policies
On Savings, Savings Institutions, Insurance Companies, Endowed Institutions
and Commercial Banks

An Address by

WINTHROP W. ALDRICH
Chairman Board of Directors
THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at the Annual Convention Dinner
of the Field Managers of the

METROPOLITAN LIFE INSURANCE COMPANY

at the
HOTEL WALDORF-ASTORIA
NEW YORK CITY

Saturday, May 27, 1939
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The Effect of Easy Money Policies
On Savings, Savings Institutions, Insurance Companies, Endowed Institutions and Commercial Banks

During the past six years, the United States has followed easy money policies that have been unprecedented in scope and intensity. The monetary authorities have subordinated every other consideration to this end. Qualitative standards in bank portfolios, the return paid to those who are thrifty, university income, the yield on endowment funds have all been sacrificed that this goal might be realized. Although easy money policies in a mild form have on occasion in the past been followed in this and other countries, it is safe to say that never before has there been such a concentration of measures towards this single goal.

Meaning of the Term “Easy Money Policy”

The phrase “easy money policy” is an omnibus term used to cover a twofold objective. From a financial point of view, an easy money policy is designed to lower rates of interest. From a somewhat broader point of view, although closely allied to the first objective, it is designed to raise commodity prices. The concept thus is a very broad one, including nearly all phases of monetary policy and practice. In my discussion I would like to lay particular emphasis on the effect of such policies on savings, savings institutions, insurance companies and endowed institutions, digressing briefly to consider their effect upon the larger commercial banks.
The Implementing of the Easy Money Policies

The measures employed to realize the twofold objective, the reduction of rates of interest and the raising of commodity prices, were those which would increase the reserve balances of member banks. It was recognized that, as these exceeded legal requirements, interest rates would decline and commercial banks, in order to cover their operating costs, would be forced to seek new outlets for their funds. In consequence, it was argued, business activity would be stimulated and commodity prices would rise.

Open-Market Operations

The initial means employed to increase member bank reserve balances consisted of open-market operations on the part of the Federal Reserve banks. Immediately following the stock market collapse in 1929, the Federal Reserve banks purchased $375,000,000 of Government securities. Through 1930 and 1931, the total was gradually increased by another $292,000,000. Through April, May and June, 1932, securities were purchased on an unprecedented scale and the total was raised by $1,000,000,000. A further increase of approximately $600,000,000 occurred in 1933. These purchases raised total holdings to $2,430,000,000 and with the exception of a relatively slight increase in 1937, the total volume of Government securities held by the Federal Reserve banks has not changed since the end of 1933. For nearly six years the Federal Reserve banks have played a passive role in the money market; other factors have operated to increase reserve balances.

Silver Purchases

Another means employed to lower rates of interest and to raise commodity prices has been the issuance of silver
certificates. Since January 1, 1934, nearly two billion ounces of domestic and foreign silver have been purchased at artificially high prices and approximately $1,300,000,000 of silver certificates have been issued.

The Increase in the Gold Stock

Quantitatively, the most important factor affecting member bank reserve balances over the past five years has been the rapid increase taking place in the monetary gold stock. Since January 1, 1934, the increase has amounted to nearly $12,000,000,000. Of this huge total, about 70 per cent is accounted for by imports and the balance by domestic production, by sales of scrap gold to the Treasury, and by the so-called "profits" of gold devaluation.

It is difficult to appraise the exact effects of the devaluation of the dollar upon the gold inflow. It is doubtless true that, in the absence of devaluation, a large amount of gold would have been received from Europe. The fear of Europeans with regard to their currency and with regard to the political situation would in any case have caused a large flow of capital to the United States.

Even granting that such would in any event have been the case, the importance of devaluation must not be underestimated. It gave rise to the "profits" of gold devaluation. It has meant that the gold received has been taken into our monetary system at $35 an ounce instead of at the old buying price of $20.67 an ounce. In subjecting the French and other monetary systems to great pressure, it has contributed to the flight of capital to this country.

Increase in Reserve Balances

The easy money policies adopted, i.e., the purchase of securities by the Federal Reserve banks, the issue of silver certificates, and gold devaluation together with the
gold imports have raised member bank reserve balances to $10,097,000,000. Despite administrative increases in reserve requirements, despite increases in required reserves resulting from the increase occurring in member bank deposit liabilities, and despite a rapid increase in the volume of money in circulation, excess reserves now amount to $4,300,000,000.

It must not be assumed, as some have alleged, that these excess reserves represent savings of the people of the United States and that in consequence, the decline in interest rates is justified. It must be borne in mind that the increase in reserves has resulted largely from imports of gold, which themselves were the result of the inflow of refugee capital. This capital will not remain here indefinitely. Should the political atmosphere in Europe become less tense, it can be assumed that a large amount will return. Funds will flow back to be employed more profitably at home. The return flow of refugee funds will prompt an outflow of gold and the gold stock of the world will be redistributed as political sanity is restored. Member bank reserves will decline. To base long-run monetary policies on member bank reserves, which have grown on the basis of an inflow of "hot money" rather than on the basis of savings, is to court disaster.

The Purchasing Power Theory

Part and parcel of the easy money thesis is the doctrine that the present depressed state of business activity is the result of a deficiency in consumer purchasing power. In consequence it is argued, fiscal deficits must be incurred, great public works projects must be undertaken, and Federal expenditures must be on a lavish scale in order to increase such purchasing power. Some even assert that deficits must be permanent in order to rescue our econ-
omy from what they allege is permanent stagnation. In my opinion such doctrines are simply the theories of John Law in modern dress. Purchasing power consists not of fiat money or of fiat credit but of goods and services produced. Instead of following some Pied Piper of false monetary doctrines, governmental activity should be directed towards increasing the sum total of goods and services, which alone constitute real national income.

Assumptions of Easy Money Advocates

It was assumed by the advocates of the easy money thesis that the reduction in rates of interest, accompanying the increase in member bank excess reserves, would stimulate business activity. Businessmen would be induced to borrow, the construction industry would be stimulated and the capital market revived. It was assumed, too, in consequence of the increase in the price of gold and silver, and the increase taking place in bank credit, that commodity prices would rise. Price indices were to be restored to what was considered a "normal level."

Goal of Easy Money Advocates Not Achieved

How far these policies have fallen short of announced goals is well known. Business activity continues at a low ebb. The capital markets have not experienced a strong revival. The commercial loans of banks remain disappointingly low. This situation, of course, is but proof of the old adage that businessmen will not borrow despite low interest rate levels, unless attendant circumstances are such as to inspire them with confidence regarding future business prospects.

Moreover, the policies adopted have not had the effect upon the commodity price level anticipated by the easy
money advocates. The reason is that sharp price increases can result only from a business boom based on confidence, or from a growing fear of the currency sufficiently intense and widespread to prompt a flight from the dollar into commodities.

The fact that commodity prices have not risen as much as the easy money advocates had expected must not make us complacent as to the future impossibility of rapid price increases. The potentialities of a sharp credit expansion and price increase are present. Budgetary deficits cannot continue indefinitely without eventually causing a widespread lack of confidence. Existing excess reserves would permit a credit expansion of huge proportions. The setting has been provided and if psychological attitudes change, a sharp price increase could occur.

Effect of Policies on Rates of Interest

Up to the present time the principal effect of the easy money policies has been on rates of interest and the decline that has taken place is too well known to demand statistical evidence. The first decline occurred in open-market interest rates in New York City, which are always the most responsive to changes in monetary policy. The decline in these was followed by declines in the yields on Government obligations and in the rates charged by banks in the larger centers to their borrowing customers. Gradually the decline in interest rates has spread to other lending markets and to other parts of the country until all types of loans and investments have been affected.

Nothing can be so beneficial to a country as a decline in rates of interest, provided that this is the consequence of an increase in real savings. It gives evidence of an accumulation of wealth, of thrift and of solidity in society. Such were the forces present in the rapid decline
in rates of interest that took place in the 70's and 80's of the last century. This decline reflected an increase in savings, resulting in no small measure from a growing confidence in the currency, that itself arose from a cessation of Civil War inflation and the defeat of "Greenbackism."

The recent decline in interest rates cannot be attributed to the same causes. Savings have reflected no proportionate increase. The decline is a consequence rather of monetary policies and of bank credit expansion and hence, in my opinion, will prove far less enduring than a decline that rests on the firm foundation of an increase in the savings fund.

**Easy Money Polices and the Savings Fund**

As I indicated at the outset, I wanted to give particular emphasis to the effect of the easy money policies on savings, savings institutions, insurance companies and endowed institutions. Already the effects have been extremely detrimental and could prove disastrous. Investment return has been greatly reduced. If the easy money policies should result in a sharp price increase, the purchasing power of that smaller income to the individual would be lowered. The effect up to date has been to reduce the actual amount of return and a possible future effect would be to reduce the purchasing power of that smaller income.

**The Magnitude of the Problem**

The very size of savings, insurance, trust, and endowment funds as well as the fact that countless individuals are dependent upon the income yield, make this a problem of great importance. Complete and adequate data relative to the volume of savings, insurance, trust and en-
endowment funds are lacking. Some idea, however, of the magnitude involved can be conveyed by citing certain available statistics.

The Research Council of the American Bankers Association gives a figure for total savings deposits of approximately 25 billion dollars.\(^1\) According to the proceedings of the last annual convention of the Association of Life Insurance Presidents, the total admitted assets of 49 legal reserve life insurance companies, adjusted for policy loans and premium notes, come to something over 22 billion dollars.\(^2\) Another six billion dollars of savings have been lodged with building and loan associations.\(^3\) The trust assets of national banks come to an additional 9½ billion dollars.\(^4\)

The total of the funds enumerated comes to 62½ billion dollars. It must be remembered that this total is far from being all-inclusive. Data of trust funds, of banks other than national banks and data of investments made directly by individuals are not obtainable.

In addition to the volume of savings owned privately or held for the benefit of private individuals is that amount held by endowed institutions. A few years ago the United States Office of Education stated that the total endowment of all institutions of higher learning came to 1½ billion dollars.\(^5\) To university endowments, must be added those of religious institutions, of hospitals, foundations and organized charities. It would be very con-

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\(^1\) Savings Deposits and Depositors in Banks and Trust Companies of the United States 1928, 1933, 1938, p. 3.

\(^2\) Proceedings of the Thirty-Second Annual Convention of the Association of Life Insurance Presidents, p. 96.


\(^4\) Ibid., p. 6.

servative to estimate the grand total of all these funds as well above 75 billion dollars.

**Some Specific Effects of Lower Rates of Interest—Savings Banks**

To cite certain specific effects of present interest rate levels, The National Association of Mutual Savings Banks reports that the average interest rate paid to depositors which, at the beginning of 1929, amounted to 4.46 per cent had fallen to 2.43 per cent by the beginning of 1938. In New York State alone, the rate of interest paid on mutual savings bank deposits declined from 4⅞ per cent to 2 per cent in the seven-year period from 1931 to 1938. Inasmuch as total deposits in all mutual savings banks amount to approximately $10,000,000,000 the decline in the rate of interest paid has reduced the interest income of all depositors by about $200,000,000 a year. With the average account standing at $695, the easy money policy has in effect pilfered the pennies of the modest income groups in our country.

**Insurance Companies**

Over the past several years the earnings of life insurance companies have been at the lowest point ever reached. Low earnings along with the expectation of still lower rates of interest have been reflected in increases taking place in premiums charged or decreases in dividends paid to policy holders. It must not be concluded, of course, that the reduction of interest income has been the only factor in the increases taking place in premiums or in the decreases in dividends. Another cause has been the decision of the companies to maintain a more liquid position. The easy money policies, however, have been an important cause in raising the cost of insurance and
have wrought hardship upon those groups who desire to provide for their old age and for their dependents.

**Endowed Institutions**

Easy money policies have also brought about a reduction in the endowment income of Universities which, according to a recent report issued by the General Education Board, has been a "source of anxiety to those responsible for the operation of endowed colleges and universities as well as to those interested in their welfare."(6) The United States Office of Education has reported that endowment income from 1930 to 1934 shrank from $69,000,000 to $56,000,000.(7) The yield on the "pool account" endowment of Columbia University has been reduced from a peak of 5.76 per cent in 1929-1930 to 3.73 per cent in 1938-1939.(8) The decline in investment yield on university endowments has been so large that it has more than offset the income on additional gifts received. In consequence institutions of higher learning have been forced to raise tuition fees. In certain instances, salaries of the teaching staff have been reduced. Where this was not done, the promotions that would ordinarily have been expected have been long deferred. The teaching load has been increased. The consequence has been that students by reason of higher tuition fees, and the faculty by reason of reduced compensation, slower advancement or longer hours, have all borne the cost of easy money.

**Large City Banks**

Large city banks felt the incidence of easy money policies much earlier than did savings banks, insurance companies and endowed institutions. The reason is that bank

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(7) Ibid., p. 4.
(8) Kemmerer, E. W., The Outlook for our College Endowments, p. 4.
portfolios to a larger extent consist of short-term paper, the rates on which respond quickly to changing conditions in the money market. The average maturity is much shorter than in the case of the investment portfolios of savings banks, insurance companies and universities, the yield on which lags behind money market rates both on the downward and the upward sweep. This is but another way of saying that a great discrepancy exists now between the higher interest received on total portfolio holdings and the lower yield received on new acquisitions.

In so far as commercial banks are concerned, the effect of easy money policies has been not only to reduce interest yield but also to change the character of the portfolio. It is well known that interest rates on commercial loans are at the lowest levels on record. Two-thirds of the loans by the New York City banks are extended at rates ranging between 1 and 2 per cent. Rates on short-term investment securities are at infinitesimally low levels.

In consequence of this situation, the large city banks are being driven into new credit fields and are being forced to lengthen the maturity of their earning assets. Personal finance loans, installment loans and capital loans are bulking larger in the loan portfolio. Long-term bonds are being purchased to secure the yield, which, though low in itself, is higher than the microscopic return on short-term securities. Reluctant though banks are to become involved in the vicissitudes of long-term interest rate fluctuations, many of them feel forced to do so in order to cover their operating expenses.

Despite all efforts to increase income and reduce expenses, bank earnings are at a very low point. Were it not for the profits and recoveries realized in connection with the security portfolios, the members of the Federal
Reserve System as a group would have failed to earn their dividends for 1938. These non-recurring items were entirely responsible for the net profits that were realized.

May I again give emphasis to a thought expressed earlier this evening. If the decline taking place in rates of interest had been in consequence of an increase in savings, it would have been highly salutary and there would be some assurance as to its permanence. Unfortunately this has not been the situation. The decline rests on the quicksands of monetary policy rather than on the permanent foundations of savings. Even though the lower rates will not prove enduring, they will constitute a tax upon the thrifty, prudent and foresighted as long as they are in effect.

Easy Money Policies and Price Increases

If the easy money policies should result in a flare-up in prices, the consequences would be even more disastrous than has been the case. This is not at all a remote possibility and frequently in the past commodity prices have bulged upwards when rates of interest were held artificially low. The effects of price increases upon the purchasing power of endowment incomes, life insurance policies, etc., have received considerable emphasis in recent years, so I need but mention this phase of the subject in passing.

An increase in prices will prove quite as detrimental to financial institutions as to those individuals who have saved and who have savings. Operating expenses of life insurance companies and banks will increase as labor and material costs rise. And though commodity price increases eventually will bring about an increase in the long-term rate of interest, this will lag so far behind the price rise that it will afford little relief. Additional serv-
ice charges will have to be imposed to cover operating costs.

Rapidly rising prices will cause bank lending standards to deteriorate. When prices are rising rapidly, it is very difficult to distinguish between sound and unsound credit demands. How true this is was well illustrated by developments in the immediate post-war period.

Responsibility of Financial Community

In view of the present effects of the easy money policy and its possible future consequences, what should be the duty of those responsible for our financial institutions? Certainly it is not enough that we should resign ourselves to the inevitable and try to hedge against future developments. Even if we were so disposed, the laws regulating the investments of insurance companies, savings and commercial banks would prove a barrier. Financial institutions have not full freedom in the purchase of stocks and other variable income investments. And even if there were no legal barriers, considerable time would be required to effect radical changes in the character of the investment account of the larger financial institutions. The very size of their portfolios makes their investment policy less flexible.

It would seem to me that the constructive policy for all of us would be to join together in a stand for sound money, the realization of which would involve the termination of present easy money policies. In this connection, may I quote from a letter, written on August 12, 1896, by the President of a large insurance company. Writing with reference to the bimetallic controversy, which was then at fever heat, he stated that, in his opinion, the present accumulated funds of his company must be regarded "as a sacred trust, placed with us by those hun-
dreds of thousands of people as a provision against not only premature death but old age as well, and any hardship caused by the depreciation in the value of such provision should not be permitted without protest.” Confronted with policies quite as dangerous, as the bimetallic proposals of a generation ago, it behooves us to protest on behalf of those who have left their funds with us as a sacred trust.

The present is a particularly opportune time to make a stand for sound money inasmuch as several of the powers of the Executive over the currency, unless extended by Congressional action, shortly terminate. Those to expire include the power to alter the metallic content of the dollar. The House of Representatives has voted to extend this power to June 30, 1941; the Senate has not as yet taken action.

It seems to me that a first step in the restoration of a sound financial policy would be to allow the power to further devalue the gold dollar to expire. In fact, I would go beyond this and would urge the reintroduction of the gold coin standard and of gold coin redemption, on the basis of the present gold dollar. This step would logically be followed by a repeal of all silver enactments.

Convinced as I am that the old gold dollar should never have been devalued, I am enough of a realist to conclude that its re-establishment is not now within the realm of the practical. Only if England, France and the sterling bloc of nations were to take simultaneous and proportionate action could we consider restoring the old gold dollar, which would involve lowering the price of gold from $35 to $20.67 an ounce. Of necessity we are compelled to reconcile ourselves to the devaluation that has occurred. This does not mean that we should coun-

(9) On April 24, 1939, H. R. 3325, 76th Congress, 1st Session.
tenance further devaluation. It is for this, among other reasons, that I suggest that the devaluation powers of the President be allowed to expire and that specie redemption in gold coin be reintroduced.

To continue these powers would imply that there are good reasons for further devaluation, or that this country is willing to engage in currency warfare, or that some sort of monetary emergency still exists. In my opinion none of the reasons cited for a continuation of the President's powers has validity.

The reintroduction of the gold coin standard not only would carry assurance against further devaluation but would do more than any other single measure to restore business confidence. Confidence would be given to the business structure of the entire world in the same manner as that in which the undeviating adherence by England to the gold standard from 1821 to 1914 inspired worldwide confidence.

The re-establishment of the gold coin standard should be accompanied by other measures designed to prevent member bank reserves from rising further and to reduce excess reserves. Only in this way can the extreme easy money policy be brought to an end. To prevent member bank reserves from rising further, the Treasury, in my opinion, should once again begin sterilizing gold imports. Furthermore, those profits of gold devaluation that are still unutilized should remain impounded. Otherwise they will very likely be employed in a manner to increase member bank reserves.

In order to bring about a reduction in member bank reserves, the Board of Governors of the Federal Reserve System should again raise member bank reserve requirements to the maximum permitted by law. This would bring about a reduction in member bank reserve balances.
of about $800,000,000. Even if this action were taken, excess reserves of $3,500,000,000 would still remain. It should be noted that even this reduced total is so large that it remains outside the scope of complete control on the part of the Federal Reserve banks whose open-market portfolio comes but to $2,500,000,000.

In concluding, I want to give emphasis to the fact that the easy money policies followed by this country have left us with a heritage of monetary problems that much time and patience will be required to solve. Six years of unsound policy cannot be swept aside in a day. Even though the ultimate goal may be somewhat far removed, there are certain first steps which should be taken immediately. These I have already referred to. One of them is to terminate the President's powers to devalue the gold dollar further. This is an immediately pressing problem and one on which those of us who are apprehensive over easy money developments can at once unite and make common issue.
The Incompatibility of Democracy and a "Planned" Economy

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THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
The Incompatibility of Democracy and a “Planned” Economy

An Address by

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THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at the
One Hundred Thirty-eighth Commencement Exercises of

WASHINGTON AND JEFFERSON COLLEGE
WASHINGTON, PENNSYLVANIA

Saturday Evening, June 3, 1939
The Incompatibility of Democracy and a "Planned" Economy

The foundations of Washington and Jefferson College were laid in the same year which saw the adoption of our present form of constitutional government. Between the growth of the College and its adaptation to the life of the community and the evolution of the principles of democracy embodied in our Constitution there is an instructive analogy. Since 1789 Washington and Jefferson College has undergone numerous amalgamations and reorganizations. Yet the fundamental purpose of the College—that of giving to the youth of each generation the opportunity of acquiring the perspective, knowledge and understanding which will enable them to become intellectual and spiritual leaders of the future—remains the same as it was 150 years ago. Because of this singleness of purpose, the College has grown and prospered and has exercised an increasingly important influence during the passing years.

A similar continuity of growth in the midst of a changing environment is characteristic of the democratic institutions which were created by our Federal Constitution. During the century and a half which has elapsed since the adoption of our Federal Constitution the outward forms of democratic government have been modified and adapted in many respects to meet our growing needs. Yet, despite the changing social, economic, and political conditions, the
principles of democracy have been preserved. Under the solid protection of these principles embodied in our Constitution, the country has grown great and strong.

The Adaptability of Democracy to Economic Change

Indeed, the vitality of democracy is due to its resiliency and adaptability to changing conditions. In the early days of our history, we were predominantly an agricultural nation; our manufacturing was on a small scale; and our shipping was carried on by merchant traders. Today, our economic life is characterized by large scale enterprises and mechanization; we have our mass production industries, transcontinental railroads, national merchandizing organizations—all made possible by increasing scientific knowledge and technical skill, and all contributing to an efficiency and productivity surpassing anything the world has ever known.

Obviously the role of government has had to change along with this economic evolution. We have had to pass laws to prohibit predatory actions on the part of small but powerful minorities, such as laws against combinations in restraint of trade, and against monopolies, corners, and market manipulation. We have had to pass laws to maintain competition, laws setting socially desirable levels of competition, laws which make it possible for the man who is strongest and most efficient to attain success rather than the one who is merely the smartest or most unscrupulous. We have had to legislate against fraud, against unfair advertising, against deceptive labelling and other practices which take advantage of either the ignorance or confidence of consumers. We have had to pass laws for the maintenance of healthful and safe working conditions. We have been obliged to pass laws regulating the sale of securities, the banking business, the transportation business,
and many other interstate activities. Such laws and regulations, passed in order to maintain a sound, well-functioning economy, are not incompatible with democratic principles, despite the fact that they interfere with the freedom of many individuals.

There is a limit, however, to the adaptability of democracy. There comes a point when the extension of government controls and the progressive curtailment of liberties make impossible the living of life in a democratic way. Although the specific amount of government control which makes democracy unworkable is difficult to gauge, we must try to assay it in order to understand the significance of the changing political-economic relationships which are being effected with breath-taking rapidity throughout the world. We are continually confronted in these times with the responsibility of deciding whether only the outward forms of democracy are being changed, or whether its fundamental principles are being threatened. Upon the rightness of our judgment hangs the future of the democratic way of life.

The Essence of the Democratic Ideal

In the first place, we must clarify in our own minds just what we mean by the democratic way of life. The institutions of democracy may vary widely from country to country and from time to time; they are shaped by the size, history, temperament, and economic maturity of each nation. Some democratic countries have a parliamentary system of government; some have a government of checks and balances; some have kings, others presidents; some have written constitutions, in others the liberties of the people are protected by ancient charters, by statutes or immemorial customs which have the sanctity of constitu-
tions. There is a common foundation, however, which lies beneath the varying institutions in every democracy. This common foundation is an attitude of mind—a loyalty to the democratic ideal.

The essence of the democratic ideal is first of all the inviolability of the fundamental rights of the individual so that each individual may be free to develop the best that is in him. To make this liberty effective, we must have opportunity to do those things we wish to do, provided they are not harmful to others. We must have freedom of speech, of conscience and of thought. We must have tolerance for all races, all creeds, and all minority interests. We must recognize the equality of all citizens before the law. This does not imply a simple and crude equalitarianism, because that is impossible, human nature and capabilities being what they are, but it does mean equality of opportunity for all. To make this liberty effective, we must have a free educational system which will produce men and women who can think logically, dispassionately and objectively, and will produce leaders who can direct the affairs of state wisely and well.

In the second place, democracy implies a form of government which, in spirit and in action, places the individual above the state, a government which so values the freedom of its citizens that it will take no step to restrict their activities that is not, beyond all reasonable doubt, required for the general good. Obviously such a government must be responsive to the will of the governed; it must be the servant, not the master, of its citizens. Such a government must rule by general laws sanctioned by custom and long usage, or duly approved by a responsible representative legislature. These laws must set standards that can be comprehended, and their administration must
be without prejudice or discrimination. Democracy presupposes the ability to solve all disputes by reason, rather than by force, through the decisions of a judicial system whose impartiality is beyond question.

These principles of democracy are being threatened the world over today. Personally, I do not for one moment believe, as some dictators claim, that men are tired of liberty or that democracy is incompatible with our modern industrial organization. I do not believe that the totalitarian state with its planned economy ever has or ever will come about because the philosophy of totalitarianism has supplanted the ideal of democracy in the hearts of men, but rather, if it comes, it will be because men fail to understand that the economic system of free enterprise is essential to democratic institutions. It is the appalling casualness with which governmental action that may have the effect of destroying our system of free economy is imposed and accepted, that constitutes the real threat to our democratic institutions and way of life.

The Economic Basis of Democracy

Because economic difficulties have beset us in recent years, the path of least resistance has been to let the Government try to solve our problems for us. The thought is often expressed that the free enterprise system has failed, because we still have unemployment, distress and periodic maladjustments. Therefore, it is argued, the Government must "do something"—on the assumption that anything new will be better than the status quo. This is an understandable psychological reaction, but the road, I fear, will lead to a goal we would not knowingly seek. We may well find that if we take the easiest route without first consulting the road maps, or heeding the danger signals on the
way, we will be led to strange and foreign lands, barren lands which will yield us neither the safety, security, nor prosperity which we have set out to find.

It was not mere coincidence that democracy and the system of free private enterprise developed together. The interrelationship between political and economic freedom has at times been considered sinister by some of the more vehement critics of our democratic ways, as if democracy were merely a political rationalization of an economic imperative. Personally, I see in the simultaneous origin of economic liberalism and political democracy a vitally important fact and one that cannot be too strongly emphasized. Their growth has been parallel for the simple reason that one cannot exist without the other. A democratically "planned economy" is an impossibility.

I realize that such expressions as "free enterprise" and "planned economy" mean different things to different people. Therefore, I shall try to define what I have in mind when I use these terms, and then I can proceed to discuss why democracy is possible under a free enterprise system, but impossible under a system of economic regimentation.

The Mainspring of the "Free Enterprise" System

The mainspring of the private enterprise system is the free price mechanism. I do not think the function of prices in a free economy is sufficiently appreciated by the majority of people who daily act and plan according to the dictates of market prices. It is our price mechanism and the automatic and unconscious community "planning" which springs from it that have made possible the specialization, division of labor and industrial efficiency that have brought our civilization material wealth undreamed of in the past.
Our price system is made up of many different kinds of prices—wage rates, interest rates, rents, stock market quotations, commodity prices, wholesale prices, retail prices, charges for professional services, and many others. All of these prices are continually fluctuating in response to underlying conditions of demand and supply, and in so doing they direct every phase of economic activity. The world's resources of land, labor and capital are not limitless; consequently, something or someone must direct their use. It is the interplay of the various sets of market prices, each fluctuating according to the demand and supply, that determines what is to be produced first and how much should be produced at all; what the most profitable employment opportunities are, and what the relative worth of different kinds of work may be; how much of the current output should be consumed and how much saved and invested to increase the productive capacity of the future.

Under this system of market prices, it is the ultimate consumer who decides what is most desirable and of greatest value. This system makes possible, as it were, a dictatorship of 130 million individuals—each one freely expressing, by the way in which he spends his dollars, his preferences and desires. The price mechanism also makes possible the determination by each individual of the work he wishes to do, and the plans he wishes to make for the future. The price mechanism is probably the only possible device yet conceived which can weld the personal and individually determined preferences, desires, and ambitions of men into a social order.

Thus it is that the free enterprise system, through the functioning of market prices, exalts the individual and in so doing contributes to the realization of the democratic ideal.
By and large, over the years, the price mechanism has worked smoothly. I do not wish to imply that it has ever functioned perfectly,—but perfection is never attained by mere humans. Admittedly, there are "rigid" and "sticky" prices which, because of their inflexibility, fail to direct activities as rapidly or as accurately as might be desired. Admittedly, prices can be and often are distorted by unwise policies of government and of industry. Admittedly also, the price mechanism has not succeeded in preventing periods of economic crisis with their disheartening distress and suffering. Indeed, it is at such times that governments tend to assume control over the price mechanism.

A "Planned Economy" Defined

And this leads me to a definition of what I mean by a "planned economy." In a planned economy, the state no longer plays the role of the traffic engineer who fixes traffic rules and devises well-designed roads which facilitate the daily passage of thousands of vehicles without aggravating jams or serious crashes; instead, the state attempts itself to determine the destination, route and speed of every vehicle by remote control. Stated in economic terms, the state attempts to exercise directly or indirectly that control which is furnished in a free economy by the price mechanism.

State policies in the past have often indirectly affected prices. The final price of any commodity or service is often determined to some extent by taxes, by tariffs, by monetary policies, by credit controls aimed at "cheap money," and so forth. Prices and economic activities can adjust themselves to such policies if they are adopted with wisdom and if they do not come in too rapid succession. Such policies which indirectly or only incidentally affect prices may or may not be economically desirable, but they
do not in themselves necessarily violate democratic principles. The democratic way of life, however, is seriously threatened when governments deliberately substitute for the impersonal price mechanism the dictates of economic planners.

Direct governmental price-fixing may come about for any one of a number of reasons. Frequently, "cutthroat" competition, during a crisis, leads to a demand by business itself for the setting of minimum prices. Or, it may be that the less efficient firms in an industry, where over-capacity exists, clamour for price-fixing to maintain their economic life. Or, it may be that the over-extension of credit through government deficit financing necessitates rigid price controls all along the line to forestall a ruinous inflation. Or, it may be that other government policies have been so poorly devised or carried to such extremes that they lead to future demands for price controls.

Whatever the causes, the results are uniformly disastrous to democracy in the long run. The free price mechanism may be suspended, but its function cannot be dispensed with. Someone must make the decisions as to what is to be produced, and in what proportions; how much each of the factors of production are worth; how much more wages should be paid for one kind of work than for another; how much should be saved; how much should be invested, and so on. When these decisions are made by a small group of government planners, the individual is robbed of his essential economic freedom.

The Economic Ramifications of a "Planned Economy"

Let us examine for a moment the economic implications of this substitution of government for individual price determination. How is the government to decide what prices are "just" and "right"? It may be glibly said that prices
should be set so that they cover the "costs of production"—but whose costs should be taken as a base—those of the most efficient producer, those of the marginal producer, or a general "average" which may be nobody's cost? Also "unit" costs are never absolute; they are relative, depending on the rate of operations, which in turn depend on the quantity demanded—both unknown factors to the price-fixers. Added to this are the complications of classification of goods and services. Even when products are fairly homogeneous, there are innumerable differences in sizes, shapes and qualities, and each of these must be subject to a separate price decree.

In addition, the state must decide, if it fixes prices, what is a "fair" profit, and beyond that what is a "fair" valuation. Someone must decide whether investment should be permitted in a given industry—and if so, how much.

The state may start to fix only some prices—wages, interest rates, retail prices, wholesale prices, commodity prices, or any others—but if it starts by fixing some, it must end by fixing all. Otherwise, gross injustice would be done, and industrial deadlock would follow. Costs and prices must be kept in balance. In our complicated, closely interrelated economy, where the price of a finished commodity may reflect the price of literally hundreds of component goods and services, one fixed price invariably entails another.

Price-fixing, also, inevitably involves the determination of production, administratively. If a price is set too high, demand will fall off and over-production will ensue unless output is limited to the restricted demand. Often production quotas are fixed as a substitute for price-fixing, as limiting the supply will ordinarily raise the price. But whether production restriction comes before or after price-fixing, it gives rise to a host of new complicated problems.
And incidentally, when states fix prices and production, serious dislocations occur in the export markets. If prices of commodities which enjoy a world market are fixed above their price in other countries, exports will be cut off; if they are allowed to sell at the world level, they may be out of line with other domestic prices. This dilemma has been met by export dumping, export subsidies, rigidly controlled foreign exchanges, and barter through government-controlled corporations. It is significant, that in the final analysis, when governments attempt to set prices, the price mechanism breaks down completely, and is replaced by a reversion to forms of barter trade.

The difficulties involved in price-fixing by government edict are neither new nor unknown. The Romans under Diocletian experimented with government price-fixing and found it too complex for even a dictator to cope with. Here is what H. J. Haskell, author of the delightful new book, "The New Deal in Old Rome" has to say of this early experiment:

"Late in the third century after Christ the anarchy was ended by an energetic and able soldier and administrator. Diocletian, with army backing, became dictator, reorganized the administration, and stabilized the currency on what he believed was a sound basis. Unfortunately, like some modern rulers facing a similar problem, he overvalued his new monetary unit. Prices promptly responded with another violent rise. Diocletian recognized the suffering that resulted, but naturally did not understand the cause. The trouble, he thought, lay in greedy profiteering. In 301 he issued his famous edict setting maximum prices and wages. After denouncing the profiteers in the preamble, he an-
nounced maximum prices for between seven and eight hundred articles and types of work and service.

"In its technical descriptions the edict reads like a modern tariff act. There is millet ground and millet unground; olive oil first quality and olive oil second quality; goose artificially fed and goose not artificially fed; cabbages best and cabbages small; washed Tarentine wool and washed Laodicean wool. Maximum salaries are included for barbers, wagon-makers, elementary teachers, teachers of Latin and Greek, and many others.

"The act had teeth. The penalty for evasion was death. The Emperor had so expanded the civil service that a contemporary wrote, with disgusted exaggeration, that half of the men of the Empire were on the government payroll. There were plenty of inspectors. But this early attempt at price-fixing failed. It is recorded that business men closed their shops, that many articles of commerce disappeared, and that food riots resulted. A dozen years later we read the obituary of the act: 'For merest trifles blood was shed and, out of fear, nothing was offered for sale and the scarcity grew much worse until, after the death of many persons, the law was repealed from mere necessity.'"

Price Regimentation Destroys Individual Liberty

Under a regime of governmentally fixed prices the continuation of democratic institutions is impossible.

In the first place, government planning, as I have defined it, means the destruction of individual initiative and self-realization. When one is told what price one can
charge, what profit one can make, what work one can do, there is neither the motive nor the opportunity for individual growth and advancement.

Secondly, a government undertaking delicate price dictation which vitally affects the life and welfare of all its citizens could tolerate no criticism. When price decisions are made by government planners, someone is bound to be dissatisfied. If the number of aggrieved persons is large and if the state permits them to cry out that injustice has been done, the enforcement of decisions will be next to impossible. A government cannot put a dissenting 49 per cent of a nation in jail! The government must necessarily, therefore, forestall the possibility that dissension will become widespread by denying free speech to all critics. Thus government economic planning requires the suspension of individual judgment concerning what is wise or just.

Under a planned economy, because of the impossibility of reconciling all conflicting interests to the satisfaction of all concerned, the welfare of the individual is considered to be unimportant; the individual must be submerged for the good of the "cause." To make this selflessness palatable, ideologies having the force of religious faith are stamped into the minds of young and old. Thinking, when permitted, must be only along prescribed standardized lines. When patterns of thought are dictated from above, what happens to free thought—and to freedom of conscience?

Government planning inevitably leads to intolerance of minority views and a disregard of minority rights. A government regulating all the details of economic life and doing all the thinking for its people cannot stop at legal technicalities protecting minority interests. The sacrifice of the individual for the good of a cause invariably leads
to intolerance, and intolerance feeds upon itself. In extreme cases, minorities, be they racial, religious, cultural, or economic, are in grave danger of the most callous persecution.

The enforcement of the price decisions requires a large and very efficient corps of secret police—and a secret police visiting at any time homes, stores, factories, warehouses with a carte blanche for exploratory investigations, violates the very essence of democratic principles. Yet without such an enforcement staff, the innumerable detailed and specific price decrees would be honored far more in the breach than in the observance. We have seen in the last few years in our own country the breakdown of an attempt to fix industrial prices and production on a large scale—and the breakdown was due to the fact that in those industries where there were large numbers of small units, producers could not be “kept in line.” Enforcement in a democratic way proved impossible.

Still another ramification of a governmentally priced economy is that equality of all citizens cannot exist. The government planners and administrators become a specially privileged class, not because of any exceptional ability and knowledge but because of personal loyalty to a “cause.” “Party” members—all believers in the wisdom and justness of the decisions of the planners—are also endowed with special favors and prerogatives.

Price Regimentation Undermines the Institutions of Democracy

Furthermore, government “planning” necessitates radical changes in the techniques of government. The whole concept of representative democratic government implies that the power of a state must be limited to its capabilities, and limited to the ability of the people to exert effective
control. If government is set apart from the people or above them their interest in its direction is dissipated in a mass of technicalities. When a state grows powerful enough to direct the details of economic life, it becomes a political octopus too complex for popular comprehension, and too omnipotent for popular control. Thomas Jefferson realized this fully when he designed our Republic. His study of history and contemporary politics led him to the firm conviction that "The generalizing and concentrating all cares and powers into one body...has destroyed the liberty and the rights of men in every government which has ever existed under the sun."

Furthermore, representative government is not organized for effective economic regimentation. A large elected assembly is too cumbersome and unwieldy for effective action in designing, executing, and enforcing plans. A Congress of 531 men cannot decide how many shoes should be produced, how much cotton will be needed next year, how much electricians should earn a day and so forth. Representatives, no longer able to deliberate and legislate according to the wishes of the electorate "back home," have to hand over their jobs to "experts" who will give the voters not what the voters want, but what the experts think they should have. When governments attempt to make price decisions, they must be so organized that an individual, or at most a small commission or planning board, has the final authority on all matters. Government by law must end when government by administrative "economic planners" begins.

Also, many of the most important economic plans cannot be drawn for one year, but must be made for many years ahead. Once started, they cannot be shifted or abandoned in response to changes in public opinion. Public
opinion cannot be permitted to form, and certainly must not be allowed to exert any effective influence on the affairs of state.

Furthermore, a government which even pretends to be responsive to the public will cannot afford to acknowledge its mistakes. Errors, of course, will occur, and the mistakes will be on a grand scale. Under the private planning system, if one person misjudges a market, if he makes too many hats, or stocks up on too many sets of Chinese checkers, he will suffer and his creditors may have to take some losses, but the economy as a whole, will not be greatly disrupted. If similar errors of judgment are made by a central planning board—and they are much more likely to be made by such a body, because the decisions they have to make are vastly more complex—everyone must pay for the miscalculation, which will be on a gigantic national scale. What actually happens is that government planners never dare admit their errors; they must always cover up to "save face." And in covering up, new mistakes follow the old ones in desperate succession.

If a government attempts to maintain its democratic form, while at the same time it indulges in economic planning, as I have defined it, the result is government by intrigue, partisanship, and pressure groups. When a government has favors to ladle out in the form of fixed prices, production quotas, minimum wages, easy terms of credit, and so forth, it is only natural that organized pressure groups will become even more vociferous and domineering than they have been in the past. We all know the technique whereby the interests of a small well-organized minority are placed above the general welfare. The more decisions a government has to make arbitrarily, the more we will have legislation by pressure groups, and administration by personal favoritism and intrigue.
It is no disparagement of government administrators to say that no man or group of men is capable of being trusted with unrestricted power. Even the best and most socially minded of administrators can become tyrannical if granted dictatorial powers. It is easy to devise plans for a Utopian society if one can assume away human fallibility, but such plans are not worth the paper they are written on.

Our economy today is so complex that no one person can have sufficient knowledge to guide and regulate it. No one person can possibly comprehend all the intricate details of our specialized activities. It usually takes one a lifetime to master any single sphere of our economic life, be it salesmanship, banking, engineering, office management, or building a house. Furthermore, even the wisest men cannot agree among themselves as to what should be done to improve this or that particular part of our economic organism. They cannot agree on a diagnosis, let alone a cure. We have discovered many facts relative to our economic and social institutions in the last fifty years, but we still do not know enough to make possible successful economic planning by supermen no matter how intelligent, experienced, or socially-minded they may be.

For these and many other reasons, I maintain that a democratically “planned economy” is an impossibility. Free enterprise and democracy must fall together, as they arose together.

A “Planned Economy” is No Bargain

I have already mentioned that the pressure for economic planning by governmentally-controlled prices usually comes in times of crisis and is born of a sense of futility and despair. We have examples in the world today where freedom of thought, religion, and all self-expression have
been bartered away for a mess of apparent prosperity. If, by selling out our liberty, we could achieve that material abundance which would give to all of us those necessities of life which we now consider essential to our happiness—if this could be bought by the sacrifice of freedom, an arguable case might be made out in favor of such an exchange, though I, for one, would think the price exorbitant. However, it is only too true that even after we sell our hard-won freedom we receive in exchange only a synthetic prosperity, a shoddy product that looks well when bought, but deteriorates rapidly.

The authoritarian state with its five-year, ten-year, lifelong planning may give to its citizens temporarily a bare minimum of economic security. It has yet to be proved that it can lighten the work of labor, lengthen hours of leisure, increase comforts and conveniences, or create an enduring culture. It has yet to be proved that the security attained is one that will be lasting. But even at best, assuming that rationed security will not be shaken asunder in a mighty international conflict or internal debacle, it must not be forgotten that the price of such security is the sacrifice of individual growth, progress and strength of character. Also, it must not be forgotten, that democracy, with its concomitant, the free enterprise system, despite all its shortcomings, has made possible a degree of material wealth and joy of living that surpasses anything the world has ever known. This has been accomplished by men free to think, to dream, to create, and to achieve.

The Responsibility of the College Graduate Today

Colleges, and especially college graduates, in these times, have a grave responsibility. The social, economic, and political difficulties which confront the world today are appalling. Many believe that we are heading towards
another era similar to the “Dark Ages,” in which all that we prize and cherish, civilization itself, will crumble. But this sort of reasoning is unduly fatalistic. Life may be conditioned, but it is not predetermined.

We must have faith in our own ability to cope with problems which face us and think things through. In this task you, our college graduates of today, must assume the leadership for which your training here has fitted you. For the past four years you have been acquiring tools of knowledge—techniques of rational thinking. You are now ready to apply these tools to the practical problems of our times. You must continue to seek out ultimate values—you must strive to maintain balance and perspective—you must bring to a confused world the light of the truth. This you must do if you wish to preserve your heritage of democracy—not only in form but in actual substance.
The Public Debt and the Private Citizen

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THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK
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An Address by

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THE CHASE NATIONAL BANK
OF THE CITY OF NEW YORK

at a Luncheon Meeting of the

BOSTON CHAMBER OF COMMERCE
Boston, Massachusetts

on Thursday, December 12, 1940
The Public Debt and the Private Citizen

Over the past six months, the United States has embarked upon a defense program of great magnitude. The invasion of the Low Countries and the collapse of the French defenses forced a quick reappraisal of our strategic relationships in the Atlantic and the Pacific. We became convinced that it was only through making ourselves strong that our way of life might be preserved in a world in which democratic idealism was being replaced by the policies of dictatorial powers. We abandoned the illusion that we could insulate ourselves from a Europe in which destructive forces were rampant. Historical experience should make us realize that we are a part of the whole complex of world forces, and that we must, in the future, try in a more active way, to shape those forces in the interests of world peace and in the preservation of man's freedom.

This afternoon I wish to discuss the defense program in its economic and financial aspects, to call attention to the costs that are involved, to indicate the ways and means of financing these costs, and to emphasize the relation of that program to the private citizen. The magnitude of the defense program is, at the present time, little appreciated. We are still in the initial stage of rearmament, and the economic effects have not yet made themselves apparent.
The sums already involved are far larger than is generally realized. The defense appropriations by the third session of the 76th Congress came to nearly nine billion dollars. Contract authorizations came to an additional eight and one-half billion dollars. Together, these total seventeen and a half billion dollars, a sum which exceeds the total ordinary expenditures of our Federal Government for the entire thirty year period prior to our entrance into the first World War. This sum is more than 24 per cent of estimated realized national income for 1940. To the appropriations and contract authorizations already voted by the present session of Congress, large additional amounts for defense will doubtless be added by the next Congress. These vast sums, of course, are in addition to the ordinary expenditures of the Government for which Congress, at this same session, appropriated five billions, 300 millions. That amount did not include 154 millions representing permanent, special and indefinite appropriations, nor did it include interest on the public debt estimated at one billion, 100 million dollars.

Prospective defense expenditures caused the Secretary of the Treasury to suggest, in a recent press interview, that the Congress would be requested to increase the Federal debt limit to 60 or 65 billion dollars. He added that such an increase would suffice until June 30, 1942. On the assumption that the lower, rather than the higher, debt limit is required by deficit financing, total gross Federal debt eighteen and a half months from now will amount to 60 billion dollars.

Financial Aid to England

Our Federal debt, direct and guaranteed, will be further increased if the Federal Government decides to extend direct financial aid to England. There will be
much discussion in these coming weeks about the extent and nature of the financial aid we are prepared to give. Many ingenious proposals have already been made, some of which seem designed more to avoid raising the issue on the floor of Congress than to settle it on its merits. The impression seems to prevail that the Johnson Act and the Neutrality Act are somehow involved. The fact is, however, as I am reliably informed, neither Act prohibits our Government from giving direct financial aid to Great Britain, though both interpose barriers against private citizens or corporations giving credit to the British government or to any agency of that government. So it would appear there is nothing in the law to prevent the United States Government from giving credit to Britain or from making an outright grant-in-aid to Britain. Whether it is desirable or not to amend the Johnson Act and the Neutrality Act so as to permit private grants of credit to Great Britain is a matter relatively of small importance.

Both political parties have declared it to be the American national purpose to give every aid to Great Britain short of war. If that pledge means anything it means that our full industrial and financial strength shall be thrown into the scales on the side of England. Let us meet the issue head-on without subterfuge or evasion, and put it directly up to Congress to provide Britain with the funds she will need urgently in the near future. These funds can be furnished by a Federal guarantee of British credit, by a loan from the United States Treasury, or in the form of an outright grant. For the purpose of the present discussion it makes little difference which method of dealing with the situation is followed. The main point is that the funds be available when needed.
Our aid should be given promptly and generously, before England's financial sands have run dangerously low. It should be extended before she has utilized her last remaining dollar asset, before she has exhausted the last of her other foreign resources. England is valiantly defending the ramparts of the democratic world, including our own. We can no more afford to have England break down financially than we can contemplate her defeat in this war. In both cases our own interests are vitally involved.

The Load on American Productive Capacity

Now, it goes without saying that our own defense program plus what we must do for Britain puts a great load on American productive capacity. It has been estimated that, over the next eighteen months, total direct purchases in this country by the American and British governments will absorb 25 per cent of the capacity of our steel plants, and that the indirect purchases of these governments will increase this figure to 50 or 60 per cent. A large part of the recent improvement in rate of operations in the textile industry is a direct result of our war orders. Our aircraft and machine tool industries are now almost entirely occupied in filling military requirements. The capacity of our shipyards must be greatly expanded to meet the need for warships, not to mention the enormous need which is sure to develop in the immediate future for merchant vessels for England and for ourselves. The influence of army and navy orders is being felt in various other industries, including heavy machinery, hardware, men's clothing, and lumber. I believe it is safe to say that two-thirds of the unfilled orders of the electrical equipment industry are government orders. Thousands of dwelling units must be constructed to house those now being employed in
the defense industries, and the railroads will need additional freight cars because of the primary and secondary effects of the program.

The United States will emerge from the program, as it is presently conceived, with a two ocean navy composed of 645 combatant ships in addition to a vast number of auxiliary vessels, a naval personnel of about 550,000 officers and men, naval bases on the Atlantic seaways, with perhaps 25,000 airplanes, and a trained army of at least 1,500,000 men. Unless we can be assured of lasting peace, this armed establishment, once developed, must be maintained, and this in itself will involve continuously heavy charges on the budget.

A program of this magnitude must necessarily give rise to sober reflection on the ability of the economic system to produce the goods required, and to careful consideration of the accompanying fiscal policies.

In a broad way, the defense program simply involves channeling a smaller or larger part of our productive capacity into the procurement of armaments. It will probably be larger, rather than smaller, for the experience of all nations is that modern defense programs, and participation in actual warfare, take a very large share of the real national income. In England and Germany, well over 50 per cent of the national income is being absorbed by war expenditures.

To a certain extent, the goods required by the American defense program can be obtained through an increase in productive effort. How much can be obtained in this fashion depends upon the tempo of the program, the available supply of workers trained in the particular skills required, the possibility of training additional workers quickly, and the existence of idle plant capacity in the defense industries. As we know all too well, we
have been suffering in this country from an excess of plant capacity and a long period of unemployment, representing together a very considerable slack in our industrial processes. In some departments, such as the airplane and machine tool industries, this slack has already been taken up. As the process goes further, we shall be faced with the need to curtail non-military consumption.

We deceive ourselves if we think we can have the cannon, the tanks, the airplanes, and the ships that our military and naval establishments require, and still fully meet civilian demands for durable goods. Already priorities of an informal character have been adopted and, with the lapse of time, additional priorities will probably be imposed. Priorities are in reality merely another name for rationing. But happily, in this fertile country, we do not have to choose between cannon and butter. We can have our cannon and butter too, even if we do have to limit our demands for new model cars.

Financial Problems of the Defense Program

The financial problems of the defense program, the counterpart of the industrial problems, arise from the need to channel a larger share of the nation's money income into the hands of the Government. To obtain the funds required for governmental expenditures, should exclusive use be made of taxation? Should appeals be directed to investors? Should resort be had to the expansion of currency or credit? What consequences flow from the sale of the public debt to commercial banks as opposed to investors? Can we so finance the program that higher commodity prices will be avoided? Which of these financial and fiscal measures serve best the interest of the private citizen, in the short run and in the long run?
Categorical answers obviously cannot be given. The answers will depend upon the existing fiscal situation. We must build upon what we have. Unfortunately, the fiscal position of the Federal Government is not relatively as strong as it was at the beginning either of the Civil War or of the first World War. The national debt is large, and less elasticity remains in the Federal tax system. In the past decade, the Federal debt has risen by 28 billion dollars, and Federal taxes have been increased sharply. We are inaugurating our defense program from a high plateau in public debt and taxation. In 1917, we entered war with government costs low, with a modest debt, and with a tax system that could readily be adjusted to the changed conditions. Our present situation is much less happy.

Conservatism in fiscal policy demands that the costs of the defense program should be financed, as far as possible, from taxation. Past experience has shown that this is the most desirable method of obtaining the funds required for military use. Armaments, however necessary, are economically non-productive and should not, unless this is unavoidable, form the basis of debt increases. Taxation has the advantage of reducing non-military consumption and, in consequence, of releasing productive facilities and materials for defense requirements. A reliance upon taxation minimizes also the danger of expansionist increases in bank credit and makes easier post-defense financial and economic readjustments.

To the principle that as large a share of the defense program as possible be financed through taxation, I hasten to add several necessary corollaries. In the first place, non-defense expenditures should be curtailed sharply. In the second place, the Federal tax system
should be revised and thoroughly integrated to make a harmonious whole. Taxation itself should not be pushed beyond the limits of productive return. The limits to taxable capacity, the incidence and economic effects of taxation, should receive most careful consideration. Tax rates should not be so high that productive effort is impaired, that incentive is reduced, or that corporations are unable to maintain plant equipment. The limits to taxable capacity are determined by factors partly psychological and partly economic. Involved in this most complicated problem are the willingness of individuals to reduce their living standards, and the ability of the nation to endure further taxation without impairment of its productive equipment.

**Increasing the Public Debt**

Even though the tax system be reformed and tax increases be provided, the defense program will no doubt be financed to a great extent through public borrowings. There was a time when public debts were looked upon with disfavor. But in recent years, public debts have often been taken as the mark of a civilized nation, and the lavishness of governments has been defended as enhancing the well-being of private citizens.

Formerly, we adhered rigidly to a belief in a balanced budget. Debts accumulated in emergencies were reduced in succeeding periods. The Civil War debt could have been completely retired in the early years of this century, had not a public debt been required for the backing of the national bank notes. The World War debt was reduced from 26 billions to 16 billion dollars in the decade of the Twenties.

In recent years, a belief in the wealth-creating powers of Federal deficits has had wide currency and has under-
lain the fiscal policies of this country. In consequence, the public debt has increased rapidly. The spending program of the Government first rested on the belief that government expenditures, whether for purposes economically productive or not, should be used to offset business depression. To this initial belief, the doctrine has been added that government expenditures should be used to offset the alleged stagnant forces in our economy, or, in other words, that public investment should be substituted for private investment. Whatever the rationalization of the spending program, I submit that it has not only failed to realize its objective of full employment, but has left the country in a weakened financial condition to embark on the defense program.

To the extent that public borrowings are required by the defense program, every effort should be made to sell the issues floated directly to private individuals and to savings institutions. As far as possible, the sale of securities to commercial banks should be avoided. The sale of the Treasury's obligations to endowed institutions, savings banks, insurance companies, and individuals rather than to commercial banks, has a double advantage. The private demand for goods is reduced and commercial banks deposits do not rise. The dangers of credit excesses are rendered less.

The mistake made in the World War of encouraging individuals to borrow from their banks to buy Liberty Bonds should also be avoided. This practice proved a powerful stimulus to forces of expansion, and experience is convincing that individuals should be encouraged to purchase government obligations from their own accumulation of capital. The extent to which individuals will be able to buy Government bonds from savings
will depend, of course, upon how far those savings are depleted by taxation or increased by lessened consumption.

Safeguarding the Interests of the Private Citizen

Through the first year of the war, England has followed many fiscal policies that might well be emulated here. Every effort was made to sell obligations directly to investors. Relative to the magnitude of the costs of the war, reliance upon bank credit expansion was small. British fiscal policy safeguarded the interests of the private citizen. His interests suffer if defense or war requirements are met by inflationary credit expansion. Commodity prices are bound to rise. In consequence, those groups in the community powerless to obtain wage or income increases are the ones which bear the heaviest burden. This situation inevitably calls forth a demand for the imposition of totalitarian controls, for controls over prices, over wages, over individual choices as to spending and saving, in short, over every phase of economic activity. In the sense that they lead to totalitarian controls, inflationary methods strike at the very heart of our democratic institutions.

In putting forth the suggestion that government obligations be sold to endowed institutions, savings banks, insurance companies and individuals, I realize that the easier course administratively is to sell defense obligations directly to commercial banks. Little effort need be exerted. Greater effort would be required to sell obligations to investors. Loan drives would have to be instituted and higher rates of interest would have to be paid. A break would have to be made with the easy money policies of the past.
Doubtful Benefits of Easy Money

The easy money policies of the Federal Government are incompatible with the principle of thrift which is so necessary if private citizens are to subscribe for Government obligations. These policies have such a direct relation to the financial problems of the defense program that consideration of them is germane to the present discussion. Recently they have been subjected to general discussion, and differences of opinion have arisen between public officials and others as to their desirability. That the existing low level of interest rates reduces the borrowing costs of the Federal Government is generally recognized. However, in the determination of policies affecting interest rates, the narrow pecuniary interests of the Treasury should not dominate. The public welfare must be given primary consideration. It is not conducive to the public good that rates of interest remain artificially low, for reasons which will presently appear.

By easy money policies, I mean the reduction, through monetary means, of rates of interest below where they would have ruled on the basis of the savings of the community. In this country, interest rates have been forced to extremely low levels. The unprecedentedly low interest rates have not been beneficial on the whole to the private citizen. They have not activated private enterprise, as was alleged would be the case. They have penalized thrift and discouraged savings. They have diminished the incomes of all who have savings accounts, and of all who hold life insurance policies. The extremely low interest rates have encouraged governmental extravagance. They have forced changes in the portfolios of commercial banks which are advantageous neither to commercial banks nor to the community at large. Commercial banks have been forced into long-
term investments and long-term loans. Their assets have tended to become more immobile.

Since the beginning of 1934, our easy money policies have taken the form of marking up the price of gold, of failing to sterilize gold imports, — that is, the failure to set gold aside so that it does not become the base for an expanding volume of credit — and of buying silver. The spending program of the Federal Government has caused Government authorities to exercise their influence in the direction of easy money. Federal deficits have reduced the demand for commercial loans, and commercial banks, to cover their modest operating costs, have purchased a large proportion of the increase in the public debt, though sold at abnormally low interest rates. The fact that commercial banks hold a substantial amount of long-term bonds, and the fact that higher rates of interest will increase the costs of our Federal Government, make a break with the extremely easy money policies of the past six years very difficult. Nevertheless, a break must be made. Present artificially low interest rates cannot be continued indefinitely. The sooner the change comes, the smaller will be the financial, economic, and social costs, and the less the danger of the imposition of totalitarian controls on our credit and capital markets.

Excess Reserves and Our Surfeit of Gold

The core of the easy money policies is to be found in the present large volume of member bank excess reserves, i.e., deposit balances with the Federal Reserve banks over and above legal requirements. Consequently, a reversal of these policies requires a reduction in excess reserves. The existing volume of excess member bank
reserves is of primary significance. They are responsible, on the one hand, for the present low level of interest rates and provide, on the other hand, the basis for a huge multiple expansion in credit. If the credit expansion that is potentially possible takes place, we will experience the sort of thing witnessed in the last war and again in the decade of the Twenties. Each was a period of rapid credit expansion, followed by a severe depression.

Member bank excess reserves have increased in the main as a result of the gold inflow and of the failure of the Government to sterilize gold imports. Up to the outbreak of war in 1939, the gold inflow, itself, resulted from a capital influx of unprecedented proportions, due to the abnormal conditions then existing, and since that time has resulted from war purchases by the United Kingdom and her Allies.

The effect of the gold inflow upon the commercial banking system is not generally appreciated. It brings about an increase in total and excess reserves of the Federal Reserve banks; an increase in total and excess reserves of member banks; and an increase in the deposit liabilities of the commercial banks themselves. The excess reserves of the Federal Reserve banks now amount to about 12 billion dollars\(^1\) and those of all member banks to about 7 billion dollars.

The total reserves of the Federal Reserve banks and of member banks\(^2\) would not have risen if the Treasury had sterilized gold imports. Had it done so, it would

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\(^{1}\) Assuming that the Board of Governors of the Federal Reserve System permits the Federal Reserve banks, as it may under Section 16 of the Federal Reserve Act, to offer direct government obligations as collateral for Federal Reserve notes.

\(^{2}\) If payments for gold imports had been made by selling Treasury obligations to member banks, their excess reserves would have declined by reason of the increase taking place in their deposit liabilities.
have paid for the gold from funds borrowed rather than through the issue of gold certificates. A gold sterilization program involves a rise in the gross public debt. But this is an increase that does not adversely affect the private citizen. It is a debt incurred by the gold purchased and the interest cost on that debt is small in comparison with the social gains of such a policy.

The Treasury did follow a sterilization policy from December, 1936, to April, 1938. The policy of gold sterilization, coupled with three increases in member bank reserve requirements, reduced excess reserves to manageable size. Had the policy of gold sterilization been continued, member bank excess reserves would have remained in this condition.\(^3\) The credit system would have been divorced from a gold inflow of abnormal size and growing out of abnormal conditions.

As it was, the policy of gold sterilization was abandoned. Member bank required reserves were reduced slightly, and excess reserves, in consequence of the continued gold inflow, rose to their present huge totals. The very magnitude of the problem makes a change much more difficult now than in 1937. However, a change must be made if the private citizen is to be given safeguards against uneconomic expansions of credit.

**Measures of Rational Credit Control**

I believe there is still time to take measures which do not have the totalitarian taint but which may keep

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\(^3\) To prevent excess reserves from disappearing completely, the Treasury would, from time to time, have had to desterilize an amount of gold sufficient to provide the additional reserves required by the increase occurring in member bank deposit liabilities and to offset the effect on member bank reserves of the increase occurring in the volume of money in circulation.
credit expansion within reasonable bounds. I know that this suggestion runs counter to the belief that dangers of credit excesses do not exist while there is a large body of unemployed. I know it is contrary to the doctrine that a rising internal debt is no source of danger irrespective of the purpose of that debt, irrespective of its distribution, and irrespective of the way in which it was financed. These doctrines, in my opinion, lack valid foundation and should not be used as a justification for the failure to terminate easy money policies, for the failure to exercise prudence over governmental expenditures, and for the complacency with which the increase in public debt is viewed.

It is in the interests of the private citizen that measures be taken to bring an end to extremely easy money policies and to check excesses in credit expansion. These constitute one part of a conservative financial program, of which the sale of the public debt directly to investors constitutes another important part. The measures that I would suggest to be taken are as follows:

1. That gold coinage and gold redemption be reintroduced.

2. That future additions to the gold stock be sterilized.

In connection with this suggestion, it should be provided by Congressional enactment that any increase in the debt by reason of gold sterilization be exempt from the debt limit and that the gold so sterilized should be desterilized only with the approval of the Open Market Committee of the Federal Reserve System. The approval of the Open Market Committee should also be required for the use of the unused portion of the profits of gold dollar devaluation.

3. That the Exchange Stabilization Fund, resulting from gold dollar devaluation in 1934, be used to
grant credits to foreign nations or to others only to the extent of the $200,000,000 in the active account. Credits extended above this amount should come from the general funds of the Treasury. Otherwise member bank excess reserves will rise.

4. That the monetary powers now vested in the President be withdrawn. Powers of credit control and of money market control should be returned to the Federal Reserve banks. They were established to exercise such powers and only if they exercise them can they once again perform the traditional role of central banks as "keepers of the Government's financial conscience."

5. That the Board of Governors of the Federal Reserve System raise member bank reserve requirements to the maximum now permitted by law. This will reduce excess reserves by over one billion dollars.

6. That the Board of Governors of the Federal Reserve System use the powers granted under Section 11e of the Federal Reserve Act to add to the number of cities classified as Reserve and Central Reserve cities.

7. That the Board of Governors of the Federal Reserve System be granted, under adequate safeguards, additional powers to raise member bank reserve requirements. Doubtless, these powers should not be used until sufficient time has elapsed to note the effect of the measures already suggested. When administrative increases in member bank reserve requirements are made, the increases should be sufficiently large to bring total excess
member bank reserves within the scope of control of the open market portfolio of the Federal Reserve banks.

This suggestion is frequently criticized on the ground that it immobilizes gold in the banking system, making its repatriation impossible. It must be remembered that there is no more complete way to freeze gold in the credit system than by credit expansion based on it. If an outflow of gold should develop in the future, it could be met by the use of the unused profits of gold dollar devaluation, by the use of gold held in the Treasury's inactive account, and, if necessary, through a reduction in member bank reserve requirements.

8. That expenditures for non-defense purposes be vigorously reduced.

The various measures suggested above have a direct bearing on the welfare of the private citizen. To safeguard his interests, the increase in public debt incident to the defense program should be lodged as far as possible with investors. Government securities should not be coined into commercial bank credit. Increases in fiat credit are quite as harmful in the long run to the body economic as are increases in fiat currency. Dictates of prudence require that the public deficit not be so financed that the defense program will assume a feverish character to be followed by an equally severe slump. Only by following conservative fiscal policies will the private citizen be protected, and will our industrial machine operate most efficiently to bring the defense program to a successful conclusion.
Balanced Deflation, Inflation, or More Depression

NUMBER THREE
THE DAY AND HOUR SERIES
OF THE UNIVERSITY OF MINNESOTA
April 1933
THE DAY AND HOUR SERIES

As a part of its own service and educational program the University of Minnesota brings to its campus each year many distinguished leaders in all fields of thought. These thinkers together with our own staff of scholars offer information and interpretations that are of more than passing moment and worthy of a larger audience than that which gathers in the lecture halls. This series of papers is intended as a suitable medium through which such speakers may reach the larger public in the state and nation.

It is the business of a real university to stimulate discussion and to do and encourage frontier thinking on social, scientific, economic, and cultural problems. By so doing it commits itself to no one view but dedicates itself to a point of view, that of the open mind.

L. D. Coffman, President.
Balanced Deflation, Inflation, or More Depression

BY

JACOB VINER

THE UNIVERSITY OF MINNESOTA PRESS
This lecture is the second of three in a series entitled Proposals for Economic Recovery, arranged by the University in cooperation with certain representative citizens of Minneapolis and St. Paul. It was delivered in Northrop Memorial Auditorium on February 20, 1933, by Dr. Jacob Viner, professor of economics in the University of Chicago, special expert for the United States Tariff Commission and United States Shipping Board, 1916–19; consultant economist for the United States Tariff Commission, 1919–20; visiting professor, Graduate Institute of International Studies, Geneva, Switzerland, 1930–31 and 1933–34.
Balanced Deflation, Inflation, or More Depression

* * *

That the existing economic situation is desperately bad is not subject to question. Whether it is holding its own or getting worse; whether there is anything that can be done about it, and if so what; what will be the outcome if conditions do not improve in the near future; these are questions that everyone is asking, but to which the most competent persons can give but partial and qualified answers. Nevertheless, public opinion, the man on the street, will play, and has already played, an important part in deciding whether anything shall be done, and if so what. The crowd, it is true, never works out a definite and detailed program, but in a democratic country, and especially in the absence of great leaders, it does, by its favorable or hostile pressure, influence the direction policy shall take.

There is no shortage of advice, either for the government or for the public. The difficulty is rather that of choosing from among the multitude of counsels. Economists should be best equipped to give sound advice, since almost alone of all groups they have no special axe to grind, and since also almost alone of all groups they have specially devoted themselves to the task of studying economic phenomena from the point of view of the general public interest. The economist, however—unfortunately, I believe, for this country—has little prestige with the American public, even on those subjects on which he alone has expert knowledge, and the public prefers to take its economics from newspaper editors, politicians, bankers, and men who in happier days were able to accumulate or inherit a million dollars or more. I concede that the economist is not wholly without a

* 5 *

Thus, the public must first be brought to understand the need of cooperation in economic matters. Cooperation can be attained; but cooperation requires an understanding of the facts and principles involved. The economist can and should give this understanding.
DEFLATION, INFLATION, OR MORE DEPRESSION

share in the responsibility for this situation, but it is nevertheless a regrettable situation. In any case, I ask you to be generous enough to listen without prejudice to a lecture on economics, even though the only qualification which the lecturer has is that he is an economist by profession and training.

Intelligent prescription for a depression is impossible without knowledge of the nature of the disease. A business depression is a mob phenomenon, and the individual as such is helpless to stem its tide and, as a rule, is unable to insulate himself from its effects. Until the downward tide ceases, he is carried along with the rest. But granted that once a depression is under way there is nothing which the ordinary individual can do either to end it or to escape it, the question remains: Is there also nothing which individuals acting in concert or which their governments can do, to abate its severity or even to restore some measure of prosperity? It is to this question that I will specially direct my remarks.

There can be distinguished five conceivable lines of policy that can be followed in dealing with a depression, which I will label as: (1) the “do-nothing” or “let nature take its course” or “painful waiting” policy; (2) the hortatory or incantation policy; (3) the “do the wrong things” policy; (4) the induced balanced deflation policy; and (5) the inflation policy.

Our policy during the last three years has been an uncoordinated mixture of all of these methods. Inertia, painful waiting for a turn of the business tide, has been the chief ingredient, with resort also to incantations, to errors of commission, and to homeopathic doses of inflation—and in recent weeks, with a trace of induced balanced deflation.

I

THE "DO-NOTHING" POLICY

For the “do-nothing” policy, there is, in ordinary depressions, much to be said. Experience seems to support it. We have had many depressions before; nothing was done about them, and yet we not only successfully emerged from them but went on to ever-rising standards of economic well-being. This policy, more-
DEFLATION, INFLATION, OR MORE DEPRESSION

over, is naturally adapted to the democratic organization of society, where diffusion of authority, conflicting counsel, and the clash of opposing interests, tend to make inertia the rule of life. There is a curative, a self-corrective process, in the economic mechanism which does tend to bring depressions to an end, and which has always hitherto succeeded in doing so.

The central characteristic of a depression is a more rapid rate of decline in the use of spendable funds than in commodity prices. The rate of decline in the use of spendable funds is directly due to two factors: a contraction in the amount of spendable funds in existence, and the immobilization or non-use of such funds as still exist, which manifests itself objectively in a decline in their velocity of circulation. The primary cause for this contraction and immobilization of funds is to be found in the normal response of business men to a declining excess, and still more to a deficit, of prices as compared to costs. This adverse price-cost ratio is itself the product of two factors: first, a more rapid decline in the prices of the things the producer sells than in the rates at which he can hire or buy the factors of production, and, second, a decline in volume of sales, which operates to decrease the number of units of product per unit of the productive factors employed and thus to raise unit costs. When costs exceed prices, the business man will not use funds he owns or borrow additional funds from the bank or the investment market to conduct current productive operations, to maintain inventory, or to extend plant; and the bank would not lend to him under these conditions even if he were willing to borrow. The process, moreover, is cumulative or contagious. If one business man contracts his operations, his expenditures contract; this reduces the flow of spendable funds to others and they contract their expenditures in turn; this compels other business men further to contract their expenditures and production, and so on indefinitely, in a vicious spiral.

In the meantime, however, the prices of the factors of production are under pressure, and after a time they break. The prices of raw materials and especially of agricultural products are usually first to give way, followed next by wages. Bankruptcy and
DEFLATION, INFLATION, OR MORE DEPRESSION

receiverships in some measure dispose of fixed interest charges. Economies, selection for retention of the ablest and most conscientious workers on the staff, and technical improvements aid still further in reducing costs to a level where they are once more below prices. A profit margin thus eventually reappears for producers; they resume use of their own funds and borrow more from their banks and the investment market; the increased flow of spendable funds raises the price level again and increases the volume of sales; and industry is again on its way to prosperity. As in the downward trend, so now in the expansion phase, the process is contagious and cumulative, and the resumption of activity by one producer works to entice other producers into a like resumption of operations.

This curative process has not been wholly absent during the present depression. But factors peculiar to this depression, in degree if not in kind, have so far made it insufficient to bring about recovery. The disturbed state of international relations has intensified the feeling of uncertainty as to the future. The pressure on currencies and budgets of the great and rigid load of international debt obligations, governmental and private, long-term and short-term, and the strangulation of world trade by skyscraper tariffs, import quotas, and exchange controls have contributed to a sharper decline of world price levels than ever before and to a great disturbance of currency and budgetary stability.

In the domestic sphere, taxes have been an increasing burden on industry and have, moreover, had a perverse flexibility, rising during the depression period when it was peculiarly urgent that they should fall. Of equal, if not of greater importance than the tax burden, utility rates have also grown in relative importance to the national economy, and in the main have remained unadjusted to the general fall of prices. Railroad freight rates have not only not decreased in the face of a fifty per cent decline in wholesale prices, but unbelievable though it should be, they have actually been permitted to rise since the beginning of the depression, and are pressing down as a crushing weight on all industries requiring long-distance hauling of bulky commodities.
DEFLATION, INFLATION, OR MORE DEPRESSION

Wages have given way over wide ranges of industry, probably more so than in previous depressions. But the reduction of wages was unduly delayed, and its extent probably lessened, by Hoover Administration pressure against wage reductions. The increasing extent to which business has organized itself on a quasi-monopolistic basis has resulted also in attempts by important sections of industry to resist the downward trend of prices by deliberate restriction of output, with results far from uniformly favorable for themselves and uniformly unfavorable for the rest of industry. A larger proportion of business than formerly is now conducted in rented premises, subject to contractual, inflexible rent charges, instead of in owned buildings. All of these factors have operated to increase the rigidity of costs in the face of an exceptionally severe fall in prices, and much of the responsibility for the length and severity of the depression is to be attributed to them. In a perfectly flexible economy where money costs and prices quickly adjust themselves to changed circumstances, there could be price level fluctuations, profit fluctuations, or fluctuations in the real income of labor, but there could not be substantial fluctuations of employment or production. Our system rests upon the assumption of the existence of price flexibility and cannot operate smoothly without it. But in fact the price structure is shot through with rigidities, and even, as in the case of tax rates and freight rates, with perverse flexibilities.

If the apostles of inertia, of painful waiting, have any rational basis for their dogma, it must be their assurance that in time, even though no concerted and deliberate measures directed to that end are adopted, money costs will fall sufficiently to restore a profit margin for business, and thus bring about a resumption of productive activity. Here and there business men have succeeded in reducing their costs to the level of present prices and are operating at fair profits. But these are rare exceptions. Industry, where it is operating at all, is operating on a restricted schedule and at a loss. Dividends paid in 1933 will be but a shadow of their pre-depression amount, and even these dividends will be paid largely out of surpluses accumulated in the fat years,
or with the aid of raids on depreciation reserves, or as expres-
sions of hope in the future rather than as manifestations of satis-
faction with the actual state of affairs. I still believe that even
if nothing is done costs will eventually probably fall sufficiently
to restore a profit margin. But I am becoming more and more
convinced that there is serious risk that they won’t do so quickly
enough to forestall wholesale economic collapse, if reliance is
placed wholly on the self-acting processes of recovery.

We have already had three years of patient waiting, probably
three years too much. It is arguable that even dangerous reme-
dies now threaten less risk of disaster than does continuance of
inaction. The advice so widely offered that we should avoid all
risky or costly procedures, with its implication that we can do
so simply by doing nothing, is under prevailing circumstances
absurd advice. It would be comparable to advising a man in a
burning building not to risk his life by jumping, but rather to
follow the safe and conservative policy of waiting for the rain
to put the fire out.

II

The Hortatory Method

I come now to the hortatory method. President Hoover has
long been a convinced exponent of resort to incantations as a
means of exorcising social evils. During his war-time rôle as
food administrator, he relied on slogans and appeals to patriot-
ism where in other countries mandatory rules and regulations
were applied. Again during the depression President Hoover and
his staff of soothsayers with extraordinary persistence insisted
that prosperity was around the corner, if nothing were done to
frighten it away. As a substitute for prosperity he gave us slo-
gans, just as a substitute for government relief of the unem-
ployed he asked the public “to give until it hurts.” Business
men and the press have become infected with the same delusion,
and the public has been burdened with appeals to “Buy Now”
and to “Buy American” and told, in thousands of dollars of ad-
vertising space, that “It’s up to you, women” to end the depres-

* 10 *
DEFLATION, INFLATION, OR MORE DEPRESSION

It is by no means certain that full response to some of these appeals would have been aids rather than hindrances to recovery. Even if there were no ground for doubt on that score, it is one of the characteristics of a depression that the types of action which would be beneficial if followed in concert by all are suicidal for the individual who follows them alone. Mankind cannot be induced by exhortation to do en masse what is patently injurious to individuals if done singly. You can't socialize rugged individualists by waving a wand at them, and the chief effect of the hortatory policy is undue postponement in the formulation and execution of a program of genuine action by the only agencies who have the power to do so.

III

DOING THE WRONG THINGS

Sane persons, of course, would not deliberately adopt a policy of doing the wrong things, but they may do so through errors of judgment. To give and defend a detailed list of the errors of commission of which the government has been guilty would require more time than is at my disposal and probably would serve no useful purpose. I will concentrate, therefore, on two major errors of commission of the Hoover Administration in dealing with the depression — its treatment of agriculture and its campaign for maintenance of the boom level of wages.

The most important contributions to recovery from past world-wide depressions were made by farmers and workers in quickly reducing their charges for agricultural products and labor. These reductions, of course, were not made out of public spirit but from necessity, but we need not worry about motives if only the actions to which they give rise are commendable. Agriculture has in this depression been the only major portion of the national economy which has continued to operate and to produce to the limit of its capacity. There could be no business depressions if all sections of the national industry were as readily to adjust their demands to the level at which the market would absorb their full output.

* 11 *
DEFLATION, INFLATION, OR MORE DEPRESSION

There are many who argue that it would have been better for the community as well as for the farmers themselves if they had responded to falling prices by allowing their lands to lie idle, which is what, in effect, manufacturers do during a depression. They overlook that if farmers followed the urban model, depressions would mean not merely distress but wholesale starvation. They fail to see that you can't increase the prosperity of a nation, even though you may increase the wealth of selected individuals, by sabotage, by deliberately restricted production. When one section of industry keeps on operating at full steam, while other sections lay down their tools, the section that continues to operate may be keeping the whole economy from going to smash but thereby assumes a disproportionate portion of the depression burden. That section of the community is not only morally entitled to relief, but it becomes in the general interest that it receive it before it also is forced to stop production.

But instead of relief the farmers were given the Farm Board Act and the Smoot-Hawley tariff; the former disorganized their markets and got them more deeply into debt, and the latter, through inciting retaliatory and defensive measures abroad, deprived them of their foreign markets. There was no excuse, except unworthy political excuses, for either of these measures. There was no lack of warning as to how they would operate. It is true that the farmers themselves were largely responsible for the enactment of both measures. But a competent government's duties do not consist merely in giving to its citizens what they think they want, but also in restraining them from making fools of themselves.

In past depressions wage reductions have contributed to recovery by making possible a restoration of profit margins for industry in spite of the fall in commodity prices. During the New Era, the Hoover Administration became apostles of the high-wage fallacy, the doctrine that high wages are a guarantee and an essential of prosperity. At the beginning of the depression, Hoover pledged industry not to cut wages, and for a long time large-scale industry as a rule adhered to this pledge. There is not time for an adequate exposure of the errors of economic
DEFLATION, INFLATION, OR MORE DEPRESSION

analysis from which this high-wage doctrine derives its plausibility. But its basic fallacy, to which, unfortunately, many of my professional colleagues have succumbed, can be made clear in a few words. All that is guaranteed by wages higher than employers can afford to pay and still give employment to the available supply of labor is unemployment. The doctrine asserts that high wages mean high purchasing power, but an unemployed laborer has no purchasing power at all, however high may be the wage rate he would get if he had a job. Large payrolls do mean high purchasing power, but high wages may and often do reduce rather than increase the size of the total payroll. Moreover, $100 in a pay envelope constitutes no more purchasing power than $100 in dividend coupons, unless the poor hoard a smaller proportion of their income than do the rich, which I doubt. It would be very nice if simply by doubling or tripling all wage rates overnight we could end the depression, but its effect would be rather to make unemployment complete instead of partial. President Hoover would have rendered a service instead of a disservice to labor if instead of pledging employers to maintain their wage rates he had obtained from them a pledge to maintain their total payrolls, with freedom to reduce wages as circumstances made necessary.

IV
INDUCED BALANCED DEFLATION

Next for the policy which I have labeled induced balanced deflation. If costs fell as rapidly as prices, there would be no depression in the sense of unemployment and impaired national real income. If prices were stabilized at their present level and costs were to decline in the same proportion from their pre-depression level, the depression would end, as the result of what I would call balanced deflation. Assuming that there are no means, or no adequately safe means, of raising price levels, and assuming that costs had not fallen sufficiently to offer inducements to business men to carry on their operations on something approaching to normal capacity, is it not possible to force or
DEFLATION, INFLATION, OR MORE DEPRESSION

induce costs to fall until there is again a balance between costs and prices? In other words, cannot the rigidity of the elements entering into costs be broken down through governmental action? This question can best be approached by dealing separately with the major items constituting costs of production: raw materials, wages, interest, rent, freight and utility charges, and taxes.

In the main the prices of raw materials, and especially of agricultural products, have fallen in greater degree than have the prices of the more advanced products into which they enter. The problem for these is how their prices can be raised rather than how they can be further lowered. But there are some important raw materials, notably steel and steel products, anthracite coal, cement, and brick, which through the quasi-monopolistic organization of their industries have succeeded largely in resisting the general downward trend of prices. They have been aided in this by the deliberately slack enforcement of the anti-trust legislation by the federal government during the depression. There are valid criticisms to be made of the anti-trust legislation, especially in so far as it presents an obstacle to reduction in costs of production through mergers, elimination of competitive expenses, and so forth. But when the government during a depression lends its moral support to price maintenance and output-restriction, it is operating indirectly to lengthen and intensify the depression. Price maintenance through restriction of output means price maintenance through intensified unemployment. There should be vigorous condemnation and prosecution of all concerted endeavors to restrict output.

With wages I have already dealt somewhat. The pre-depression wages have given way to a considerable degree in the last eighteen months, and in small-scale industries and in small towns they have frequently been drastically reduced. Except here and there in the few industries in which trade unions still retain an influence, or where employers with more sentiment than wisdom are showing a preference for high wages over fuller employment, there are visible to me only two important groups

* 14 *
of labor whose wages should be further reduced in the interest of economic recovery, namely, the wages of railroad labor and of government employees. If freight charges and tax rates are to come down, it is necessary that wages of these groups of labor be further reduced. Without a reduction of freight charges and tax rates, and in the absence of a general rise in prices, there is no reason to expect early recovery from the depression. In both instances the government has a deflating rôle to play, since it stands as protector of railway wage schedules and is of course directly and immediately responsible for the level of salaries and wages paid to its own employees.

During the seven fat years 1923 to 1929, industry in general freed itself largely from bonded indebtedness, and in this respect was in a favorable position when the depression began. The reverse was true, however, of agriculture, of urban real estate, of the railroads, and of state and local governments, which during these years accumulated a great load of fixed bonded and mortgage indebtedness, a load which has become intolerable with the decline in prices and in volume of business, and which leaves those struggling under it without adequate credit for bank loans with which to finance current operations. Assuming as before that prices will not rise, this debt load must be drastically reduced. For farmers and private business, provided no net equity remains or such equity as remains can be concealed from or is not insisted upon by the creditors, a remedy lies through bankruptcy or receivership proceedings, and this remedy, while costly, is salutary. But as long as some equity remains, and sometimes long after it has all vanished, the debtor struggles to avoid the stigma of bankruptcy, and thus merely postpones the inevitable and increases the damage done.

There should be little stigma attached to bankruptcy proceedings in a time like this. Some of our best citizens have survived them without loss of caste. In the urban real estate field, the situation would in large measure have been cleared up by this time if the legal profession and the politicians, often in collusion with the courts, had not grasped the opportunity to fatten, like vultures, on the distress of their fellow citizens. In the case of
DEFLATION, INFLATION, OR MORE DEPRESSION

the railroads and of farm mortgages, the situation remains to be dealt with. In other countries, less costly procedures and remedies are possible which, by deflating but not wiping out the creditors' claims, render reasonable justice between debtor and creditor and permit the debtor to resume operations with lower interest and capital charges, and with rehabilitated credit for new borrowings. In this country, constitutional provisions stand in the way, unless voluntary consent is given by both parties, but the governments can, and apparently are about to, aid this process of mutual agreement to deflate indebtedness. The Reconstruction Finance Corporation, by its loans to railroads, has postponed this necessary task of deflating debts, and has thereby served to lengthen and deepen the depression rather than to shorten and moderate it. Unless prices rise, time will in due course take care of all these private debts, through bankruptcies, foreclosures, receiverships, defaults, and compositions. But speed is urgent, and it is urgent, therefore, that governments—and especially the federal government, which is so hostile to measures tending to raise price levels—should hasten the process of debt deflation by every means, legal or nearly so, at their disposal.

Government debts are important as a factor in the depression chiefly through their contribution to the tax burden, and here there is no easy remedy of a deflationary type. Reduction of federal debt or interest by fiat is to most Americans unthinkable, and would undoubtedly for some time seriously disturb confidence. Reduction of the federal interest burden by conversion at lower rates of interest is possible to some extent, but it would require skillful management and whole-hearted cooperation by the banking system. There is little ground for anticipating substantial relief to the federal budget therefrom unless a patriotic appeal such as the British for voluntary conversion at lower rates were made and were successful. The experiment should be tried, however.

The state and local debt burdens are less manageable than the federal, and I see no means of relief. The credit of local governments is already sadly impaired, and successful conversion opera-

* 16 *
DEFLATION, INFLATION, OR MORE DEPRESSION

tions are out of the question. There are no legal barriers to state repudiations, but in most states local governments must continue to carry out the letter of their bond contracts as long as taxable property still exists within their jurisdiction, and as long as there still remain schoolhouses which can be closed, and school teachers who will work without pay. Local governments have found it necessary to pay the interest on their bonds even after they could no longer find the funds with which to provide relief for the unemployed. Under the American legal code, local governments have sacred obligations to their bondholders but apparently to no one else.

The rent problem is closely similar to the private debt problem, but apparently there is less sacredness about a rent contract than a bond, and rent contracts, moreover, usually have shorter terms than do bond contracts and therefore are more quickly adjustable to changed circumstances. In any case, there have been wholesale rent concessions irrespective of the terms of the leases, and it is only corporations of great wealth who find landlords obdurate to appeals for rent concessions.

In the case of freight and other utility charges, governments are in a position to act without need of new legislation or powers. Freight and utility charges should be flexible, should be reduced during depressions, and should be permitted to rise during prosperity. The utilities should expect a "fair" return on their investment on the average over the good years and bad, and not in every particular year whatever the consequences to the rest of the community. Rate reductions now should be accompanied by pledges of rates during the next prosperity period sufficiently high to offset any losses resulting from present reductions. The freight rate structure is so absurd that it would be amusing were its effects not so tragic. The notions of railway executives that they can survive the depression and the new competition by charging rates so high that they are patently strangling industry and agriculture and suppressing traffic only serve to heighten the common impression that the difficulties of the railroads are not wholly unrelated to the quality of their management. But if the railroads cannot survive lower rates
DEFLATION, INFLATION, OR MORE DEPRESSION

without assistance, it would be much better for both the rail-
roads and the public if government subsidies were devoted to
rate reductions rather than to liquidation of ancient debts. It
is curious that the metropolitan press, which is so convinced
that the high tax burden is the chief obstacle to economic re-
covery, shows no interest in the high utility rate structure, which
falls more directly on business operations, and is, dollar for dol-
lar, an equal burden with taxes on whomever it falls.

Reduction of taxes, and especially those taxes which press
directly upon production is, however, an essential part of a pro-
gram of balanced deflation. The difficulties are great, and should
not be minimized. During a depression the tax base, whether it
be income or property or commodity sales, shrinks, and to main-
tain the same tax revenues it is necessary to increase the tax
rates. But an increase in tax rates operates further to compress
the tax base, and from this vicious circle there is no escape ex-
cept through a drastic cut in government expenditures or through
financing a large fraction of the expenditures during the depres-
sion through borrowing. For state and local governments, im-
paired credit and constitutional debt limits are obstacles to
recourse to borrowing. For the federal government, the cam-
paign for balancing the budget has made it dangerous to increase
the debt substantially, because of the adverse effect it would
have on the morale of a scared public taught to measure the
stability of government by the financial record for a single year
or short period of years.

Had it not been for this campaign of fear, however, it would
have been sound policy on the part of the federal government
deliberately to permit a deficit to accumulate during depression
years, to be liquidated during prosperity years from the higher
productivity of the tax system and from increases in tax rates
when they would do no harm. The outstanding though uninten-
tional achievement of the Hoover Administration in counteract-
ing the depression has in fact been its deficits of the last two
years, and it was only its own alleged fears as to the ill effects
of these deficits, and the panic which the big business world pro-
DEFLATION, INFLATION, OR MORE DEPRESSION

fessed to foresee if these deficits should recur, which have made
this method of depression finance seriously risky. Had the gov-
ernment and the business magnates retained their mental bal-
ance, there would have been less cause to fear net ill effects
during a depression than during the war from even a ten billion
dollar deficit.

Given the necessity, however, for reducing government expend-
ditures, it is much more desirable that this should be done
through temporary reductions of salary and wage scales to a
level with prevailing conditions than by cutting down important
government activities. Both methods have the same beneficial
effect on the taxpayer as such, but the latter method adds to
the number of unemployed, deprives the public of the benefit
of valuable governmental services, and disorganizes and demor-
alizes governmental working staffs much more than would rea-
sonable wage reductions accompanied by assurance of continued
employment.

In order to have its maximum beneficial effect, it would be
necessary that a program of induced balanced deflation should
be pursued vigorously and simultaneously along the whole front
of undeflated costs. Such deflation would inevitably involve
hardships and inequities in individual cases. It is to be regarded,
however, as a surgical operation, effective only if done quickly
and to the full extent necessary. Procrastination in executing it
or its execution in a half-hearted way might well result in its
failure to accomplish its purpose. In several respects, it could
be so managed as to deprive it of its harshest features. Wage
reductions could be made temporary in form; in bankruptcy
settlements and compositions of debts there could be included
provisions to the effect that, in the case of early business recov-
er, the surrendered claims of the deflated creditors would be-
come reinstated in part. Such contingent provisions would not
lessen the degree of immediate relief to business and agriculture
and would give some basis for hope to creditors and wage earn-
ers that the impairment of their economic position would not
be permanent.

* 19 *
Inflation as a Means of Recovery

I come finally to the policy of inflation as a means of bringing about a recovery of prosperity. Here peddlers of nostrums find a promising field for their operations, and here also apostles of inertia, dispensers of chloroform, tend to rely upon ridicule as a substitute for reasoned argument and find that it works very well. “Inflation” is an old word and during its long history has accumulated a wide range of meanings, many of them contradictory. I will use the term inflation to mean an increase in the total amount of spendable funds, whether consisting of coin, paper money, or bank deposits subject to check.

The basic argument for inflation is that it would operate to raise product-prices more than cost-prices, would in this way restore a profit margin for business, and thus would bring about an increased volume of production and of employment. Against inflation many things are urged. It is said, for instance, that: (a) it can’t be done; (b) if attempted, it would drive us off the gold standard; (c) all previous attempts at inflation have ended in disaster; (d) inflation involves a violation of contract and is morally reprehensible.

I can see little force in most of these objections. Inflation has been accomplished many times, especially in times of war. Inflation as I have defined it has more often been practiced under the gold standard than off it. We had a generation of inflation on the gold standard after the discovery of the Californian and Australian gold fields in the middle of the nineteenth century, and again twenty years of it after the discovery of the Klondike and the invention of the cyanide process for extracting gold from ore at the end of the nineteenth century. Inflation, whether off or on the gold standard, is much safer, much more easily regulated, if practiced on an international scale than if brought by a single country, and if practiced internationally all of the inflation anyone could reasonably ask for would be possible without endangering the gold standard in the slightest.

There have been a few previous attempts at inflation which, conducted without restraint and under abnormal circumstances,

* 20 *
DEFLATION, INFLATION, OR MORE DEPRESSION

ended in disaster. There have been dozens, perhaps hundreds of cases, however, where it was kept within bounds, and while not necessarily beneficial, did not have disastrous effects. As far as I know, it has never until the present depression been used deliberately as a means of ending a depression, and has generally been unintentional, or has been used to help finance a war, a use against which much can be said, since in war time what is ordinarily needed is not an artificial stimulus to business, but rather restrictions on over-expansion in directions not contributing to the attainment of military victory. There is no lack of knowledge as to the technique of controlling an inflation, and if it involves risk, the risk lies not in ignorance as to methods of control but in lack of determination on the part of government, central bankers, or the public, to exercise such control.

Deliberate inflation may involve violation of the letter or of the spirit of contracts, but the only visible alternatives are similar modification of contracts through forced deflation or through bankruptcy, or else economic collapse. Under inflation there is no need for reduction of the real income of the creditor class below the level that they had cause to anticipate when the contracts were made, and even creditors would be well-advised to prefer inflation with its reduction from present nominal purchasing power to inability to collect anything because the debtors were breaking under an undeflated debt load.

It is often said that the federal government and the Federal Reserve system have practiced inflation during this depression and that no beneficial effects resulted from it. What in fact happened was that they made mild motions in the direction of inflation, which did not succeed in achieving it, did not succeed even in accomplishing "reflation," but which probably did slow up somewhat the rate of price decline. The loans of the Reconstruction Finance Corporation, in so far as they involved new credits instead of substitution of sound for unsound credit, the open-market purchases of the Federal Reserve banks, have been in the main but two different aspects of a single operation. The Reconstruction Finance Corporation obtains its funds from the federal treasury. The treasury obtains its funds mainly by sale of short-
term securities to the banks. The banks recover the funds which they have thus lent to the treasury by sale of government securities in the open market to the Federal Reserve banks. The loans of the Reconstruction Finance Corporation and the open-market purchases of the Federal Reserve banks are not to be added to each other, therefore, as is often done, in order to estimate the extent to which government and central banking agencies have pumped new funds into the credit market. At no time, moreover, since the beginning of the depression has there been for as long as four months a net increase in the total volume of bank credit outstanding. On the contrary, the government and Federal Reserve bank operations have not nearly sufficed to counteract the contraction of credit on the part of the member and non-member banks. There has been no net inflation of bank credit since the end of 1929. There has been instead a fairly continuous and unprecedentedly great contraction of credit during this entire period.

Many of the methods of inflation currently advocated would not, or would not necessarily, accomplish it. Increases in paper money would increase the total amount of spendable funds only if they were not offset by corresponding decreases of bank deposits subject to checks. In any case, an increase of paper money in greater proportion than that in which the public wished to hold its cash balances as between currency and bank deposits would rapidly be converted into bank deposits, and conceivably its only effect would be to increase the cash reserves of the banks or decrease the indebtedness of the member banks to the Federal Reserve system. The initial form of the inflation has no special significance and would soon change if not in accordance with public customs and habits.

Similarly, proposals for periodic stamp taxes on paper money, in order to speed up its rate of circulation, sound sensible—if they do—only because it is overlooked that if there is a special tax on holding cash balances in one form but not in another, everyone will learn to use the taxed form of money in making payments and to do his hoarding in the untaxed form. Such measures would increase the velocity of circulation of the taxed

* 22 *

DEFLATION, INFLATION, OR MORE DEPRESSION

money, but only by decreasing to a corresponding degree the velocity of circulation of bank deposits and coin. In order to have the desired effect, such taxes would have to be levied on all forms in which cash balances can be held, including coin and bank deposits. What would thus be accomplished would be a backhanded form of inflation, where the velocity of circulation of spendable funds would be increased, but not its amount. The difficulties of administering such a measure would appear to be enormous.

Another common proposal, namely, to devalue the dollar or reduce its gold content by, say, 25 per cent would, in the absence of other concomitant measures, operate to raise the price level in two ways. First, exports would be stimulated because of their lower prices in foreign currencies, and imports would be restricted because of their higher prices after conversion into the devaluated American currency. This would result in higher prices for the export industries, and in larger gold reserves for the banking system. Second, the devaluation of the currency would increase the dollar value of the present gold reserves of the banks without increasing the dollar value of their present demand liabilities, would thus increase their gold reserve rates, and would enable them to increase their loans with greater safety in so far as adequacy of reserves was concerned. But tariffs and the depression have reduced our foreign trade to a small fraction of its former proportions, and it now seems to be insufficient to be an important short-run regulator of our price level. Countries on the gold standard, moreover, would be likely to apply import quotas and administrative restrictions on our products in order to protect their domestic producers against increased inflows of American goods, and countries off the gold standard might further depreciate their currencies to countervail the effect on their trade of our devaluation. Our banks also might welcome the additional liquidity which the measure gave them, without hastening to use it as a basis for expanding their loans. Finally, the gold clause which appears in a great part of our bonds, mortgages, and long-term leases, and is now being included in even ordinary short-term promissory

* 23 *
notes, would present an embarrassing legal problem for which no satisfactory solution has yet been suggested.

There are many advocates of remonetization of silver at a mint price greatly in excess of its current market price as a means of raising the price level, but there is even less to be said for it than for most inflationary proposals. If the government wishes to inflate, there is no reason why it should not retain the immediate profit from the fiat currency for itself rather than give it to the silver-mine operators. The total available stock of free silver in the world is not sufficient to make any great impression on the price level unless silver were overvalued many fold for currency purposes. The rise in the market price of silver would operate to extend to the silver-currency-using countries the destructive deflation from which the gold standard countries have been suffering, but from which they have largely escaped because of the decline in the gold price of silver.

Assuming for the moment that a deliberate policy of inflation should be adopted, the simplest and least objectionable procedure would be for the federal government to increase its expenditures or to decrease its taxes, and to finance the resultant excess of expenditures over tax revenues either by the issue of legal tender greenbacks or by borrowing from the banks. It will be remembered, however, that this would not actually result in inflation as I have defined it, if the new greenbacks were hoarded, or if the new borrowings were of private funds which would have been used in any case, or if the banks in their continued search for liquidity reduced the amount of their loans to others to an equal degree. In order to bring about inflation it would be necessary to increase government expenditures sufficiently to more than offset for some period of time any counter measures of a deflationary character by banks or individuals. Can this be done, and what would be the consequences?

Theoretically, it is clearly conceivable that it would take extraordinary amounts of government expenditures to accomplish this end, if banks continued to liquidate their loans and private individuals to hoard their bank funds as a reserve against future needs and to hoard government money as insur-

* 24 *
DEFLATION, INFLATION, OR MORE DEPRESSION

ance against bank closures. This procedure could work only if it did not cause general fear of an early departure from the gold standard and therefore a flight from the dollar into foreign securities and foreign currencies, and if upon the first signs of an impending price rise business men actually began to buy commodities and to resume productive operations in order to profit from the low prices while they still continued to be available. I cannot see any justification for confidence that an aggressive inflationary policy of this sort would not immediately result in a flight from the dollar, in panicky anticipation of the effects in business circles of a grossly unbalanced government budget, and therefore in more injury than good, at least as long as we remained on the gold standard.

But what if we went off the gold standard? Once off, individuals would have nothing to gain by fleeing from the dollar to foreign currencies, since the exchange market would probably immediately over-discount the prospective fall in the internal purchasing power of the dollar. There would still be an incentive to flee from the dollar internally, but the internal flight from a paper currency does not take forms restrictive of business activity such as hoarding of money, but on the contrary leads to rapid expenditure on commodities, building, and so forth, in order to profit from the anticipated price rise.

If going off the gold standard were as simple a matter for us as for England and Canada, I would not only advocate it, but if the mere cessation of gold payments did not suffice to lower substantially the internal purchasing power of the dollar I would recommend its accompaniment by increased government expenditures financed by the printing press or by loans. You have no doubt been told that unemployment has not decreased and production has not increased in England and in the other countries which went off the gold standard in 1931, and that these countries as a result of their departure from the gold standard have lost in prestige and have suffered from an unstable currency. But these countries made one mistake when they went off the gold standard. Their mistake lay in their too restrained use of the freedom which the departure from the gold standard gave

* 25 *
DEFLATION, INFLATION, OR MORE DEPRESSION

them. Instead of attempting to raise prices, they tried instead to stabilize them at the then prevailing level, relying upon the stimulus to their exports of the fall in the foreign exchange value of their currencies to bring them an increased measure of prosperity. They failed to foresee that the progress of the depression, the continued deflation in the gold standard countries, and the multiplication of tariff and other restrictions on foreign trade would more than neutralize the tendency of the depreciation of their currencies to increase their exports. Although, therefore, half the world went off the gold standard with England, none of it has actually inflated, has actually increased its total amount of spendable funds.

The countries which went off the gold standard have nevertheless weathered the economic storm much better than we have done. If they did not restore prosperity for themselves by abandoning gold, they at least escaped the further deterioration which we have suffered since the autumn of 1931. In England, for example, prices, production, employment, have held their own since 1931, which is much more than we can say for ourselves. England has even balanced its budget during this current fiscal year, whereas operating under the supposedly conservative gold standard we achieved the greatest peace-time budget deficit in history. I doubt whether in comparison with us England has lost in prestige since the autumn of 1931. If so, I would like to know on what grounds. In any case too high a price can be paid for prestige. Nor has our gold standard currency been more stable than the English paper currency. The contrary has been the case. In internal purchasing power, the English pound has remained practically stationary, whereas our dollar has, to our sorrow, substantially appreciated. On the exchange markets our dollar has of course fluctuated exactly as much in its power to buy sterling as sterling has fluctuated in its power to buy dollars. The only stability our currency has had has been stability in its exchange value for gold.

The gold standard is to many men a sacred institution, adherence to which rests on faith, on devotion, if necessary on self-sacrifice, but not on reason and calculation. I do not share

* 26 *


DEFLATION, INFLATION, OR MORE DEPRESSION

these religious convictions, but I nevertheless am firmly con-
vinced that, because of special circumstances prevailing here,
for the time being at least it is impossible for us to consider de-
liberate abandonment of the gold standard or even any serious
tampering with it. The actual process of going off the gold
standard, while it is under way, is extremely painful, costly,
panic-breeding. England was able to go off over a week-end. In
this country, it would undoubtedly require weeks, if not months,
of public and congressional debate, during which utter confusion
would be likely to prevail. The gold clause in contracts, peculiar
to us, would be an additional complication persisting even after
we had formally abandoned the gold standard, and even if the
gold clause were eventually nullified by judicial decision to the
effect that it was unenforceable, or that it was not binding dur-
ing an emergency, it would in the interval before a final decision
could be rendered cast doubt on the solvency of all railroads
and other corporations having such clauses in their bonds. Many
persons also would question whether we can safely trust our
legislators to exercise with due caution, sobriety, and intelligence
the power of price regulation which they would have if our cur-
rency system were no longer tied to gold.

If we are to have inflation, therefore, we must have it within
the gold standard and without resort to budgets badly enough
unbalanced to terrify Wall Street. These two conditions suffice
to make impossible any policy of deliberate inflation on a large
scale through unilateral action on our part. If it is to be accom-
plished at all, it must be accomplished by international agree-
ment, as a part of the general economic settlement which we
must hope and pray will be the outcome of the International
Economic Conference. If all, or even a substantial number, of
the important commercial nations will agree that they will en-
deavor to raise their internal price levels within twelve months
by say fifteen per cent, will pledge themselves by pegging oper-
ations and international loans to maintain the exchange values of
their currencies at approximately their then prevailing levels,
will contribute to the process of balanced deflation by writing
down pre-depression international debts, public and private, and

* 27 *
DEFLATION, INFLATION, OR MORE DEPRESSION

will pledge themselves to restore tariff walls to their 1929 levels or lower and to abolish the administrative barriers to trade which have accumulated during the depression, I am optimist enough to be confident that the prospects of early prosperity will seem promising enough to business men and banks throughout the world to lead them of their own accord to put their spendable funds into use to finance production, to restore employment, and to bring about the needed rise in price levels without necessitating substantial additional expenditures on the part of governments or abandonment of the gold standard by countries still adhering to it.

A full return to the 1929 price level is not essential for the recovery of prosperity. The decline in the prices of the factors of production which has already occurred, together with the economies and the technological improvements which have been introduced under the pressure of three years of falling prices, will make a moderate increase in prices suffice for prosperity. Even if the important participants in the International Economic Conference should only pledge themselves to prevent a further decline in commodity price levels, economic recovery might still take place, although after a longer delay, through the progressive operation of the process of balanced deflation, without the assistance of an artificially induced rise in price levels. Without speedy balanced deflation or induced inflation, or preferably a combination of both, prospects are extremely gloomy. If the International Economic Conference should fail to produce substantial results in one or the other or both of these directions, then we must fall back on drastic balanced deflation within our own country as the only hope for relief. If this should also fail, then we must steel ourselves to withstand more depression, whose final outcome for our civilization, and especially for our present mode of economic organization, no one can as yet foresee.

OPEN DISCUSSION

QUESTION: Is England on the silver basis?

MR. VINE: No, England is on a paper basis, but has not altogether discovered it yet and is still retaining too much of

* 28 *
DEFlation, Inflation, or More Depression

the gold standard psychology. I may say in this connection something I intended to say in my talk: although I concede that England has not increased her prosperity, the reason why is that England has not used to full advantage the freedom she got. She has merely held her own. There has been no expansion of paper money or bank credits. The gold reserve requirements are still as binding now as if she were still on the gold standard.

QUESTION: If England is on the paper basis, what is back of it?

MR. VINER: All that is necessary to give value to the currency is to keep the quantity restricted sufficiently. It doesn't have to have any intrinsic value.

QUESTION: What reasons are there for supposing that any of the proposals for limited inflation now before Congress would accomplish any more than the Bland and Sherman acts of the last century?

MR. VINER: There are two kinds of history of American monetary experiences. There is the history written by those who believe that strict adherence to that nowadays most profound of our religious institutions—the gold standard—was all-important, and who would put as the great periods in our history the dates when Congress resisted the temptation to tamper with the gold standard. I think myself that a lot is to be said for William Jennings Bryan and his 16 to 1 campaign of the 1890's; and that the country itself would have come to that conviction if the process which was then crushing the farmers had continued for three or four years. The only thing that has saved us in previous severe deflations has been a series of miracles. In the middle of the nineteenth century, the discovery of gold fields in California and Australia came after forty years of very severe deflation comparable to what we are suffering now. Again, toward the end of the nineteenth century, came the discovery of gold in the Klondike and the Transvaal and the cyanide process of extracting gold, which itself raised the price level so that the farmers got relief through rising prices. People talk of similar miracles being in prospect now. They may come. But I wouldn't gamble on it.

* 29 *
DEFLATION, INFLATION, OR MORE DEPRESSION

QUESTION: Is there any kind of an inflationary proposal involving an expansion of money that would not be discounted by the banks and in a way which would result in a shrinkage of currency?

MR. VINER: The banks have no means whatever of countervailing an inflation if you are not on the gold standard. Under the gold standard they can flee from the dollar. Off the gold standard, hoarding doesn’t do any good. Under a paper currency the only practicable mode of insurance against loss of value of one’s cash holdings is to buy commodities, build homes, and so forth—not a very undesirable consequence. Bankers have no personal cause to fear inflation. If they are the greatest stalwarts against inflation, it can’t be because of self-interest, but it is their feeling of what is good for the country.

QUESTION: Is it not likely that most of the so-called inflationary proposals now before Congress, if passed, would have so serious an effect upon the bond market and banking system that the effects would be deflationary rather than inflationary?

MR. VINER: Under a paper currency there is no particular reason why inflation should have an adverse effect on the bond market unless you expect wild inflation. In England bonds have not fallen in price since England went off the gold standard. On the contrary, they have risen. The British have more confidence in their present economic status. If you mean by inflation, wild unregulated inflation—such as has happened in some countries—that would hurt not only bonds but many other things as well. And, as I have already said, the process of going off the gold standard would be very costly altogether apart from any accompanying inflation.
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Minneapolis
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NUMBER FOUR
THE DAY AND HOUR SERIES
OF THE UNIVERSITY OF MINNESOTA
April 1933
THE DAY AND HOUR SERIES

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L. D. Coffman, President.
International Economic Recovery

by

H. G. Moulton

The University of Minnesota Press
This is the third and last of a series of lectures on Proposals for Economic Recovery, arranged by the University in cooperation with certain representative citizens of Minneapolis and St. Paul. It was delivered in Northrop Memorial Auditorium on March 9, 1938, by Dr. Harold G. Moulton, president of Brookings Institution. In recent years he has written on aspects of the international situation: "Principles of Money and Banking," "Financial Organization of Society," "The Reparation Plan," "Japan, an Economic and Financial Appraisal." With others he has written: "America and the Balance Sheet of Europe," "Germany's Capacity to Pay," "Russian Debts and Russian Reconstruction," "The French Debt Problem," "World War Debt Settlements."
International Economic Recovery

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The subject of economics becomes important to the layman only when economic conditions are bad. In the days of prosperity there do not appear to be any important economic problems demanding solution, and the truth is that if anyone in boom times suggests that the tendencies that are under way will likely lead to disaster, if not corrected, he is likely to be regarded as a mere pessimist out of step with the march of progress. But when depression comes, then the economist is chided if he does not present quickly some simple solution for the difficulties with which the world is confronted.

It takes a period of depression to make us realize the economic interdependency of the world. When times are favorable, it is the assumption among the great majority of people that this country, for example, can get on perfectly well without the rest of the world. We are self-contained, able on the basis of our own resources to flourish and prosper. But when depression overtakes us, we are likely to believe that it is primarily due to difficulties arising in other parts of the world. In any event, the international economic interdependency of the world is brought home to us in new and striking ways.

As a preliminary to the discussion of the more immediate aspects of the international problem and the possibilities of effecting international recovery, I have thought it might be desirable for me to sketch very briefly, in a summary fashion indeed, the development of a world economic system over the past century, and I can perhaps best do this by referring to the developments that have occurred in one after another of the leading nations of the world.

* 5 *
INTERNATIONAL ECONOMIC RECOVERY

England, as you are all aware, took the lead in becoming a nation with wide international relations. England began early in the last century to assume a rôle of leadership in the field both of industry and of finance. Her pre-eminence throughout the period of the nineteenth century was due primarily to two factors in her economic life. The first was the momentum of an early start in the field of manufacturing industry, and the second was the early development of a sound banking and monetary system. England adopted the single gold standard as early as 1816, and throughout the nineteenth century there was no danger at any time that contracts made in terms of English currency would not be honored in relatively stable money. That, combined with her industrial expansion, gave to England a position of international importance well before the middle of the century.

In fact, Great Britain began to be an important investor in foreign countries early in the century—in India, through the process of direct investment; in the United States, through the purchase of bonds. The Baltimore and Ohio Railroad Company floated bonds in England in the early 40’s, and through the middle and later part of the nineteenth century, the English people invested heavily in American securities. There followed a little later an investment by the English people in the British possessions, in the Orient, and in South America until, by the end of the century, the financial life of Great Britain, by virtue of her trade relations, her investments, and by virtue of her banking connections, extended throughout the world. As a part of this problem of becoming internationally interdependent with the rest of the world, Great Britain abandoned in the decade of the 40’s the protective tariff on imports to the end that cheap raw materials and foodstuffs might give her particular advantages in the export trade in manufactured commodities.

While becoming to some extent an investing nation toward the middle of the century, France, on the other hand, always maintained her agriculture as an important part of her economic life. By 1870, France had two billion dollars of foreign investments in England, the United States, and near-by European
countrieds, and out of those investments she paid the bulk of the indemnity of 1870, amounting to about one billion dollars. Between 1870 and the World War France gradually extended her foreign investments, particularly into the African colonies and in Russia.

It was not until the fourth quarter of the nineteenth century that Germany emerged as a great industrial and financial power. The development of Germany in the last quarter of the nineteenth century was the outstanding development of the past seventy-five or a hundred years in Europe. Germany became a great manufacturing nation, purchasing foodstuffs and raw materials in other parts of the world, converting them into finished products, and selling them in turn over wide areas. Germany also became a great financial center, financing through short-term credits the trade and industry of a large part of central and eastern Europe and extending her investments through the purchase of securities in numerous countries of the world.

Now this great development of urban civilization in Europe made possible the prosperity of agricultural countries in far parts of the world. The opening up of the great Mississippi Valley and of the Northwest to profitable farming was a direct result. The United States and Europe combined in specialized production and the exchange of our produce, and each was absolutely dependent on the other.

In the last quarter of the nineteenth century, there began in the Far East another great development. From about 1600 to 1868 Japan had been completely isolated from the rest of the world as a matter of national policy. Not only was all immigration into Japan forbidden, but all emigration was forbidden, and all trade relations with the outside world were forbidden. As a result of a long era of peace within Japan there was developed on those little islands a great increase in production. The population of the islands in 1600 was something like ten or twelve millions of people; by 1720, the population had become about twenty-eight or thirty millions. The area of Japan is about equal to that of the state of New Mexico and the productive area about that of West Virginia. The economic organization that

* 7 *
INTERNATIONAL ECONOMIC RECOVERY

was developed was capable of sustaining a population of twenty-eight or thirty millions and no more than that, as was evidenced by the fact that the population remained stationary for over one hundred years. It was kept stationary, not by means of birth control, but by infanticide, disease, and famine.

After the opening of Japan to the rest of the world in 1870, it became possible by linking those islands up with the rest of the world to increase their population in the next sixty years from thirty to sixty-five millions, and also to increase the standard of living. These increases were made possible by virtue of the fact that Japan now began to specialize along the lines where she had the greatest relative advantage and to exchange her products with those of the outside world. She furnished raw silk to the industrial nations of the West and she drew, in turn, upon the outside world for other raw materials. She drew raw cotton from the United States, Egypt, and India and converted it into finished products for the supplying of her own population and for export, particularly to the Asiatic mainland. Now I mention the Japanese case because it illustrates, as nothing else can, the possibilities of expansion in wealth-producing capacity and in standards of living that come when a nation does depart from isolation and links itself up with the larger world economic organization.

Over the past century we have built up through the ordinary processes of trade and finance an economic system that is worldwide in its ramifications. Its successful functioning depends upon more or less specialized production in the various parts of the world and the exchange of commodities between regions and nations. The system depends, moreover, upon the maintenance of balanced trade relations. The state of normal balance, or equilibrium, which existed before the World War, was completely upset by the war and its aftermath.

The great shifts in private international investments and the creation of vast new inter-governmental indebtedness transformed nations from debtors to creditors, or vice versa, almost overnight. These great changes were, however, not accompanied by any corresponding changes in the agricultural and industrial
INTERNATIONAL ECONOMIC RECOVERY

organization of the various countries involved. On the contrary, the war served greatly to increase the exporting capacity of the nations which were becoming creditors and to decrease that of those which were becoming debtors—this because the war borrowing went for destructive purposes, rather than for the up-building of productive capacity, as is the case with normal peace-time loans. Then, immediately after the war, tariffs were adjusted upward by creditor countries with a view to preserving their expanded industries; but with the result that the trade readjustments necessary to permit the new international indebtedness to be liquidated were rendered virtually impossible.

The extension of vast new loans to Europe between 1924 and 1930—amounting to about four billion dollars—served for some years to obscure the true state of affairs. The loans enabled the borrowing countries to import heavily from the United States and at the same time to make the scheduled payments on reparations and inter-allied debts. But, at the end of this period, the international economic situation was more out of balance than ever. European indebtedness to the United States was greatly increased; but we were as unwilling as before to permit payments to be made in European goods. In fact, as we shall see, we again raised our tariff. At this juncture the world depression began—from a complex of causes which need not here be discussed. It is my purpose rather to indicate the ways in which the progress of the depression is tied up with international economic conditions, and to show why thorough-going recovery cannot be effected without international cooperation.

INTERNATIONAL INTERDEPENDENCE

The intricate business relationships of the modern world may be concretely illustrated by tracing the effects of the financial breakdown in central Europe in the spring of 1931, which ushered in the acute stage of the world depression. The inability of Germany to meet the strain of reparation obligations, coupled with banking difficulties in both Berlin and Vienna, resulted in a loss of confidence in the financial and economic stability of central Europe. This resulted in large withdrawals of foreign
funds from Germany and in heavy transfers of liquid assets abroad by German citizens who feared a repetition of the tragic financial debacle of 1923.

The international repercussions which followed the German financial crisis reached dimensions that no one had conceived to be possible. The shock to public confidence as well as the direct effects upon international trade immediately increased the difficulties of maintaining financial stability in other countries. The resort to heroic fiscal measures by the British government, for example, produced an exchange panic in Great Britain and the Bank of England was forced to suspend specie payments and the export of gold in order to prevent a complete dissipation of the nation’s gold supply. A number of other countries quickly restricted gold exports as a measure of defense or precaution; and thus the results of years of post-war endeavor to restore the gold standard as the basis of sound international commercial and financial development were practically undone.

In the United States the effects were manifested perhaps most strikingly in the extraordinary decline in the value of securities, both foreign and domestic, and both stocks and bonds. Of more far-reaching importance was the threat to the gold standard in the United States. Over $700,000,000 in gold flowed out of this country in a four-week period in the early autumn—the result of a withdrawal of bank deposits and the liquidation of investments by foreigners. While this drain was successfully met, it produced a widespread feeling of panic and led to an enormous volume of hoarding—which in turn contributed to the difficulties of banks and the further demoralization of the security markets.

The effects upon agriculture and industry were equally pronounced. The shrinkage of exports resulted in a further collapse of commodity prices, particularly of such great export staples as cotton and wheat. This calamity in its turn produced its chain of adverse consequences throughout the entire economic and financial structure. Our present difficulties represent the culmination of the series of consequences that began with the financial disorganization in Germany and Austria.

* 10 *
INTERNATIONAL ECONOMIC RECOVERY

THE PROCESS OF DESTRUCTION

The process of deflation leads at every turn to restriction of output and curtailment of income. Once depression is well under way, it is essential for each individual, each business unit, each bank, each educational institution, each governmental agency, each nation, to economize, that is, to reduce expenditures. But the road to individual solvency is unfortunately the route to collective insolvency. This is because the expenditures made by my business constitute the income received by your business. Every curtailment of anyone’s outgo means a curtailment of somebody’s income. As a result of this process of restricting expenditures—however necessary it may be for each individual or unit enterprise—the aggregate income of society steadily shrinks.

Since I am concerned here primarily with the international situation, let me elaborate on this aspect of the depression process as it relates to a nation. A nation in its business relations with the rest of the world is essentially in the same position as is an individual in his relations with his fellow citizens. The nation—by which I mean not the government, but the people collectively—has numerous payments to make to foreigners for imports, for services rendered to us, as interest on foreign debts, et cetera. At the same time, it has income due from abroad as payments for exports, for services to foreigners, interest on investments abroad, et cetera.

When hard pressed to meet foreign obligations, as has been the case during this depression, a nation seeks to restrict the volume of its obligations abroad, chiefly by curtailing imports, which represent the flexible item in international transactions. But, if European countries reduce their purchases of American cotton and wheat, for example, the result is to decrease the volume of foreign money available to us with which to purchase European exports. Moreover, the restriction of our exports of cotton and wheat spreads intensified depression throughout the areas producing these commodities, lessening automatically their capacity to buy manufactured commodities in the domestic mar-

* 11 *
INTERNATIONAL ECONOMIC RECOVERY

ket. In turn the necessary restriction of American purchases in Europe affects not only their export industries, but indirectly, through its repercussions, all European industries.

A panic on the foreign exchange of a nation is just like a run on an individual bank or on a series of banks. For example, a loss of confidence in British investments or in the British currency, or in British banks, leads foreign individuals and institutions who have investments or bank deposits in England to withdraw them. This involves selling such investments in the London exchange market for gold or for dollars, francs, or other currency.

Nations like England and the United States, which are financial centers of the world, are in just as vulnerable a position when such a situation develops as are nations that are indebted heavily to other countries. The volume of British or American investments which can be unloaded by foreigners and the volume of deposits in British and American banks which are subject to withdrawal on demand are so great that the total national gold supply may be insufficient to meet the strain. Just as an individual bank has demand obligations greatly in excess of its cash resources, so a particular nation may have to meet obligations abroad in excess of its available cash resources. Under normal conditions, no great amount of actual gold is ever called for; but once confidence is impaired and fear reigns, the credit system breaks down. A suspension of gold payments becomes essential to prevent the complete disappearance of a nation’s gold supply—into the hands of foreign holders or into the safety vaults, chimney corners, or the stockings of domestic hoarders. Suspension continues until such time as reviving confidence permits the resumption of specie payments without fear of excessive withdrawals. Always such confidence is restored in due course—sometimes as the result of financial readjustments or helpful legislation, and sometimes as the result of the operation of so-called “natural forces.”

I have perhaps devoted overmuch time to these banking and financial phenomena as they relate to international trade and business conditions; but a clear understanding of the interwoven network of international financial relationships and the
INTERNATIONAL ECONOMIC RECOVERY

bearing of this upon production and trade is a prerequisite to an appreciation of the lines along which world recovery lies. No individual can solve this depression by his own policies and acts; no single community can solve it; nor can a single state. The events of the past two years have demonstrated conclusively that national action is required in connection with problems that are national in scope, and that international action is essential in connection with those problems that are international in their reach. National policies are, at the moment, the most immediately urgent, but new international policies must follow quickly if an enduring recovery is to be hoped for. On this occasion, I must confine my constructive suggestions to the problem of reorientation in the international field.

THE ROAD TO RECONSTRUCTION

There are four primary lines along which business recovery may be promoted by international cooperation: (1) by the revision of commercial policies; (2) by the restoration of the gold standard in all the leading countries; (3) by the settlement of the reparation and war debt problem; (4) by extensive reductions in military expenditures.

I

REVISION OF COMMERCIAL POLICIES

With reference to tariff restrictions, we have already noted that in the early post-war years duties were raised in many countries as a means of protecting new industries created during the war and as a safeguard against wholesale imports from countries whose exchanges were greatly depreciated. After business stabilization was apparently effected in 1925–26, a very powerful sentiment developed in favor of a general downward revision of tariff schedules. Restrictive commercial policies were regarded as an outstanding obstacle to the thorough-going resumption of international exchange.

The World Economic Conference which met in May, 1927, surveyed the whole field of commercial restrictions and reached the practically unanimous conclusion that wholesale reductions of tariffs were necessary. The conference, in fact, made a cate-
gorical statement that "the time has come to put a stop to the
growth of customs tariffs and to reverse the direction of the
movement." It was suggested that this might be accomplished
in three ways: (1) by the individual action of particular states
in reducing tariffs; (2) by joint agreement between two nations;
and (3) by multilateral agreements among several countries.

For a few months, some progress was made in the sense that
numerous contemplated increases in tariffs were not put into
effect. A committee set up by the World Economic Conference
reported at its first meeting in 1928 that the effect of the confer-
ence had substantially checked the upward movement of tariffs.
But, in late 1928 and 1929, the movement for higher protection
again gained momentum, being precipitated by the increasing
depression in agriculture in various countries. In 1928, Persia
and China introduced their first independent tariffs, and Spain,
Peru, and Chile made general revisions. Germany increased its
agricultural duties in 1929 and again heavily in April, 1930.
The agricultural countries of central and eastern Europe adopted
similar policies.

This European movement was stimulated by the alarm and
resentment felt in many countries over the Hawley-Smoot tariff
act in the United States, which after a year of discussion was
finally passed in June, 1930. This act was passed at a time
when the balance of economic argument was overwhelmingly
against higher tariffs, particularly in the United States; it was
passed over the protest of many leaders of public opinion, busi-
ness men and professional economists alike; it was passed despite
the plain threat of retaliation by many other countries — passed
on the assumption that we could simultaneously still further
curtail our imports, collect our debts in dollars (earned by for-
eigners from sales in the United States), and expand our exports
to foreign countries.

The results have been all that were anticipated by those
who condemned the measure in advance. It was quickly fol-
lowed by new tariffs in many other countries, among them
Canada, Cuba, Mexico, France, Italy, Spain, Australia, and
New Zealand. In the case of the British Dominions, it accelera-
INTERNATIONAL ECONOMIC RECOVERY

ted the movement toward the use of preferential duties within the British Empire. It also led, under the quota systems shortly to be established, to discriminations against the United States. Throughout the year 1932, the tendency has been steadily toward higher tariffs. The latest publication on "Foreign Tariffs and Commercial Policies" issued by the Department of State reports: "Aside from the restrictions on commerce arising from exchange controls, the year 1932 saw trade barriers increased by various means in over thirty-five of the sixty-five commercially important countries, with a general downward tendency in tariffs observed in only a very few areas."

The complete disorganization of normal trade relations, and the accompanying depreciation of exchanges in many countries, has also led to various methods of directly restricting imports. A number of countries have introduced a system of licensing imports, under which the foreign exporters must have special permission to sell goods in the countries in question; and a more recent development has been curtailment of imports by means of the quota system, under which indispensable imports are arbitrarily allotted among the various exporting countries. In other cases, there are outright prohibitions of certain types of import, and in still other countries, state monopolies have been established which effectively prevent foreign sales within the country.

The effect of these progressive and cumulative restrictions, resulting from the present international instability, yet intended to preserve stability for each particular nation, has been to demoralize international trade in general, and with it the production of wealth. Instead of enabling men and women in all countries to produce and trade with the people of other countries, these policies have everywhere resulted in unemployment and impoverishment.

II

RESTORATION OF THE GOLD STANDARD

The abandonment of the gold standard in many countries during the past two years, under the stresses to which reference has already been made, has served to intensify the difficulties of
INTERNATIONAL ECONOMIC RECOVERY

conducting international trade. The fluctuation of exchanges introduces uncertainties into all business transactions, and thus militates against the making of the time contracts upon which trade depends.

It has been argued by many persons that the abandonment of the gold standard by a given country is a constructive policy. It is contended that the resulting depreciation of the currency will make that country a cheap place in which to buy, thus stimulating the export trade. It is true that there is thus a temporary stimulus to certain lines of trade; but as the cost of imported foodstuffs and raw materials rises for the same reason that the price of exports falls, the temporary advantage is soon largely, if not wholly, offset. In any event, no nation could permanently gain advantage over the rest of the world by depreciating its currency, for other countries would retaliate either by the imposition of tariff barriers, quota restrictions, licenses, and so forth, or by competing in the business of depreciating the currency. If the currency of country "A" falls 10 per cent, let that of "B" fall 20 per cent; then when that of "A" registers a further decline to 25 per cent, reduce that of country "B" to 30 per cent, and so on progressively.

The notion that the abandonment of the gold standard can give to any country a permanent advantage over others is pure illusion. The net result within a short period of time is to contribute toward general world instability. We passed through such a period of instability in the early post-war years; and it was not until the restoration of the gold standard following 1924 that international commerce could be conducted with some measure of confidence. Not until the nations of the world again cooperate and restore the gold standard, will it be possible for international trade again to flourish, for investments to be made, and, for that matter, for effective international trade agreements to be entered into. So long as complete currency instability reigns, the working out of stable trade relationships is quite impossible.

It is a fundamental requirement that the nations of the world should work together for the restoration of stable international
INTERNATIONAL ECONOMIC RECOVERY

exchanges, based on gold, for the elimination of the multitude of hampering restrictions now imposed on international commerce, for the downward revision of tariff schedules, and for the concluding of mutually advantageous trade agreements.

III

THE ADJUSTMENT OF WAR DEBTS

The foregoing discussion of maladjustments produced by the World War has laid the foundation for a summary discussion of the economics of the reparation and inter-allied debt problem. The large shifts in private international indebtedness early in the war, followed by huge inter-governmental borrowings, and in turn by stupendous reparation obligations, transformed the trade requirements of the world (if these debts were to be liquidated) without in any way promoting the capacities of the new debtor countries to meet these requirements. On the contrary, the productive capacity of these nations was greatly reduced by the war.

The statesmen of the world at the close of the war undertook to promote the restoration of world prosperity by levying upon the defeated countries the obligation to meet the full cost of the war. The economic wisdom of the policies that were laid down may perhaps best be disclosed by pointing out that we have been endeavoring in effect to promote the recovery of world prosperity from the destruction wrought by the war by requiring the poorer nations to send a flow of wealth to the richer ones. The war-time nations which suffered most heavily from the conflict, both directly in the form of wealth destruction and indirectly through the disorganization of the general financial and economic mechanism, were the nations of Continental Europe. The nation least affected by the war was the United States, with Great Britain occupying an intermediate position. Leaving Russia out of the picture, the Continental nations which suffered most severely were the Central Powers, followed by France and Belgium. While the Central Powers sustained comparatively little land devastation, their indirect or invisible losses were vastly greater than those of any of the Allies, because of the
terrific strain of waging war almost entirely out of their own resources, the loss of territory, and the destruction of their pre-war international commercial organization and markets.

Now, the liquidation of reparations and of inter-allied debts requires, in its final effect, a great flow of wealth from Central Europe to the United States. It can therefore fairly be stated that reparation and debt policies call for payments by the relatively poor to the relatively rich. This plan of restoring prosperity became effective, so far as reparations were concerned, immediately after the war. Its results were first manifested two years after the reparation "settlement" of 1921, when the German financial system and economic system broke down completely, resulting in chaotic conditions in Central Europe and producing serious dislocations in the economic life, not only of all Europe but of the outside world as well. With this collapse the German nation went—so to speak—into the hands of foreign receivers for purposes of reorganization. It had become apparent that a condition of prosperity in Germany was essential, not only to a program of reparation payment but also to the general economic welfare of the world as a whole.

With the advent of the Dawes plan, the direction of the flow of wealth was reversed. Nominally, the policy of debt collections remained unchanged, but it was supplemented by a policy of new loans to the debtor countries. As a result, there began a net flow of wealth from the United States to the impoverished nations of Europe, and particularly to Germany. The Dawes plan provided for a large loan to Germany and encouraged extensive private loans. The inter-allied debt "settlements" required, in most cases, small payments in the first five years; and the agreements were usually followed by American loans very greatly in excess of the current debt installments. Thus, on balance—whatever may have been true of particular countries—instead of America's being paid, Europe was going even more heavily into debt.

During the years from 1924 to 1929, when wealth was moving from the United States to Europe, it appeared that real progress was being made by the impoverished nations of Europe toward
financial and economic stability. But the structure of this apparent prosperity was built on insecure foundations. As the mounting payments prescribed in reparation and debt settlements were met out of new foreign borrowings, there came into existence a rapidly growing volume of new indebtedness. The process of liquidating international obligations by means of new borrowings, which increased the indebtedness in snowball fashion and which was not accompanied by corresponding changes in basic industrial and trade conditions and tariff policies, could not continue indefinitely. A collapse was inevitable sooner or later.

In 1930 the flow of wealth was, in fact, once more reversed in direction. The diminishing loans did not cover the reparation installments, plus interest on private debts. Germany, the fountainhead, was again obliged to pay from her own resources. The result, as we have already seen, was an early financial breakdown, followed by world-wide financial and economic disaster, the cost of which in terms of material losses and human suffering has already become comparable to that of the war itself.

In the light of the new collapse of Continental Europe in the spring of 1931, President Hoover took the initiative and suggested a moratorium on inter-allied debts, provided European nations would, in turn, grant Germany a moratorium on reparation obligations. This was promptly agreed to and became effective for a period of one year. Shortly thereafter, the nations of Europe which were creditors of Germany on reparation account reached an agreement at Lausanne, Switzerland, of far-reaching significance. The Lausanne agreement proclaims the termination of the Young plan and of the Hague agreements based thereon and substitutes a new set of obligations on a vastly reduced scale, with the possibility opened for a complete cancellation.

It may be of interest to recall the successive stages in the reduction of reparation expectations. The fifty to one hundred billion dollars expected at the end of the war was reduced to thirty-three billions by the London settlement, involving annual payments amounting to about two billion dollars. The Dawes plan called for annual payments not to exceed in a standard
INTERNATIONAL ECONOMIC RECOVERY

year $625,000,000. The Young plan of 1929 reduced the annual payments from $625,000,000 to about $500,000,000. The Lausanne agreement fixes the total capital sum at approximately $715,000,000, little more than annual payments under the Dawes plan, involving annual payments of only about $42,000,000—a 98 per cent reduction from the original sum and over 90 per cent from the Young plan schedules. No payments are required for a three-year period, German government bonds being lodged with the Bank for International Settlements, but with the understanding that they cannot be offered for sale until after three years. Thereafter, they cannot be sold at a price below 90; and the agreement also provides that if any bonds remain unsold at the expiration of a fifteen-year period, they shall be canceled.

Thus, to all intents and purposes, the Lausanne settlement wipes out the reparation obligation. The nations of Europe had reached the conclusion that world prosperity would best be promoted by eliminating once and for all these obligations which had hung like a pall over the financial markets of the world continuously since the ending of the war.

Although Great Britain was entitled on reparation account and in connection with her own war-time loans to her allies to receive more from Continental Europe than the amount of her indebtedness to the United States, by the Balfour policy enunciated in 1922 Great Britain agreed to receive from the Continent no more than she might have to pay to the United States. France, Belgium, and Italy, however, received annually from Germany during the period when payments were being made sums substantially in excess of those that they were paying to the United States. It was but natural, therefore, that these countries should hope that if reparation obligations were virtually obliterated, that the war debts might in due course be proportionately reduced. They made, in fact, a gentlemen’s agreement, not incorporated as a part of the Lausanne agreement, that in the event that inter-allied debts were not reduced, the decisions reached at Lausanne would not be binding.

American opinion was, however, not prepared to go all the
way along the lines indicated. In fact, for the time being, there was a powerful public sentiment in favor of no further conces-sions on inter-allied indebtedness. There is, however, undoubted-ly a growing recognition of the fact that the war debts constitute a perennial handicap to the resumption of normal trade relations, and that it would promote world prosperity if they could be permanently eliminated as a disturbing factor. Opinions naturally differ widely as to the extent of the reductions that should be made, as to the desirability of a moratorium that would leave eventual settlements to a more propitious time, and as to the possibilities of using the debts as a means of bar-gaining for trade or other advantages. The view appears to be steadily growing that debts which cannot be collected and which retard normal trade relations should be utilized as a means of securing constructive international policies that will be of ad-\vantage to the United States as well as to the rest of the world.

IV

RESTRICTION OF MILITARY EXPENDITURES

We live in a world the various parts of which are becoming increasingly interdependent with each passing year. The expan-sion of commerce and the development of modern financial agen-cies have given us a world economic system. But, our political machinery is still organized on national lines. I cannot pause to consider the vital question, whether an international economic system can permanently endure without a political organization that is co-terminus in its boundaries. I am here concerned only with noting that the recent trend toward economic nationalism, toward restricting international trade, toward national self-sufficiency, in general, is not only destructive economically but is inevitably accompanied by the growth of armaments.

It is the burden of military expenditures that is destroying the credit of nations, threatening the very foundations of the economic system. No one who has not examined the budget figures of the leading governments of the world over a period of years can have any conception of the magnitude of the fiscal burdens which military budgets impose.

* 21 *
INTERNATIONAL ECONOMIC RECOVERY

I am fully conscious of the jealousies, the prides, the fears that stand in the way of armament reductions, but I am equally conscious that progressive disarmament is an absolute necessity if world financial stability is to be maintained; and I am likewise certain that the future wars which continuing armament expenditures imply would destroy the economic civilization that has been our birthright. Accordingly, I insist that armament reduction should be sought with every power at our command.

* * * * *

These various aspects of international policy are capable of being welded into a coordinated whole; they represent a series of major objectives in a single policy of international cooperation in the solution of common problems. The interests of the various countries are obviously not identical in all respects; but where they are not, concessions are possible as a means of reaching agreement. The international debts, for example, constitute a bargaining asset which may be used to accomplish desired ends. Success will depend, however, largely upon the extent to which the leaders of public opinion in the various countries recognize that international adjustments along all of these lines are mutually advantageous—and that upon their successful accomplishment largely depends the restoration of world economic prosperity. It is fortunate that the new national administration is committed to an “outward looking” policy in relation to international affairs. There is a possibility, and there is hope, that the United States may assume a rôle of constructive leadership along the lines indicated.

OPEN DISCUSSION

QUESTION: If there is gold enough in the world to sustain the trade of the world, why the credit system; and if there is not enough gold in the world, why the gold standard? Why not some other standard?

MR. MOULTON: There is enough gold in the world to sustain the credit system provided general economic equilibrium exists and confidence is maintained. The gold supply of the world in-
INTERNATIONAL ECONOMIC RECOVERY

increases at the rate of over four hundred million dollars a year and is now in consequence something like a billion and a half larger than in 1929 before the great collapse began. It was adequate at that time to sustain the volume of business we then had and the level of prices that then existed. The difficulty is not with the adequacy of the gold supply of the world. The difficulty lies in maladjustments of the character I have been discussing.

**QUESTION:** Did the war debts as a major factor of economic maladjustment precipitate the present depression?

**Mr. Moulton:** No, they did not. The depression began in 1929 before there was a breakdown of the reparation installments. The loan policy was still continuing at that time. But once the breakdown came, they did greatly intensify the difficulties with which we are confronted.

**QUESTION:** I am sure that the speaker is not unaware of the fact that the governments of Europe and America have been well acquainted with the results of raising tariffs, but nevertheless, they continue to raise their tariffs. Doesn’t the speaker think that the forces which have caused them to raise tariffs before will continue in the future, or what advice can he give us on any new forces which would make it advantageous to let down?

**Mr. Moulton:** So long as each nation tries to work by itself alone, you are likely to have these restrictive policies, just as the individual in the face of this depression has to curtail expenditures with the results I have indicated upon the general situation. That is why I place my emphasis on the necessity of international cooperation in handling these problems. Now we are to have a world economic conference and that provides a possible means of getting together along constructive lines by a group of important nations. What the outcome will be no one can foretell.

**QUESTION:** What leverage could the United States use to bring about international commerce between the United States and foreign countries?

**Mr. Moulton:** By throwing debts into the bargaining pot,

* 23 *
INTERNATIONAL ECONOMIC RECOVERY

you may get some advantages. The debts are a weapon, a bargaining weapon, but you can’t use it unless you are willing to use it. A great many people have said, “We want to keep the debts always so we will have something to hold over them.” We can’t gain anything if we always hold them. When the right time comes, they will have to be used.

**Question**: I should like to ask what in the opinion of the speaker has been the effect of the American attitude toward the League of Nations on the problems which he has discussed.

**Mr. Moulton**: I don’t know.

**Question**: In connection with the last question, can we get disarmament before we get world organization and security, whether through the process of the League of Nations or some other organization?

**Mr. Moulton**: I don’t think we can get economic disarmament until we have new international cooperation along economic lines, either through agencies such as the World Economic Conference or the League of Nations.

**Question**: I would like to ask how can we expect to deal with nations which are strictly on the silver basis? How can we ask them for gold? How can we expect to trade with them in that which they haven’t got?

**Mr. Moulton**: We trade commodities. That is what we do in the last analysis with nations on the gold basis.

**Question**: I would like to ask the speaker if it is his judgment that there is not much hope (I take it to be so from the statements he made), whether there is not some hope that we by ourselves can get some measure of prosperity even if the rest of the world does kind of stay down in the dumps.

**Mr. Moulton**: I was very careful to say in the beginning that we could not have thorough-going, well-rounded prosperity unless we had international cooperation along the lines of international economic reconstruction. As I indicated in a talk last evening, I think there are possibilities for us to improve our domestic position by domestic policies; but that is only going to go part of the way, and it is particularly true that the great

* 24 *
agricultural areas of this country cannot be expected to enjoy prosperity so long as their great markets in Europe have restricted purchasing power.

President Coffman: Mr. Wilson, when he spoke on the Farm Allotment Plan, said the ultimate solution would be international, and Mr. Viner said inflation was only a temporary expedient.
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NUMBER SEVEN
THE DAY AND HOUR SERIES
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March 1934
THE DAY AND HOUR SERIES

As a part of its own service and educational program the University of Minnesota brings to its campus each year many distinguished leaders in all fields of thought. These thinkers together with our own staff of scholars offer information and interpretations that are of more than passing moment and worthy of a larger audience than that which gathers in the lecture halls. This series of papers is intended as a suitable medium through which such speakers may reach the larger public in the state and nation.

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L. D. Coffman, President.
The A.A.A.

BY

JOSEPH S. DAVIS

THE UNIVERSITY OF MINNESOTA PRESS
This lecture was delivered in Northrop Memorial Auditorium on December 11, 1933, by Dr. Joseph S. Davis, a director of the Food Research Institute of Stanford University, and formerly chief economist for the Federal Farm Board. His recent publications include "The Farm Export Debenture Plan," "The Specter of Dearth of Food . . .," "The World Wheat Problem," and "The Voluntary Domestic Allotment Plan for Wheat."
The A. A. A.

* * *

SEVEN short months ago (on May 12, 1933) the President signed a notable tripartite law. Its first twenty sections constitute the Agricultural Adjustment Act, under which the Agricultural Adjustment Administration was set up. The next twenty-one sections constitute the Emergency Farm Mortgage Act of 1933. The last five sections grant the President extraordinary powers with respect to currency and credit. Although operations under the last two portions of this law are of great interest and importance to agriculture and the nation at large, it is the Agricultural Adjustment Act and Administration that I am here to discuss.

The convenient abbreviation A. A. A. invites not only the use of superlatives but also attempts at alliteration. Avowedly adopted as an audacious adventure against adventitious adversity affecting agriculture, aimed at abridging acreage, averting additional accumulations, and achieving advantageous acceleration; avidly attacked and ardently acclaimed—whatever one's views, the language furnishes amply abundant a's in which to couch them. But it is inappropriate to use a light tone in treating so serious a subject.

In a brief hour I cannot discuss the A. A. A. to Z, Zed, Izzard, through the C. C. C., the D. M. C., the F. S. R. C., and all the agencies, commodities, and sections involved. I must make plain at the outset, however, that I shall not undertake to advocate or criticize, nor attempt to appraise and forecast. Instead, I shall try to explain and illuminate,
THE A.A.A.

and to raise some questions that are of interest both to those who are in the midst of the task and to those who are affected by it. There is much more punch to a speech that lauds or damns; but in the present juncture there is less need for heat than for light. The moves of the A.A.A. have been so numerous, and so striking, that even many of us who know more than what we read in the papers are bewildered. To the interested parties the pace has seemed painfully slow, but to the side-line observer it seems terrifically swift. The experimenters are in the saddle, riding boldly and hard. It is easy simply to stand aghast, or to admire the courage and vigor displayed, or to react instinctively with all one’s prejudices against upsets to traditional notions. It is hard to get and keep intelligently informed on the developments in program, application, and effects, and to think coolly and rationally about them.

The full program, moreover, is not yet revealed nor even formulated. Secretary Wallace was quoted as saying on November 13: “The things which the Administration has done thus far in 1933 may seem spectacular but they are only a faint foreshadowing of some of the things that must be done before the United States has made for herself her true place in the family of nations.” It is therefore premature to indulge in definitive appraisals or confident prophecies. New moves, as well as altered conditions, are certain to change the basis for forecasts. But it is time for earnest, intelligent citizens to seek to understand what is being done and why, to see whither it is leading, and to observe its actual and prospective effects. It is time for competent students to examine, with open minds and without prejudice, the theories underlying the new ventures and the working tests which they are receiving.

We can endorse whole-heartedly the basic objective of the national recovery program; in Mr. Peek’s words, “it is to
raise the standard of living of all our people.” We may well
differ on intermediate objectives and on ways and means.
It is a simple fact that the A.A. Act and Administration
represent an extraordinary series of experiments, and others
are being made under other recent legislation. In itself,
this fact justifies neither pride nor alarm. There is excuse
for experiment. The times have been and are out of joint.
Even those of us who have not been hard hit since 1929 are
often tempted to say: “What a crazy world we live in!”
There are those who say that we have made such an utter
mess of things that we cannot possibly make them worse,
and those who assert that conditions have lately been so
desperate as to threaten complete collapse of the national
economy, or even the doom of civilization. In my humble
opinion this is extreme exaggeration, not only false but fool-
ish. Others feel that all experimentation is dangerous, and
that the experiments themselves threaten ruin. I venture to
disagree with them also. Civilization is tough. Wise old
Adam Smith is reported to have said: “There is a good deal
of ruin in a nation.” History, even very recent history, shows
that this country can take a deal of punishment and stand
a large amount of experimentation. Some experiments turn
out well, others badly. The Declaration of Independence and
the Constitution of the United States were noble experi-
ments; so also were the Eighteenth Amendment, the Agricul-
tural Marketing Act, and the World Economic Conference.
Proposed experiments require scrutiny; but it is seldom a
question of heaven or hell, or always one of right or wrong;
often it is a question of better or worse. So, I think, it is
here.

It is not surprising that mental inertia, prejudice, or threat
of injury conspire to produce opposition in some quarters
and skepticism in others. It is hard for any group of officials
to meet skepticism, resistance, or criticism gracefully. There

* 7 *
is a tendency to say, "Those who are not for us are against us." In view of the stress and strain under which they work, it is not surprising that the officials concerned should sometimes call others hard names, and denounce those who do not go along like docile sheep but who buck and butt in like obstinate goats. In fact, however, the procedures are so frankly experimental that the experimenters themselves need not merely sympathy and cooperation but rational resistance, good-tempered criticism, and reasoned suggestions. It is reasonable to give our chosen leaders a fair chance to play their hand in the New Deal; but there are a lot of other players, and it is reasonable not to deny them a voice. This is particularly true when it is a question not merely of a new deal, but of a new deck, several new deals, and even new rules, subject to constant change, with exceptional powers of discrimination on the part of the dealer. There is urgent need for understanding reactions to the measures and a right spirit in expressing such reactions; but the maximum benefits from the whole undertaking will be gained only if the evolution of the program is subject to influence from those who are not simply docile or aloof.

The background of the Agricultural Adjustment Act, with which most of us are all too familiar, I propose to pass over without comment. The act itself is not elaborate. It is largely permissive rather than mandatory. It leaves wide discretion to the Secretary of Agriculture. Indeed, unlike the Agricultural Marketing Act, it makes no specific provision for the organization that has been set up to execute its provisions. The substantive provisions chiefly grant authority for applying a cotton option plan, voluntary domestic allotment plans for basic agricultural commodities (wheat, cotton, field corn, hogs, rice, tobacco, and milk and its products), and marketing agreements and supplementary licenses for use with these and other farm products. The act makes provision for pro-
cessing taxes to be levied on specific basic products (and for compensating processing taxes on products competing with these), in order to finance rental and benefit payments to farmers and losses on disposal of surpluses; it also appropriates $100,000,000 for administrative expenses and rental and benefit payments. The act is to expire when "the President finds and proclaims that the national economic emergency in relation to agriculture has been ended. . . ." (Sect. 13). "Emergency," of course, is an elastic term, and only a hardy prophet would predict the date of expiration under this limitation. It will not be surprising if, before that time comes, the act is replaced by another measure ostensibly designed to be permanent.

The philosophy underlying the A.A.A. Act involves numerous elements or theories, which it is worth while to summarize in brief outline. In certain respects, which I shall mention first, this philosophy is essentially the same as that which underlay the McNary-Haugen bills, the export debenture plans, the Agricultural Marketing Act of 1929, and the operations of the Federal Farm Board. Agriculture is held to be the fundamental industry, and farmers a class of peculiar and paramount importance in society. This "agricultural fundamentalism" is a deep-seated doctrine, which few are willing to call in question; yet many of its far-reaching implications rest upon theory rather than upon proved facts. Second, our national policy, in its positive and negative aspects, is held to have operated on the whole to aid other classes more than farmers; consequently, it is held that agriculture has not had a square deal, or farmers a fair share in the national income. Third, for a variety of reasons, farmers are regarded as incapable of organizing to secure their rights as effectively as do industrialists, commercial interests, railways, bankers, and industrial employees; hence in a society shot through with organization it is held that they tend to
get "the short end of the stick" unless the government steps in to give them special aid in organizing and otherwise. In addition, it is held that a great depression, accompanied by severe decline in the level of prices, works peculiar hardship upon farmers, since prices of raw materials such as they produce tend to fall farthest, since contraction of output is not readily feasible for them, and since their debts and taxes remain fixed while their net income falls; hence it is argued that agriculture requires extraordinary governmental aid at this juncture.

Foremost among the theories expressed in the new act itself is "that the present acute economic emergency" is partly due to "a severe and increasing disparity between the prices of agricultural and other commodities, which disparity has largely destroyed the purchasing power of farmers for industrial products, has broken down the orderly exchange of commodities, and has seriously impaired the agricultural assets supporting the national credit structure." It is therefore "declared that these conditions in the basic industry of agriculture have affected transactions in agricultural commodities with a national public interest, have burdened and obstructed the normal currents of commerce in such commodities, and render imperative the immediate enactment of title I of this act." Here is enumerated a group of theories in which price disparity appears as the evil cause of sad results.

"Disparity" suggests that "parity" is definable, and the act defines it. Specifically it is declared to be the policy of Congress:

"(1) To establish and maintain such balance between the production and consumption of agricultural commodities, and such marketing conditions therefor, as will re-establish prices to farmers at a level that will give agricultural commodities a purchasing power with respect to articles that
farmers buy, equivalent to the purchasing power of agricultural commodities in the base period."

For tobacco the base period is fixed as the ten post-war years ending July, 1929, for all other agricultural commodities the five pre-war years ending July, 1914. Thus the old slogan, "Equality for agriculture," is given new precision, in a manner resembling the ratio-price plan of Messrs. Peek and Johnson some ten years ago.

Further, it is declared to be the policy of Congress:

"(2) To approach such equality of purchasing power by gradual correction of the present inequalities therein at as rapid a rate as is deemed feasible in view of the current consumptive demand in domestic and foreign markets."

How great, by this yardstick, is the disparity that the act seeks to correct? The official indexes show that in the first three months of 1933 farm prices of farm products averaged 50 per cent of the pre-war level, whereas retail prices paid by farmers for goods used in living and production averaged 101 per cent of the pre-war level. Practically, therefore, the Agricultural Adjustment Administration was given the task of doubling farm prices as a group, and then raising them by as much more as the index of prices farmers pay actually rises. Not since 1920 has the index of prices received reached 100 per cent of the index of prices paid; and only once, in the short crop year 1925, has the percentage averaged over 91. As of November 15, 1933, the indexes showed farm prices averaging about 61 per cent of "parity."

Nor is this all. The act is interpreted to mean that the normal or "parity" price of each farm product, its "fair exchange value," is as much above its pre-war average as the index of prices farmers pay is above its pre-war average. How much more this implies is partly indicated by the fact that farm prices of grains as a group were only about 35 per cent of their pre-war level in January-March, 1933. For some
THE A.A.A.

farm products the standard implies trebling or quadrupling the farm prices of early 1933.

Behind these specific declarations in the act lie three major assumptions. First, it is assumed that this statistical procedure really shows what may be called "fair prices" for farm products, though it is well known that wholesale prices of farm products in the United States were relatively higher in 1909–14 than in any period of equal length before, at least in more than a century, and though it should be well known that price relationships among various commodities not only fluctuate from year to year but change notably from decade to decade, as changes occur in conditions of production, transportation, and demand. Second, it is assumed that farm prices of farm products can be raised, through government action, by the relative amounts indicated. Third, it is assumed that if farm prices are so raised, even by curtailment of farm output at the direct expense of much higher prices to consumers, agricultural prosperity will be restored and general economic recovery enhanced if not insured.

These important assumptions generally pass unquestioned and seem to have been accepted as if they were self-evident. Actually each rests upon no demonstrated foundation. Taken together, they may be subjected to at least as severe a test as were the theories which underlay the Agricultural Marketing Act. Are the normals normal? Can the task be done? Will success mean success?

Let me elaborate the last of these searching questions. If farm production is sufficiently curtailed to insure farm producers parity prices, will they regard the income from parity prices on the reduced output as satisfactory? Accurately speaking, parity prices are only an intermediate objective; if this should be attained without achieving the larger and more ultimate objective — satisfactory income per farmer — will the success be regarded as success or failure?
Another pertinent question is this: If the restoration of parity prices itself is slow in coming, will farmers await with patience the full achievement of a goal so vigorously proclaimed as their due? Leading spokesmen of the A.A.A. have rightly given warning that magic and miracles are too much to expect of them, and have openly appealed for patience as well as cooperation; but the goal set is relatively so high and so definite that comparison of aims and achievements is inevitable.

Other features of the philosophy behind the A.A.A. must be summarized more briefly. The view is rejected that we can safely trust to time and the simple operation of economic forces to restore prosperity. It is held that something must be done to accelerate recovery; and not merely something—a vast campaign under government leadership is regarded as essential. It is held that the situation demands a grand extension of economic planning and adjustment, to be worked out by a process of trial and error. This is held to be necessary not merely to accelerate recovery but to prevent future crises and prolonged depressions, and to insure continuously more effective use of our abundant resources. The avowed intention of the Secretary of Agriculture is to develop out of these emergency measures a comprehensive system of planning for agriculture. Early in October he said: "We are face to face with the necessity for planning our production to fit the needs of all our people, plus what we can reasonably expect to export at a fair price," with "a margin of safety to allow for drought, crop failure, or other disaster." Economic engineering, including currency management and planned agriculture and industry, is held to be essential to temper the cruelty of economic forces and make them serve human ends, just as medicine and engineering have proved invaluable in tempering the cruelty of natural forces and making them serve human ends. And such plan-
ning, in view of its proponents, implies not merely plans but execution, "control." It is confidently held that government machinery adequate to the task can be developed, and that the requisite cooperation of individual farmers, private business interests, and technical experts can be enlisted and mobilized.

Overproduction of several commodities is accepted as a stark fact, not a mere illusion. Specifically, it is held that the present emergency calls not merely for diverting surplus foodstuffs and raw materials to those in dire need, into export, and to lower-value uses, but also for positive steps to contract the output of several farm products. The experience of the past three years is held to have shown conclusively that unstimulated contraction of production is too slow and too cruel, and the experience of the Farm Board that merely to advise farmers to reduce production is futile. Moreover, it is held that agriculture is so fundamental, and the prices of agricultural products so depressed, that a huge transfer of purchasing power from consumers to farmers is not only just, but necessary to promote national economic recovery in the interest of consumers themselves. This is the ground on which processing taxes are levied to provide funds for cash rental and adjustment payments, which in turn are being paid to secure contraction of production so that farm and market prices may be raised.

The larger implications of the contraction programs are beginning to be realized, albeit reluctantly. It is recognized that our productive acreage must be substantially reduced, perhaps by forty million acres; but few spokesmen have yet openly admitted that a reduction in the number of commercial farmers may also be involved. The A.A.A.A. does not assert that our agriculture must be readjusted to a basis of national self-sufficiency, but it is pessimistic regarding at least the early prospects for notable expansion of our dimin-
ished export trade in farm products. Secretary Wallace said on November 14: "By reducing acreage we are trying to get off the international market until such time as we can bring about a real increase of foreign purchasing power by tariff reduction and the negotiation of reciprocal tariffs. . . ." It was not with enthusiasm but as a warning that he said also: "If we finally go all the way toward nationalism, it may be necessary to have compulsory control of marketing, licensing of plowed fields, and base and surplus quotas for every farmer for every product in each month in the year. In other words, it will be necessary to make a public utility out of agriculture. . . ." Secretary Wallace does not shrink from envisaging this logical limit of the process of economic planning in a world obsessed by economic nationalism; but he apparently hopes that the road may have a turning toward another and better goal.

The philosophy I have sketched is worthy of detailed and fair-minded examination. There are some serious gaps in it, even in a fuller statement than I have time to present; it has weaknesses as well as strength; but so far as it goes it is reasonably coherent, and I think it is more clear-cut and comprehensive than our agricultural philosophy has ever been in the past. It is being set forth so boldly, in deeds as well as in words, that we may fairly expect its testing to bring to light such defects and positive errors as it may contain. It is with such a philosophy in mind that one must view the various programs of the A.A.A., and their success will depend in part upon the soundness of the underlying theories.

I can here deal in detail only with wheat, a product of major concern to Minneapolis. The wheat program thus far developed includes five major elements: (1) the domestic allotment plan, involving restriction of acreage for harvest in 1934 and perhaps 1935 through contracts with farmers who are to receive "adjustment payments" in three years.
beginning with this crop year; (2) the international wheat agreement, involving export quotas for the exporting countries, acreage restriction in North America, and other commitments by importing countries; (3) subsidized exports from the Pacific Northwest; (4) market-supporting wheat purchases for relief; and (5) the adoption of codes for the grain exchanges, country and terminal elevators, millers, and other wheat interests. Of these five, all but one are novel, and even the stabilization purchases differ in important respects from those made under the Federal Farm Board.

The domestic allotment plan* was the first to be launched. It was announced in broad outline on June 16, and on June 26 a processing tax of thirty cents a bushel was proclaimed, to go into effect on July 9. County allotments equal to 54 per cent of the average production in 1928–32 were announced on July 27. Three days earlier growers had been informed that on each bushel of their individual allotments contract signers would receive a first installment of twenty cents a bushel on about September 15, and not less than eight nor more than ten cents after fulfilment of the first year's acreage reduction had been certified.

During August forms, regulations, and publicity material were issued, and an extensive educational campaign regarding the plan got under way in all the wheat sections. A central feature of the plan was the formation of County Wheat Production Control Associations, with elected boards of directors to have the primary responsibility for assigning and adjusting individual quotas and passing on applications and contracts. These were formally organized in August–October. Applications for contracts were first invited. On August 28, after delays pending the reaching of the international wheat agreement, the Secretary announced that contract signers

* See also M. L. Wilson's Farm Relief and the Domestic Allotment Plan, Paper 2 in this series.

* 16 *
would be called on to reduce their acreage for 1934 by 15 per cent of the average acreage in a base period, typically 1930–32. Contract signing followed, but the process has been long drawn out, for much time has been required to get adjustments made between county figures on acreage, production, or both, as officially estimated and as totaled from individual farmers' applications. On October 16 the "County Acceptance Unit" in Washington approved the first series of county wheat contracts (Clark County, Virginia), and on October 31 the first checks were mailed to Monona County, Iowa, a center of the "farm strike" movement. In some important wheat states the first batches of county contracts have only just been mailed to Washington, and considerably less than half of the first installment can be paid before Christmas.

On October 26 it was announced that 570,263 applications had been signed reporting 51,925,612 acres in the base period. The sign-up was relatively largest where wheat is a major crop and relatively smallest where it plays a small rôle, as in diversified farming sections. Apparently it represents less than half of the eligible wheat growers, but something like 80 per cent of the wheat acreage. These preliminary figures, however, are subject to a good deal of revision, and it will be some weeks before the precise extent of participation is known. Provided the contracts are all accepted and none are cancelled for nonfulfillment, the total cash benefits on these allotments, at twenty-eight cents a bushel, seems likely to be around a hundred million dollars, less the expenses of the local production-control machinery.

In the actual application of the plan innumerable problems have arisen, the burden of work on the Extension Service and the local and central administrations has been enormous, inevitable delays have been irritating, and numerous decisions have evoked complaints. Yet the program has been pushed through, and the A.A.A. has been sufficiently im-

* 17 *
pressed with the practicability of the allotment plan with wheat to undertake to apply it, with modifications, to cotton, corn, barley, and tobacco for the next harvest, and to hogs as well for 1934; and probably other applications will be made.

Speaking of the wheat reduction program, Secretary Wallace said on September 24:

"It is a program that in the face of need breaks sharply with long-established habits of thought. To sow less wheat at a time when throughout the world people are out of work and hungry—that is not an easy proposal to understand. The facts are harsh and unpalatable. Too much wheat diminishes farm buying power. Diminished farm buying power closes factories and helps throw millions of people out of work. Because these millions of people are out of work they have no money. When in this modern commercial world you have no money, you go hungry, even in the shadow of mountainous surpluses of food.

"People on farms and people in cities who fear that our production control program will increase the number of hungry mouths simply do not understand the world situation that exists today. Piling up a wheat surplus to three times the normal as we have done in the past four years makes more hungry mouths rather than less. It took the wheat farmer off the market as a buyer of goods, and the depression spread. It spread to all other farmers, then to those whose business depends directly upon farm custom, and finally to Wall Street and the Loop. No business can keep on hiring people and making money when the buying power of the nation is off balance at the base."

How substantial a contraction of acreage the wheat plan will bring cannot yet be determined. A 15 per cent reduction on 80 per cent of the sown acreage from that of the base period (1930-32) would mean a reduction of about 12 per
cent on the whole, or about 10 per cent of the total sown for the 1933 crop, provided contracting farmers faithfully comply with the terms of their contracts and non-contracting farmers do not increase their acreage. The recent unofficial estimates of acreage sown to winter wheat afford no close check upon the success of the program to date, partly because they compare this year's seeded acreage with last year's, and partly because many contract signers had to plant their wheat before they knew what acreage their contracts would permit them to sow for harvest as grain.

Since the reduction in acreage by contract signers will fall short of the 15 per cent figure to which commitment was made in the London agreement, the Secretary announced on October 26 that measures to take out additional acreage were under consideration. Obviously such measures will have to take account of increased savings by non-signers, and particularly in the states producing soft winter wheat.

Contraction of production, of course, is the end sought. It remains to be seen to what extent reduction of acreage may be offset by increase of yield on the acres sown. Yield is largely the result of Nature rather than of the farmer's own efforts, and after two years of low yields Nature may choose to smile in 1934. But the farmer has some opportunities to influence yields. The A.A.A. contract is drawn to prevent selective elimination of lower-yielding land, increased efforts in cultivation, and unusual applications of fertilizer; but how enforceable these clauses may prove we have yet to see.

At all events, a surplus of wheat over all domestic requirements and prospective exports exists in the present year, and a larger surplus is fairly in prospect for 1934-35. The Department of Agriculture has tentatively forecast a carry-over of 240 million bushels on July 1, 1934, as compared with 386 million last July. This is at least 120 million bushels
above normal. With 15 per cent less acreage than in 1930-32, and merely average yields per acre sown, the crop of 1934 would provide a surplus above ordinary domestic requirements of between 100 and 150 million bushels. A much more radical contraction of wheat output, through reduction of acreage and/or yield, will be necessary to eliminate our dependence on world export markets. How to raise our wheat prices to a "parity" level, or even to keep them above export parity if we continue to have a big surplus supply, bids fair to remain a problem after the utmost has been accomplished under the wheat plans thus far announced.

Processing taxes have been designed to finance the cash benefits to farmers without imposing fresh burdens on the Treasury and the federal taxpayers as such. They are so fixed as not to raise the price of the processed product to the consumer above a "parity" level outlined in the Act, but this limitation is not likely to figure with many commodities. Per unit of finished product at retail, the taxes appear small in dollars and cents, and they are often exaggerated by retailers. In terms of percentages, however, the taxes look heavier, particularly on slightly processed products, such as flour. Even on commercially baked bread the small addition of a half cent attributable to the processing tax of 30 cents per bushel of wheat amounts to about 6 per cent of the retail price. Sales tax rates rarely run so high as this.

Such a tax itself constitutes an economic force, affecting the course of consumption, trade, industry, and production; and it casts its shadow before. Several effects of the wheat processing tax are already in evidence. Commercial flour production was stimulated in the weeks before the tax came into effect on July 9 and fell off in subsequent months. Consumption of flour and wheat bread has apparently been adversely affected; individuals and institutions have turned to substitutes thus far untaxed, such as corn meal and rye flour;

* 20 *
this has given rise to demands for compensating processing taxes on such substitutable foods. At local mills wheat growers are trading their wheat for untaxed flour, extensively for their own use as permitted under the Act, and to some extent for others in spite of its illegality. In consequence, the volume of commercial milling, already reduced by the loss of export markets, has been sharply curtailed since July. Wheat growing for home consumption is being stimulated in states where little wheat can be economically raised. It is too early to measure the extent of these various influences. But it is obvious that any diminution in human consumption of wheat and any stimulus to wheat production are contrary to the program itself; and it is not only uneconomic but foreign to the intentions of the program to bring about shifts from commercial to custom milling and shifts of wheat production from low-cost to high-cost areas.

The wheat allotment program has yet to meet several major tests. Will farmers who have signed contracts to reduce their wheat acreage by 15 per cent from the adjusted figures of the base period actually make these contractual reductions? Will those signers who reduce by less than the stipulated amount actually be penalized by cancellation of their contracts and refund the first installment of the payments received? Will growers who signed no contracts increase their wheat acreage and production in sufficient amount to offset a substantial part of the reduction by contracting farmers? Will the use of acreage withdrawn from wheat under the program be effectually prevented from going into other crops so as to create other surpluses? Will growers who have signed contracts feel in 1934–35 that they have gained or lost by comparison with those who have remained outside? If they feel that they have lost, regardless of the actual gain or loss as careful statisticians might compute it, will the contracts actually prove enforceable in 1934–
35? Will consumers accept with equanimity the continuation of processing taxes on an increasing range of farm products, or will prices rise so fast that reduction in processing taxes will be feasible under the program? Will farmer sentiment develop in favor of continued contractual control of acreage, or in favor of compulsory control over all farmers, or in favor of abandoning the whole enterprise? Such questions cannot be answered now except with guesses. They must be borne in mind, however, by all those who are in any way affected by the program, and by those who are studying it.

I now turn to the international wheat agreement, concluded late in August. This must be regarded as an integral part of the A.A.A. program, though nominally it falls outside. Argentina took the initiative in proposing the conference that led up to it; but the United States delegation led in winning adhesion to it, and the large credit for it is due to a Minneapolis man, Mr. F. E. Murphy.

In view of very light import requirements in prospect for 1933–34, the governments of the four leading exporting countries agreed to limit their wheat exports in this crop year to certain quotas (of which that for the United States is forty-seven million bushels), and in 1934–35 to maximum figures 15 per cent less than the average yield on the average acreage sown in 1931–33 after deducting normal domestic requirements. The United States and Canada undertook to curtail wheat acreage by 15 per cent, Argentina and Australia to limit their exports correspondingly and to prevent carry-over accumulations. The exporting countries of the Danube region agreed that their aggregate exports should not exceed 50 to 54 million bushels in 1933–34 and 50 million in 1934–35. Soviet Russia agreed to negotiate further with respect to her exports in these two years. All but one (the Netherlands) of the leading wheat-importing European countries agreed to cooperate in the effort to restore a bal-

* 22 *
ance between world production and world consumption of wheat. To this end they agreed (a) not to take any measures henceforth to increase domestic acreage or production; (b) to take every reasonable measure to increase wheat consumption; (c) progressively to remove measures tending to lower the quality of breadstuffs and thus to reduce their consumption; and (d) to follow up substantial advancement in wheat prices with a downward revision in tariff duties on wheat, such adjustment to begin when prices of British imported parcels have been for sixteen weeks at or above 63.02 gold cents per bushel (12 gold francs per quintal).

This agreement is a striking adventure into the domain of international planning, and its operation will deserve watching. It is impressive not only as a move in the direction of contracting production, regulating international competition, and expanding consumption by international cooperation, but as a rare specific attempt to reduce the barriers of international trade that have gravely aggravated the world wheat problem in recent years. There is evidence that several parties to the agreement are taking their obligations seriously, but it must be confessed that world import requirements for 1933–34 now look smaller than they did last August, and that the world price has not yet reached the minimum price specified—indeed, it has lately been little over two-thirds as high.

The third feature of the wheat program is the arrangement by which wheat exports from Oregon, Washington, and northern Idaho will be made while domestic prices in that area are higher than permit commercial export sales. The Secretary of Agriculture is reimbursing exporters for the difference between export costs and proceeds of export sales. This is the first instance of export subsidies under the A.A.A.A. program.

The Pacific Northwest constitutes a distinct wheat sur-
THE A.A.A.

plus region, ordinarily shut off by high freight rates from domestic markets east of the Rockies. It invariably grows more wheat than is needed for the region itself and for ship-
ments to California, Alaska, and Hawaii, and normally ex-
ports to foreign countries and the Philippines a third of the crop or more. In the last crop year the surplus was held so firmly that prices were too high to permit liberal exports to the Orient in competition with Australia and Argentina, or to Europe; hence the carry-over into this season was of record size. Despite heavy winter-killing, the spring wheat turned out so well that the 1933 crop was little below aver-
age. The regional surplus is therefore exceptionally large—perhaps forty million bushels. During the summer and autumn farmers sold sparingly, under the influence of reports of wheat shortage in the country as a whole and prospects for agricultural relief. Though market prices in Portland and Seattle were farther than usual below Chicago prices, they remained well above export parity, and the wheat did not move out. On June 5 the Reconstruction Finance Cor-
poration authorized the Chinese government to borrow ten million dollars to buy wheat and flour, but practically no purchases were made. Exporters, who since November, 1932, had been urging some form of export subsidy, pressed their arguments; and they were reinforced not only by wheat growers in the Pacific Northwest but by complaints of Missis-
sippi Valley farmers and millers that Pacific Coast wheat and flour were invading their markets and threatening their prices.

On July 24, shortly after the wheat market crash, the Sec-
retary announced, under authority of Section 12a of the A.A.Act, that two cents out of the thirty-cent processing tax (then estimated to yield about nine million dollars) would be reserved to finance wheat exports if opportunity arose. On October 10, after weeks of negotiation, the Secre-

* 24 *
tary of Agriculture signed a marketing agreement with wheat growers' organizations, grain exporters, and millers of the Pacific Northwest. The North Pacific Emergency Export Association was set up to administer the scheme, while permitting the actual trade to be handled by exporting merchants and millers. Its executive committee consists of its eight directors and a resident representative of the Secretary of Agriculture who has the last word. Two directors are selected by each of four organizations—the Farmers National Grain Corporation, the North Pacific Grain Growers, Inc., the North Pacific Grain Exporters Association, and the North Pacific Millers Association. In the first seven weeks of operations, up to December 4, export sales of about seven and a half million bushels of wheat and flour were made—apparently largely to China under the R.F.C. loan. The loss on these sales averaged about twenty cents a bushel. Care is taken to avoid the charge of "dumping," but some murmurs of protest have come from Australia, and the Chinese legislature has authorized the levy of substantial duties on wheat and flour. One effect of the operation has been to strengthen wheat prices in the Pacific Northwest and to hold them above export parity; hence commercial export business continues negligible. In fact, the great bulk of United States wheat and flour exports this year will be some thirty-odd million bushels from the North Pacific under this agreement.

This scheme was avowedly devised to meet a specific regional situation. General resort to subsidized exports, such as was contemplated under the old McNary-Haugen and export debenture plans, is evidently contrary to the present judgment of the A.A.A., in view of current world conditions. This particular experiment will be watched with care for both direct and indirect consequences, and the outcome may determine whether or not it will be applied again in that region or with other regions and commodities.

* 25 *
THE A.A.A.

The fourth element in the wheat program consists of open-market purchases made primarily to support weak markets, but with the intention of devoting the purchases to relief purposes. On September 25 the President announced that seventy-five million dollars worth of foodstuffs and cotton would be bought for use in relief. Beginning October 17, when the wheat market had a sinking spell, the government has made considerable purchases of cash wheat and futures, through the Farmers National Grain Corporation on behalf of the new Federal Surplus Relief Corporation. These operations, which have been extended to other commodities, somewhat resemble the early stabilization purchases under the Federal Farm Board, but the differences are important. In the present instance, relief outlets are in view from the outset. Also, whereas the earlier purchases were made in the face of a powerful drift of prices in general to lower and lower levels, the present ones are accompanied by an active policy designed to raise the general level of prices. Arrangements have been made to distribute considerable amounts of the supplies for feed use to drought-stricken farmers.

Finally, the formulation of codes for grain exchanges, millers, and other groups dealing in and/or processing wheat and its products and by-products has reached the stage where several are the subject of hearings and conferences with the A.A.A. Previously, in the weeks following the speculative crash late in July, temporary regulations of grain exchange operations had been put in force with the approval of the A.A.A. It is not yet clear how far these codes will really constitute an integral part of the wheat program or prove to be a significant element in agricultural policy.

Limits of time prevent me from reviewing similarly the programs thus far developed for dealing with other basic and non-basic commodities, but a brief summary is suggestive.

* 26 *
In all, the A.A.A. has already resorted to ten or a dozen principal devices for restoring agriculture to prosperity:

1. Reduction of 1933 crops in return for rental payments and other cash equivalents payable largely out of processing taxes, applied to cotton and cigar-leaf tobacco.

2. Emergency hog slaughter to reduce marketable supplies for the near future, through premium prices for young pigs and bonuses on bred sows.

3. Export subsidies out of the processing tax for wheat from the Pacific Northwest, with some approach to an equivalent on rice.

4. Stabilization purchases for relief uses in wheat, corn, pork, butter, cotton, and several other products.

5. Acreage contraction allotment programs for 1934, with cash benefits payable out of processing taxes, for wheat, cotton, corn, and burley tobacco, with others in prospect.

6. A production curtailment allotment plan for hogs, with adjustment payments on the reduced number of pigs farrowed and raised in 1934.

7. Loans on easy terms, virtually riskless to the borrowers, to enable participating growers to hold their cotton, cotton options, and corn for advances expected under the joint influence of price inflation and acreage contraction for 1934.

8. An international agreement with respect to wheat.

9. Domestic marketing agreements affecting fluid milk, evaporated milk, dry skim milk, rice, flue-cured tobacco, and a large variety of lesser crops.

10. Codes of "fair practice" for trades and industries concerned with farm products, including the liquor industry.

11. Processing taxes on wheat, cotton, corn, hogs, and tobacco; and the first compensating taxes on competing products, recently announced.

* 27 *
THE A.A.A.

Thus far there has been a minimum resort to compulsion, except upon minorities who have not signed marketing agreements that have been made effective. Explanation and persuasion rather than pressure (except of the financial inducement variety) have been the rule. Strenuous efforts have been made to decentralize administration of the allotment plans and operation of the marketing agreements.

When one realizes the extraordinary scope of the A.A.A., the multitude of individuals and organizations involved, and the diversity of conditions with which it is undertaking to deal, he is not surprised at complaints of delays and red tape; rather he stands amazed at the rapidity with which a new organization has functioned in so broad and complex a field. In most of its early ventures the A.A.A. has attained something approaching its immediate objective, though as might be expected, in few cases have the results yet been such as to satisfy the high hopes that have been raised. The real tests of success, the net effects in a longer run, lie ahead. It will require intensive study to relate the effects to the real causes, for popular judgment is liable to be unduly influenced by what actually happens, whether or not it is properly attributable to the efforts made.

The ultimate solution of our economic problem, in a world abundantly supplied with productive power, lies in facilitating the consumption of all the goods and services that we are able to produce and in redistributing our productive efforts so that the products will be turned out in proportion to consumers' enlarged demands. In a broad view of history and present conditions, it appears that such redistribution of productive efforts will require either a reduction of the number of farmers or the hours that they work per year, or else radical changes in our international policy, our consumer habits, or the distribution of our farming efforts, or all combined.

* 28 *
THE A.A.A.

In the midst of extreme pressure for emergency action, these problems of the longer run are properly engaging intelligent consideration by the A.A.A.

Altogether, an amazing array of ingenious programs is being carried into effect, with promise of more and more to come. We shall learn much from the experience. We shall doubtless do differently hereafter because of it. But it is quite too soon to say where it will end. Whether the outcome will be some system of thoroughgoing control of all agricultural operations, or abandonment of the whole series of procedures, or continuation with new experiments, or something in between, Time will tell; and tonight, at least, I am not prepared to forecast Time's verdict.
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The University of Minnesota Press
Minneapolis
Monetary Policies

NUMBER TEN
THE DAY AND HOUR SERIES
OF THE UNIVERSITY OF MINNESOTA
March 1935
THE DAY AND HOUR SERIES

As a part of its own service and educational program the University of Minnesota brings to its campus each year many distinguished leaders in all fields of thought. These thinkers, together with our own staff of scholars, offer information and interpretations that are of more than passing moment and worthy of a larger audience than that which gathers in the lecture halls. This series of papers is intended as a suitable medium through which such speakers may reach the larger public in the state and nation.

It is the business of a real university to stimulate discussion and to do and encourage frontier thinking on social, scientific, economic, and cultural problems. By so doing it commits itself to no one view but dedicates itself to a point of view, that of the open mind.

L. D. COFFMAN, President.
Monetary Policies

By

FRED I. KENT

THE UNIVERSITY OF MINNESOTA PRESS
This lecture was delivered in Northrop Memorial Auditorium on February 26, 1935, by Mr. Fred I. Kent, formerly vice president of the Bankers Trust Company of New York, and at present chairman of the Commerce and Marine Commission of the American Bankers Association. In addition to a wide range of activities in connection with business and banking organizations, Mr. Kent has served in many important public capacities. He was director of all foreign exchange operations during the World War and was decorated by the French and Italian governments in recognition of his services. More recently he administered foreign exchange operations for the United States, from March, 1933, when we went off the gold standard, until January 1, 1935.
Monetary Policies

* * *

Where there are men there is politics. The condition of a people is usually measured by the kind of political force that prevails at any period. When the people give their allegiance to the "wise and prudent" politicians, their progress toward more comfortable living from any given condition is assured, barring developments that may be beyond the power of men to prevent. Even then they can hope for the best outcome that the catastrophe will allow.

When, however, the people follow false leaders, the "artful and cunning" politicians who promise the impossible in exchange for the allegiance of the multitude, they destroy such democracy as may exist and prolong such hardship and suffering as may prevail. The persuasive ignorant, very often men of fine intentions, become the tools of the artful, cunning politician, the demagogue. Then to such forces are added the organized minorities that are endlessly striving for special privilege. But this is not all. The impractical idealist, the theorist who can visualize the beautiful and carry his visions to others, too often enlists himself with all his followers on the side of the mere seekers of political power. If he were content with the expression of his ideals and the exaltation aroused in his audience, he would benefit the world; but no, he must explain how these ideals can be obtained, and of that he knows nothing. It is little wonder

* 5 *
MONETARY POLICIES

that democracies in the name of liberty forge their own chains and destroy themselves.

The people are taught by the "holier than thou" that all others who are taking a place in the community and national life are exploiting them. In times of stress, by exaggerating the mistakes of these others and building up the idea that their purposeful methods to enforce hardship upon the people have caused the disaster, they create their own power. The envy, jealousy, and hatred of the masses are thus aroused toward those of their fellows whose activities may have been the means of raising the average general condition of the people. Turmoil and further hardship is the inevitable price that must be paid by humanity when it follows false leaders.

But criticism of the people is of no avail and neither can it be justified; their problems become too involved for them to understand. The individual seems to be mere flotsam on the great human tide that ebbs and flows over the land, carrying him against his desire whither it will. He naturally raises his voice in opposition to those who seem to control, whether their efforts have been well guided or fraught with error.

Education has not yet taught man how to determine when present sacrifice will more quickly uncover future happiness. He may know, when free from suffering, that even as he must work and strive for comfort so must all other men. He may know that in the competition of life give and take should ever aid those who are down to find their way up. He may know that pulling down those who are up will only add to the misery of those who are down.

But when the turn of the human tide throws many down and he is among them; when he feels helpless against forces beyond his control which he cannot understand; when he

* 6 *
MONETARY POLICIES

sees his family in distress and himself apparently powerless to prevent it, reason is replaced by panic. He then joins with the thousands of others who are equally tried, and they all together, after listening to the siren voices of those who would lead through false promises, follow them, in their effort to tear down others, straight toward the precipice of despair. Recovery is then more difficult; and so throughout history democracies have destroyed themselves.

For some strange reason every nation that has driven itself out of democracy into some form of autocracy seems to have done so in the belief that its ideas were new and that its methods were original. Instead of being new, these unsound methods have been nothing more nor less than repetitions of the failures of the past. In fact, it seems impossible to get back to their origin; they probably reach into the pre-historic times of the life of mankind.

We cannot hope to understand present monetary policies unless we first recognize that they are born of politics, and that political forces may be "wise and prudent" or "artful and cunning," and that they are ever changing.

The second thing we must recognize about monetary policies is that however exact they may appear to be theoretically when applied to a community of robots whose desires are fixed in mathematical constants and whose number is always the same, when applied to groups of people who live and die, whose numbers are ever changing, whose mentalities are in a state of flux, and who exist in a world the detail of which is never the same, no man can measure their effect.

A third vitally important condition that cannot be ignored is that monetary policies are not understandable in their entirety because of the complexity of human life; and again, that when men know that they can exchange such money

* 7 *
as they may have for things that they want, they naturally can be led to believe that if they had more money they could buy more things. The horizon of every individual is confined within his own experience as the measure of what he can understand of the experience of others. Very few, therefore, can visualize how their ability to buy if they had more money would be curtailed if there was the same proportionate increase in everyone's money without a corresponding increase in commodities.

Suppose, for instance, that everyone changed his dollars into pennies at the same time, and that new paper pennies were printed to make it possible, the new paper pennies being called "pennies" or "dollars." Suppose then that the word "pennies" was dropped and only the name "dollars" was used. Then that the old dollars, in order to keep people from getting mixed up, were renamed "pounds." The pound would now, of course, be equal to one hundred dollars, the equivalent of one hundred former pennies. What would happen?

In every shop all prices that had formerly been stated in dollars and cents would now be stated in pounds and dollars. Labor, rent, interest on new loans, and everything else would now be stated in pounds or dollars. For a time it would be hard for many people to realize the change in value of the dollar, until experience had fixed it in their consciousness. This being true, we can easily see how much more difficult it is for people to understand how the increase at the same moment of one hundred times as many dollars in the amount of money each person owned would decrease the buying power of each dollar. Prices of goods, labor, rent, etc., would not at once be marked up one hundred times in dollars as in the preceding case where names were changed,

* 8 *
but only as competition for commodities, labor, rent, etc., forced them up. That would come about because with more dollars many thousands of people would start to buy things they had long wanted but could not afford. This would reduce the number of such things for sale and those who had been accustomed to them would offer more in order to get them. And the sellers would see the extra demand and would raise their prices.

Laboring men would soon find that rising prices made it impossible for them to buy the things that they required and that they formerly had had, and so would demand higher wages. Employers could meet such demands only as the prices of the things that they sold went up and everything would not rise equally in price. As the cost of building rose and the upkeep of existing buildings went up, rents would have to be increased. So all along the line there would be a great, but uneven, rise in prices. Hardship would be increased, salaries and incomes would be worth less in purchasing power, labor would lag in its ability to obtain compensating wages as employers could only increase wages as they could obtain more for their goods, and unsettled and chaotic conditions would prevail until all adjustments had been made. Such adjustments could not restore the value of incomes that were fixed, however, and many would find that their means of livelihood had been greatly reduced.

But there are many who honestly believe that only those who have little or nothing should receive the additional printed dollars. Such people are the natural prey of the cunning politician, who adds them to those who are told that they will be benefited by the increased units of money in circulation, and so they swell the number of his followers. The honest among the advocates of great issues of money
MONETARY POLICIES

are the only ones we need consider in explaining the situation. What they do not realize is that the new money that might be printed could only be distributed to the poor or unemployed in return for work done or as a gift. But what is most important to understand is that if the poor or unemployed could get the work to earn the printed money, there would be no problem requiring the new money; but that if it were distributed in the form of gifts, someone would have to pay for it.

That “someone” is the people as a whole, and through increased prices of the goods they might buy, they would pay for the gifts. The general condition, therefore, would be no better than before the printed money was put out. It would, indeed, be far worse, because the workers would have to pay for the gifts and the non-workers would have neither jobs nor money after they had spent their gifts and consumed the goods produced.

It is because it is so hard to trace how this printed money that might be given out must be paid for that so many well-intentioned persons who really want to help humanity are misled into the belief that printed money will solve the unemployment problem.

Suppose one billion dollars in printed money is put out by the United States government and distributed among the unemployed, who exchange it for one billion dollars worth of goods. The labor that went into the production of these goods would have cost the employers, whether they were stockholders or individuals, on the average that prevailed in industry for the years 1929–32 inclusive, $816,-300,000.* Overhead, other expenses, and return to owners


* 10 *
MONETARY POLICIES

would make up the balance of $183,700,000, or a total of one billion dollars.

Is it conceivable that this billion dollars worth of goods could be distributed as gifts without someone having to pay for their production?

It would not seem necessary to trace the detail of how in the end the cost comes back, in the form of higher prices, upon the laborers and employers who produce the goods, so that those who work pay for those who do not work. But how can it be otherwise?

If an idle man receives something produced by a worker, only the two of them being together, separated from all other men, it is easy to see how the worker pays. It is not so easy to understand in a complicated social world. But to repeat: How could it be otherwise?

Increasing the number of non-workers who receive the gifts and the number of workers who produce the goods cannot alter the situation. Labor and the middle classes have always been the ones to suffer most from inflation and probably always will be.

The three considerations mentioned tell us very positively that monetary policies must be founded upon principles rather than practices if they are to serve their purpose and meet the requirements of the people. They tell us in no uncertain words that if principles are ignored in times of stress, difficulties will be increased and recoveries delayed.

What are the principles upon which sound monetary policies must be founded?

First, there must be back of a money something of value, something that the people want, in which it can be redeemed. This is important because:

1. When the confidence of a people in a money is de-
stroysed, their efforts to spend it as fast as it is received result in jumping prices of everything in unequal percentages. This causes chaotic conditions, widespread losses particularly to labor, and unemployment.

2. Political forces find it harder to destroy a money that is redeemable in something of recognized value during ordinary times of either prosperity or depression. In extraordinary depressions, political forces backed by a distressed people, if allowed to prevail, can ruin any system.

3. A money based on value acts as a brake upon over-expansion and is a protection even when abused.

Second, the “something of value” back of a money to be effective must have certain positive qualifications.

1. It must be reasonably imperishable.

2. It must bulk so as not to be too heavy for shipment nor too light for storage.

3. It must be generally acceptable to all nations so that it can be transferred from one to another to settle balances.

4. It must exist in sufficient quantity to meet the money and credit requirements of the peoples utilizing it, and it must be sufficiently scarce to hold its value.

5. It must have sufficient stability in its own value so that when it is made a legal tender it can become a common measure for all other commodities, goods, and properties. It need not and it cannot be of fixed stability as against all things at all times, since the buying attitudes of people not only affect the prices of individual articles, but while dispersion of prices as between all goods is going on constantly, the average price of all together will go up and down as massed attitudes of the people fluctuate back and forth in buying and selling complexes. So long as war prevails, catastrophes occur, discoveries take place, invention proceeds, the customs
and habits of the people change, and the desires and character of men vary from each other and over even short periods of time as against themselves, price stability will never be found. But even though it is futile to strive for price stability, it is wise to endeavor to control and smooth over the cycles in so far as possible so that over-expansion and under-consumption may be held within more tolerable bounds. However, even successful accomplishments in such control during a period of tranquility can be upset through war, catastrophe, or unrest.

Greater stability as a monetary measure can be obtained from one commodity, such as gold, while it has all the attributes required, as it does today, than from any two or more commodities as in bimetallism or symmetallism or a commodity dollar. In any event none of these has all the necessary attributes. Also, greater stability can be obtained from gold because:

1. Under bimetallism (or trimetallism, etc.), the values of the different metals used as money change as against each other, and the less valuable drive out the more valuable unless definitely fixed by law by all countries.

2. Under symmetallism values of the component parts of the monetary unit change as against each other. No one wants something of everything in a money so made up, and alloys would be useless unless broken down.

3. In the case of a commodity dollar the contents of the theoretical packages would have constantly varying values, and if actually set up there would be great deterioration in many commodities as well. A commodity dollar is in reality only an idea to talk about; the fluctuation of its contents would destroy its usefulness even if its bulk did not make convenient delivery impossible. If its component parts were
MONETARY POLICIES

warehoused and only title passed from one holder of a commodity dollar to another, it would be no better than the land money of the great Mississippi Bubble.

However, a monetary system is not complete in our world of today unless it is a part of a sound banking system. Without a banking system savings cannot be utilized to create employment and enable the production of the vast number of units of necessities and conveniences that populations of current density require.

Bank deposits may be made with currencies or with credits, and banking structures are the combination of both with the stockholders’ capital as a margin of protection. The best banking system for the people is one of efficient private operation and efficient governmental supervision. Men are men whether they are in or out of government. Neither group should have dictatorial powers over the people. The only sound division of power that mankind has found so far lies in the private operation of all businesses, including banking, accompanied by governmental supervision. Such a system, soundly organized, tends to prevent unfair activities on the side of operators and dictatorial abuses on the part of those in government.

In general, branch banking is the safer system. Political and economic forces exercised against individual banks can break them down one at a time until all are jeopardized. Guarantee of deposits is an unfair makeshift aimed to give each bank the stability of all as in a huge branch bank. No one has ever been able to show, however, wherein there can be either justice or right in making the stockholders of a well-managed bank liable for the losses of a badly managed bank a thousand miles or so away, whose operations are beyond the control and beyond the knowledge of the well-managed
MONETARY POLICIES

bank. If we imagine a druggist, a groceryman, and a butcher saddled with the losses of those engaged in the same business in other places, the wrong may be a little easier to see.

Monetary policies that reach deeply into banking systems and change their structure require special study from the banking standpoint alone, and so will not be considered further here.

Money is a means to an end and not an end in itself. Money is merely a convenience and is necessary to existence in great populations. Its principal use is as a timesaver.

It has been most interesting to follow the many ingenious plans that have been tried out in various localities throughout the United States during the depression in the hope of helping men find a way to live where banking services and the ordinary means of obtaining money have been temporarily stopped.

Methods for carrying on barter, papers stating hours of labor accomplished, issues of promises to pay by towns, industries, and associations in small amounts have all been tried out. When they have succeeded in bettering a difficult condition through the use of substitutes for money, men have waxed enthusiastic over the schemes that were new to them even though they had been tried out generations ago. Volumes have been written about how money could be done away with or trade could be carried on with substitutes for money as effectively as with money. Those who have been intrigued with these experiments have measured them against the absolute state of stagnation that had prevailed before they were undertaken, and not against an active normal community. They do not realize that their success was due to human effort. Men and women went to a tremendous amount of work to save critical situations in their communi-

* 15 *
ties throughout the length and breadth of the country. It was this work that brought success, and not crude monetary schemes. Such schemes undoubtedly did serve to lighten the burdens of the workers, for they developed a medium of exchange that was temporarily effective. But the hard work of those men and women who met their problems so bravely is not available when conditions are normal and the business machine is functioning, and neither is it necessary under a sound monetary system.

Along with the science of money the movement of prices in its relation to money is a mystery to most men. This is due largely to a lack of opportunity to become familiar with the problem. Even economists, who are inclined more to statistical studies than to human equations, fall down badly in judging the movements of prices. They often forget that money does not spend itself and, therefore, treat it as a living thing.

If every man had a quantity of money in his pocket and if he thought prices of goods were going lower, or if he questioned his ability to get more money, he would be a hesitant buyer to the extent of his mentality. On the other hand, if every man had comparatively little money in his pocket and he thought prices of things he needed were going up, or that he could get more money easily, he would become a spender in important part.

In the first case a great quantity of money would not take effect in raising prices because of the non-buying complex of its possessors, and in the second case because of the buying complex the small quantity of money would not pull prices down.

The same conditions pertain to credit. If industry will not borrow, it is futile to load the banks with funds in the belief
MONETARY POLICIES

that by so doing they will have to loan them. When industrial men fear that they will not have markets for their goods, they would be foolish to borrow money and spend it for raw materials and labor, even if they had to pay no interest at all. Many thousands of men in the United States in 1933 thought that all that was necessary to start up industry was to increase the ability of the banks to loan. Then the banks were criticized for being too liquid and holding their money when they could find no borrowers.

When industry believes that it can find markets for its goods, it will borrow even if it has to pay a high rate of interest, but if it has no confidence that it can sell its goods it will not borrow, no matter how low the rate is nor how much money is available.

But great numbers of people whose experiences were along walks of life far from actual banking transactions had had their attention called to the fact that on certain occasions when money was easy industry had expanded. They were led to believe that at such times the plethora of money and credit had made the business opportunity, whereas the business opportunity had already existed and business men merely took advantage of the easy money conditions to expand and usually to over-expand. The people did not understand this latter condition, and they were built into a political force that demanded that vast sums of money or credit be provided; and so this policy was carried out in the United States.

There is no question but that with other things equal, quantity of money and credit offers less resistance to business development than tight money. But when there is plenty of money and credit for normal business requirements and industry does not function from a cause far removed from

* 17 *
MONETARY POLICIES

money, increasing money facilities will not avail until the cause of the failure to function is removed. Usually the cause for such a condition takes form in a so-called "lack of confidence," but the cause or causes for this "lack of confidence" are the real things to be attacked.

As money was not the cause of the present depression, the inflationary expansion of credit in the United States did not lead the way out. Its advocates undoubtedly believed that it would do so, and it was the political force built upon this belief that determined this ineffectual monetary policy.

One of the greatest fallacies of the present depression lies in the belief that trying to change the relationship that had developed between debtors and creditors by the manipulation of our money would cure the difficulty. It is, of course, a proved fallacy, but it is enjoying great prominence in this depression and is riding high.

There can be no criticism of the honest belief that swept over the country that experimenting with the monetary system would uncover the solution of the trouble. The people were bewildered, but many advocates of the policy chose to descend to vituperation and the development of class strife and hatred instead of considering the subject on its merits. Of course, when one is teaching false principles success can attend his efforts only while his smoke screen lasts, and many who engage in building up forces for political power are fully aware of this fact.

But a vast number of people in all walks of life were honestly intrigued with the idea, and the political force engendered seemingly became too powerful to be ignored. This false principle became a part of our monetary policy.

Let us analyze this situation a little. Why do men borrow when they intend to repay their loans?
MONETARY POLICIES

There are four reasons for such borrowing:

1. To purchase land, improved property, stocks, or things that men desire to pay down upon until owned.

2. To purchase land, improved property, stocks, or things that they later expect to sell at a profit.

3. To carry on a business; that is (a) to meet the expense of production of raw materials or finished goods until products can be sold; (b) to carry goods from time of purchase to time of sale; and (c) to provide plant, equipment, or means of service until earnings meet the cost.

4. To meet a temporary emergency.

Except in the last case, where necessity intervenes and the proportionate total amount is too small for consideration, original loans are all undertaken with the expectation of making a profit.

Unless the creditor is a semi-partner, in which case he is not a true creditor, the return to him is measured by the risk he takes and is a fixed percentage of the amount loaned on an interest basis. The debtor, on the other hand, is free to make all that he can from the loan. The profit on his operations will be determined largely by his judgment and efficiency. Catastrophe need not be considered, since it may menace equally the debtor and the creditor. Both debtor and creditor take the risk involved in the enterprise in which the debtor engages unless the debtor is able to repay the loan from other assets.

The debtor may be borrowing for speculation, for ownership, or for business. In any case he expects a profit of some kind sufficient to enable him to pay the principal and interest on his loan and leave something over for himself. Rural dwellers who speculate with loans do so mostly in land or in commodities with which they are familiar. The urban popu-

* 19 *
MONETARY POLICIES

lation speculates more in securities, real estate, and com-
modities.

Intelligent speculation aimed to forestall the needs of
growing communities, increasing demands, probable discov-
eries, or research for inventions is of inestimable value to the
people. It widens markets, opens the way for humanity to
keep abreast of its financial and physical needs, and serves
to increase the national wealth. But wild speculation is harm-
ful, since it results in losses that may be very far reaching
and is far more destructive than the mistakes that must
occur constantly in connection with even intelligent specula-
tion.

Commodity price movements under a sound monetary
system constitute the best protection against unwise specu-
lation so far known to mankind. Of course, if men persist in
ignoring the handwriting on the wall so clearly visible in the
movement of commodity prices, they must suffer and should
suffer, and government should not step in to save them,
since they for their own profit have jeopardized the common
welfare. This is true whether one borrows to buy at abnor-
mally high prices land, securities of any kind, or raw mate-
rials for manufacture, or to engage in excessive production.

The fact that there may be no wrong intent in the minds
of those operating under such conditions does not excuse
them; nor does ignorance of the movements of market indi-
ces. It is the duty of the borrower, both for his own protec-
tion and that of the public, to study the price levels before
he asks for money. Prices are quoted in the papers daily in
certain details and weekly in very complete form, showing
the movements of averages. When a man borrows to buy
anything at an abnormally high price he should measure
with great care that price in its place in the average price

* 20 *
MONETARY POLICIES

level, as well as study the supply and demand conditions likely to prevail with respect to the special thing being bought.

The increased collateral asked by the lenders also constitutes a warning of danger. In land this takes form in the greater margin required, in commodities and stocks in the greater number of units of the goods or securities asked for. Where the creditor extends such warning in endeavoring to protect himself, and the debtor persists in borrowing and buying when prices are abnormally high, the debtor certainly has no right to demand special protection because his attempt to make a profit for himself results in a loss. There is, of course, more risk in borrowing for long time, but that should be recognized by the borrower and by the creditor, and should be taken into consideration.

With no movement of prices (if it could be brought about), men would have no guide at all in their business activities as to over- or under-production, the falling-off of demand where an article was going out of use, or an increasing desire for something, until on one side it was too late to hold losses within bounds by altering or delaying production, and on the other by increasing or undertaking production of needed products.

Looked at from the standpoint of a debtor who has to pay more than he borrows when prices fall, or vice versa, if he converts his dollars into goods, we can clearly see the fallacy.

Suppose a man borrows $5,000 for five years to buy a farm, and five years hence commodity prices are higher on the average, but land in his vicinity has gone down for local reasons, so that his farm is worth only $4,000. Should the creditor be allowed to collect more than the $5,000 because

* 21 *
he could not buy as many commodities on the average, or should the debtor be allowed to cancel his note through the payment of $4,000 because his farm was now only salable for that amount?

If it is wise and fair to reduce the amount of notes at maturity in the percentage that the commodity price level has fallen, is it not wise and fair to increase notes in the percentage that the price level has risen?

Suppose this system were established and a manufacturer borrowed $50,000 from a bank and bought 500,000 pounds of copper for use in a product at 10 cents a pound. Six months later at the maturity of the note copper is worth only 8 cents a pound, but the average price level has risen 2 per cent. Would the borrower have to pay the bank $51,000 to cancel his $50,000 note, or could he turn over 500,000 pounds of copper in settlement that would be worth only $40,000 at the current price of 8 cents a pound?

It all sounds foolish, doesn't it?

Under any such system business would be too complicated for men to handle; and yet that is the turn around of a dollar aimed to fluctuate so as to complement the movement of commodity prices.

There is no doubt that there is risk involved in doing business in this world of men. There is no doubt that one of the risks lies in the movement of the prices of goods between the time of purchase and the time of sale. There is no doubt that change in prices of goods operated in will occur through changing supply and demand, regardless of the monetary system. The only question is who should take the risk in the case of purchases made from borrowed funds, the debtor or the creditor.

There is only one answer to that question: the debtor
should take the risk. He decides what he will buy and when he will buy it. He buys because he believes he can make a profit from doing so. Again, the debtor often makes his profit before his notes become due, and falling commodity prices cannot injure him if he holds the funds to meet his obligations. If he invests them, of course he does so at his own risk. If prices are going against him on a time note, he and not the creditor has power to sell and he can take such profit or loss as his judgment dictates will be best for him in the end. In many lines of business he can hedge against fluctuating prices by selling for future delivery.

The old law caveat emptor “let the buyer beware” is safer for business and safer for the people as applied to purchases made from loans in their relation to the payment of loans at maturity. This does not, of course, relieve the creditor from the exercise of good judgment.

The debtor must protect himself by knowing all about what he buys with the loans he makes. Then, after doing so, his greatest protection lies in a sound monetary system with the most stable collateral value back of it that men can find, and today that is gold. The money content should not change so that men can measure their risks from one side only: that of the rise and fall of all business together with the price probabilities of the particular products in which they are dealing. If men will not follow the indicators of business when they borrow to buy, they will, of course, subject themselves to unnecessary loss.

But a great and commendable desire on the part of millions of people whose training has not been along monetary lines to protect those who have suffered from the depression has made them vulnerable to those whose intent may have been fine also, but whose own understanding of economics
MONETARY POLICIES

has been faulty, and all have been woven into a political force by the agitator, who himself may even have meant well. The result has been the breaking down of our monetary system to our national detriment. This has been accomplished by the political force created, a force that was apparently too strong to be ignored and that was recruited from men in all walks of life who were lacking in understanding. As men are constituted, the debtor’s will to pay, a characteristic equally necessary to success in an individual and in a nation, has been weakened.

A great political force has been evidenced in connection with the use of silver in our monetary system. When many people believe that it will help them out of their troubles they naturally try to further the silver idea. They have not noticed that some of the advocates of the silver monetary policy, in speaking for it, said that it would be a great boon to China as well as to the United States. Actually it has already resulted in the closing of banks and a money stringency in that country and in the beginning of a period of greater distress for the people of China.

In the same way there has also been created a great political force for inflation, coming from those who have been led to believe that it will correct our difficulties.

So in the United States three great political forces have arisen that, through their leaders, have demanded of our government in good faith, in large part, three different monetary policies: (1) the reduction of the gold content of the dollar; (2) silver as a part of our money; and (3) inflation under any one of several methods. Our administration has apparently endeavored to meet these demands by trying out the dollar gold-content change in the hope that it might not result in inflation, and has then followed

* 24 *


MONETARY POLICIES

with silver legislation as being less harmful than inflation, in the added hope that inflation might still be prevented.

There is no doubt whatever that the monetary uncertainty that exists at present is largely responsible for the holding back of recovery. Men cannot satisfactorily measure business risks on the basis of a money whose content in value cannot be counted upon. The disaster caused by inflation during the life of this generation in Germany, Austria, Hungary, Italy, and France ever stares us in the face. Only time will tell whether our country can escape having similar unnecessary and far-reaching difficulties brought about as a result of inflation.

If all of these monetary problems could be studied dispassionately, the political force would undoubtedly turn toward sound monetary policies. Unfortunately it is not the way of those who may be striving for political power. They make up for the weakness of their arguments by viciously attacking other men and by so doing arouse the jealousy and anger of their audience to such a pitch that sound analysis has no chance. Such methods are effective only during times of stress and not always even then. The degree of hardship that exists is apt to measure the kind of political forces that prevail—whether they may be "wise and prudent" or "artful and cunning."

It might be illuminating to call attention to one instance in history, similar in character to innumerable others where the monetary policy was the outgrowth of politics, which applies more or less to our own situation. A commentary on the conditions that prevailed in Great Britain in 1821, written at the time, read as follows: "Although the distress was felt with equal severity by nearly all industries, the agricultural interest, being by far the largest, and having by far
the greatest influence in the House, managed to obtain the best hearing.”

Another interesting condition that developed during the period between 1816 and 1825 lay in the actual failure of the banks in Great Britain to induce industries to borrow money and reestablish business, the reason being that the industries were fearful that they would not have markets for their goods.

Many monetary policies have been put into operation when the politics of the time were “wise and prudent,” and we have learned what is sound from experience with monetary policies that were established during such periods. It is to be hoped that now that the gold clause decision has been handed down by the Supreme Court, the people, having felt the effect of the turmoil in their lives caused by the uncertainties created by our monetary policies previous to the decision, will not let themselves be carried away by those whose arguments for unsound money are largely confined to vilification of their fellow citizens, and instead will study dispassionate statements on both sides when forming their own opinions as to suggested monetary policies.

Such consideration will surely aid our administration in accomplishing the recovery that has been so long delayed partly because of the creation of great political forces that have not always been “wise and prudent” in their demands for monetary reform.
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The University of Minnesota Press
Minneapolis
Income Distribution under Capitalism

NUMBER TWELVE
THE DAY AND HOUR SERIES
OF THE UNIVERSITY OF MINNESOTA
January 1986
THE DAY AND HOUR SERIES

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Income Distribution under Capitalism

A CHALLENGE TO AMERICAN BUSINESS MEN

BY

H. G. MOULTON

THE UNIVERSITY OF MINNESOTA PRESS
This address, delivered in Northrop Memorial Auditorium on October 31, 1935, presents briefly the results of a series of investigations conducted by the Brookings Institution in Washington, of which Dr. Moulton is president. A fuller treatment of the subject may be found in his "Income and Economic Progress," the fourth volume of a series including "America’s Capacity to Produce," "America’s Capacity to Consume," and "The Formation of Capital." Dr. Moulton is the author also of an earlier paper in this series, "International Economic Recovery," and of many other books and articles on financial aspects of the domestic and international situation.
Income Distribution under Capitalism

* * *

The subject we are to consider is, I believe, of more fundamental significance than any other with which mankind is concerned. Upon our ability to discover the means of making continuously effective use of our productive resources and of progressively stimulating further technological advancement depends not only the economic and social welfare of the masses of the population but also the very perpetuity of our economic and political institutions.

In the short interval of time since the founding of the American republic, man's power over nature has been increased vastly more than in all preceding history. If we were to let the span of human history be represented on the face of a clock, the period elapsing up to the last two centuries would be the equivalent of the time from noon to ten minutes before twelve midnight. The last ten minutes represents the period during which the capitalistic system, as we know it, has evolved. Economic progress in these last ten minutes has greatly exceeded that in the preceding seven hundred and ten minutes.

This phenomenal development is, of course, not to be ascribed entirely to the system of free enterprise, which unleashed the powers of inventiveness and opened wide the doors of opportunity for the development of individual talents and capacities. Great scientific discoveries, the opening up of new highly productive areas, and the momentum
INCOME DISTRIBUTION UNDER CAPITALISM

gained as each new generation has built upon the achievements of the past have all been powerful factors.

The focal point of our present interest, however, is not the rate at which progress has been achieved during the modern era but rather the forces that appear to be responsible for its apparent retardation at this particular juncture in history. When one stops to think closely about the question, it would seem that the rate of economic progress should be a constantly accelerating one. The larger the margins achieved above the requirements for subsistence, and the greater the accumulation of scientific and technical knowledge, the more rapid should be the rate of economic growth and the higher the standards of living—provided, of course, that the rate of population increase is restrained. In other words, the first thousand years were the hardest, and in each succeeding century the forward road should become easier.

A great many observers have in recent times been concerned over the fact that the rate of economic progress appears, superficially at least, to be lagging rather than accelerating. Somehow, the older and more mature economically a nation becomes, the less rapid—for one reason or another—appears to be the rate of its economic growth. We do not seem to be able to make full utilization of our existing productive facilities. This fact has seemed to indicate to some that we have reached a stage of permanent overproduction necessitating restriction of output and more leisure instead of more wealth. To others it has suggested that there must be some underlying difficulty which seriously impedes the operation of the economic system.

It was with a view to throwing light upon the great problem thus briefly suggested that the Brookings Institution, organized for the purpose of ascertaining and interpreting the

* 6 *

facts about great economic and governmental problems, submitted three years ago to the Maurice and Laura Falk Foundation of Pittsburgh, created for the purpose of promoting human welfare, a project for investigating the relation of the distribution of income to economic progress.

The very wording of the title, The Distribution of Income in Relation to Economic Progress, suggested the fundamental lines along which the investigation would be projected. The fact that business enterprises seldom produce at full capacity, that the greatest problem of business managers appears to be to find adequate markets for their products, raised in the minds of many business men and economists the question, Is not the primary difficulty a lack of purchasing power among the masses? and this led at once to the correlative question, What is the bearing of the distribution of income among the different groups in society upon the demand for the products of industry?

In the view of many people it seemed obvious that since producers groan under the burden of “excess capacity” at the same time that consumers complain of unsatisfied wants, the trouble must lie in the failure of the system to transmit purchasing power broadly to the masses. In sharp contrast, others contend that the center of the economic system is production. While temporary maladjustments may restrict productive output, it is urged, as a normal long-run procedure we produce all we can and our consumption is simply determined by the amount the economic machine is able to turn out. In the light of such divergent views the need of a searching study of the interrelations between production and consumption, as revealed by data and information drawn from the actual world of affairs, was evident.

As you are all aware, our investigation has covered a num-
INCOME DISTRIBUTION UNDER CAPITALISM

ber of more or less distinct, though interrelated, subjects, and the final volume, on which I am reporting this evening, is an interpretive synthesis of the entire investigation. The four resulting publications are America's Capacity to Produce, America's Capacity to Consume, The Formation of Capital, and Income and Economic Progress.

Since many of you are familiar with the conclusions reached in our studies of production, consumption, and capital formation, only incidental reference need here be made to the first three phases of the investigation. In order, however, that you may have before you in succinct form the successive steps involved in the inquiry as a whole and be able to judge for yourselves whether or not the investigation has been carried out in a thoroughly scientific manner, I shall give a very brief recapitulation.

I use the term "scientific" deliberately, because of a widespread impression that the subject of economics does not readily lend itself to scientific determination. It is our belief that because of the extensive factual and statistical information about the business world that has been accumulated in recent times it has been possible to pursue the present investigation by methods quite as scientific as those prevailing in the natural sciences. In some connections, to be sure, it has not been possible to make as accurate measurements as one might wish, but the lack of precision, we believe, in no wise affects the fundamental validity of the conclusions reached. In order to present our findings as succinctly as possible and at the same time to reveal the methods employed, I shall describe the several steps in the analysis as a whole.

USE OF PRODUCTIVE RESOURCES

The first step was to ascertain the degree to which our productive resources are ordinarily utilized. We found that in

* 8 *
the prosperity period of the twenties our productive facilities were used to only about eighty per cent of capacity. This phenomenon of excess capacity was characteristic of the entire period from 1900 to 1929, with no definitely discernible upward trend during the period as a whole. During the depth of the depression in 1932, the rate of output for the economic system as a whole was scarcely more than sixty per cent of capacity, and in many lines of manufacture it was as low as twenty or thirty per cent.

The second task was to determine whether the failure to utilize our productive capacity fully might be explained by any impediments or maladjustments within the productive mechanism itself. We were unable to discover any bottleneck, weak link, or defective part in the productive system. That is to say, there was no impediment in the way of a shortage of raw materials, industrial plant and equipment, power or fuel, transportation facilities, money and credit, or labor that might explain the failure of the system as a whole to operate on a capacity basis. The source of difficulty had, therefore, to be sought outside the productive machinery.

**Distribution of Income**

As the next step it was therefore necessary to study the distribution side of the economic system. Might the difficulty be found in a maladjustment between productive capacity and purchasing capacity? To throw light on this question it was necessary to show how the national income is divided among the various groups comprising the body politic.

We found, in brief, that the great masses of the population had incomes insufficient for primary requirements and that there existed a potential demand vastly greater than could have been supplied had we operated our economic system at full capacity. At the higher end of the scale, incomes were
INCOME DISTRIBUTION UNDER CAPITALISM

not only in excess of consumptive requirements but in many instances in excess of practical consumptive possibilities. Over the period from 1900 to 1929 the poor were not growing poorer but richer. But the rate of income growth was nevertheless more rapid in the upper income strata.

SPENDING AND SAVING

The fourth step was to determine the effect of the unequal division of income upon the allocation of the total income as between spending for consumption and saving for investment. We found that the savings of those with incomes of less than $2,000 were negligible, whereas those in the higher income brackets saved a substantial percentage of their total income. Of 15 billion dollars of individual savings in 1929, as much as 13 billions were made by 10 per cent of the population. Since the number of people in the higher income groups was increasing, the percentage of the total national income that was diverted to investment channels was increasing.

EFFECTS OF INEQUALITY OF INCOME

The fifth step brought us to the crucial question, namely, whether the restricted flow of funds into consumption channels, resulting from the unequal distribution of income, served in any way to impede the operation of the economic system. To answer this question it was necessary to study the forces that govern the transformation of the money savings of individuals into new capital equipment.

According to traditional views, the greater the amount of money directed into investment channels the better, for it will all be used to expand plant and equipment, thereby increasing production capacity—and hence consuming capacity in the future. Our analysis showed, however, that since

* 10 *
new capital is constructed with a view to making profits out of the sale of the products of such capital, an expansion of plant and equipment will not take place in any large way unless consumptive demand is at the same time increasing.

Our study of the facts of industrial history disclosed further that the growth of new plant and equipment is closely adjusted to the rate of increase of consumptive demand rather than to the volume of savings available for investment purposes. In the prosperity period of the twenties, for example, only a portion of the money savings rendered available in the markets was utilized by business men for the purpose of building new plant and equipment. The excess went to bid up the prices of securities already outstanding, thereby producing serious dislocations in the financial markets. In short, we found on the one side that the flow of money into consumptive channels was inadequate to call forth the full use of the existing plant and equipment; and, on the other side, that the excessive flow of funds into investment channels produced a security market boom, the ultimate collapse of which was an important factor in precipitating the depression of 1929.

As a result of the investigation of production, consumption, and the process of capital formation, we reached the following basic conclusions:

First, the unbalanced distribution of income—and consequent restricted flow of purchasing power through consumptive channels—explains our inability to find markets adequate to absorb the full output of our productive establishments.

Second, the slow rate of growth of consumptive demand serves to retard the rate at which new capital is constructed and hence the rate of economic progress.

* 11 *
INCOME DISTRIBUTION UNDER CAPITALISM

Possible Lines of Progress

With the basic source of maladjustment disclosed, our problem shifted from diagnosis to prescription. By what means might the flow of the income stream to the various groups in society be modified so as to expand progressively the effective demand for consumption goods and call forth an ever greater volume of production? What are the possible lines of attack on this problem? In what directions is economic progress most likely to be found?

As a preliminary to a discussion of this problem it should be clearly understood that a mere redistribution of the existing income of society will not accomplish the desired results. If the entire income of the nation had been divided absolutely equally in the most prosperous year we have ever known, each person would have received about $665. If all the income derived from investments in 1929 and all the salaries received by corporation officials had been conscripted and distributed to the masses, the per capita income would have been increased by only about $140. The amount that could conceivably be redistributed at the present juncture without bringing the economic system to a halt is so small as to be of negligible significance.

The paramount requirement is to increase progressively the total amount of income to be divided. Only if the aggregate income increases from 80 billion dollars a year to 100 billions, to 150 billions, to 200 billions, will it be possible to achieve the goal desired. What we need is a dynamic society in which ever increasing quantities of newly created goods and services will become available to everyone. The distribution of income from year to year is thus of significance not for its momentary effects upon the well-being of the masses but for its possible cumulative effects in promoting a fuller
utilization of our productive facilities and a consequent progressive increase in the aggregate income to be available for division.

Numerous persons, aware of the character of the conclusions reached in the first three volumes of our investigation, have evidently been expecting us to suggest some clever device, or panacea, with which to remedy the existing maladjustments. One of the most striking attributes of the human mind is its desire for some simple or single solution to the problem with which it is confronted. Any number of such "conclusive remedies" have come to my desk, as no doubt to yours, in the course of recent years. But anyone who has had a broad and varied experience, either in the world of business or as a professionally trained student of the actual operation of the complex economic system, knows that there is no easy formula by which the economic machine may be automatically, instantaneously, and perpetually perfected.

In our analysis we have given careful attention to several alternative, though not necessarily mutually exclusive, lines of attack upon the problem. In each case we have sought to determine both the potentialities and the limitations. By a process of elimination we have reached a judgment as to the particular road along which progress, as we conceive it, is most likely to be achieved. At the same time we have indicated other contributing means and suggested the places at which further investigation is required.

Methods of bringing about a different division of income are of two broad types, the one direct and the other indirect. The direct method involves a modification of the income stream at its source, that is, in the disbursing offices of business enterprises. The indirect method involves an unmodified initial distribution and then a subsequent redistribution.
through the medium of taxation machinery. I shall say just a few words about the latter first.

TAX-FINANCED SERVICES

Taxation has already played a role of no small significance in raising the standards of living of the masses. For many years, federal, state, and local governments have collected taxes for the purpose of providing educational and recreational facilities and, increasingly, public health service. These free services have not only contributed very materially to the well-being of the masses but, since such services come free, have resulted in a larger margin for expenditures on other types of consumption goods. As the years pass, the furnishing of such services out of funds derived from taxes may well be made very much more important than it has been heretofore.

On the other hand, many types of public expenditures—which provide incidental employment—are not of great direct significance for the masses. If the people had free choice in the matter they would clearly not express themselves in favor of additional public works as compared with better food, clothing, shelter, and more necessities and conveniences in the home. However important the construction of public works may be in a period of depression, such enterprises can be justified as permanent policy only if they yield larger satisfactions to the people than might be rendered through increasing the output of basic necessities. As long as widespread under-consumption exists, a program of public works will not solve the basic need. Not unless the government were to take over the production of food, clothing, and other basic necessities would it be possible thus to give the people what the people most stand in need of. We conclude, therefore, that taxation has a place in a program for redistributing income—

* 14 *
an increasing place as the years pass—but not a place of primary or fundamental importance.

**Alternatives to Consider**

Turning now to the direct methods, there are two principal alternatives to be considered. The first is the increase of money wages without proportionate increase of prices, and the second, or opposite, is the reduction of prices without a reduction in money wages. Before considering these alternatives, let me emphasize that our analysis is concerned not with the economic situation as it presents itself in the midst of depression, when normal price and wage relationships have been seriously disturbed, but rather under normal long-run conditions.

It is readily apparent that if there should be a general increase in money wages unaccompanied by offsetting increases in prices, the purchasing power of the wage-earning classes would be enhanced. It is clear also that if prices generally were reduced while money wages remained unchanged, the real income and purchasing power of the masses would likewise be increased. It is clear also that wage increases, accompanied by corresponding price increases, do not increase purchasing power, and that price reductions achieved by cutting wages do not give to the laboring classes any added purchasing power. The relationship between wage levels and price levels must be modified if the workers' income and purchasing power is to be expanded.

**Wage Increase**

Since public interest has been focussed chiefly upon the wage-increase method of raising the income of the workers, this method must be given first consideration. To simplify our discussion, let us ignore the practical difficulties involved
INCOME DISTRIBUTION UNDER CAPITALISM

in bringing about a general increase in wages unaccompanied by price increases. What we are chiefly interested in for the moment is in determining to what extent this method, if successful, would reach to the heart of the problem of raising the income of the consuming masses.

The industrial labor population of the United States constitutes only one portion of the great consuming public. Of a total population of 122,775,046, at the latest census, 44,636,770 were classified as farm population, and another 9,183,453 lived in towns of less than 2,500 inhabitants. The urban population was 68,954,823, of which 4,717,590 lived in towns of between 2,500 and 5,000 inhabitants. A substantial part of this urban population would receive no benefits from the wage-increase method of distributing income. Persons employed in government activities, in educational, philanthropic, and charitable organizations, or in personal or domestic service would not necessarily obtain increased salaries. These workers, with the professional groups, constitute a population of something like twenty million people.

The wage-increase method of disseminating the benefits of technological progress would, therefore, extend to no more than 40 per cent of the total population. Moreover, the importance of the farm population is not fully revealed by the number of people involved. The farmers as a class have the lowest incomes of any important group in the body politic. In 1929 per capita income of the farm population as a whole was only $273. Any method of distributing income that leaves the farm population out of the picture obviously falls far short of the desired goal.

Moreover, the increase of money wages tends to promote a basic maladjustment between two great divisions of our economic life and thus to impose a serious barrier to eco-
INCOME DISTRIBUTION UNDER CAPITALISM

omic progress. The struggle to obtain higher living standards through the medium of higher money wages has been the cause of a long and deep-seated conflict between the agricultural and urban populations. The people of the cities have fought for higher wages even though it has meant somewhat higher prices for industrial products. The farmers have long fought for lower prices on the commodities they have to buy. The struggle underlies the so-called granger movement of the seventies; it explains the traditional opposition of the agricultural South to high protective tariffs; and it lies at the basis of farmer opposition to trusts, monopolies, and combinations in all their forms. It explains finally the present agricultural program of restricting output as a means of restoring "price parity" between agriculture and industry.

Investigation and analysis clearly reveal that the wage-raising method of increasing the purchasing power of the labor population has over a long period of years been instrumental in giving them higher standards of living. The objection to the method is simply that it is not sufficiently inclusive in scope and thus produces maladjustments that serve to impede the most effective functioning of the economic system as a whole.

Price Reduction

In contrast, when prices are reduced (without a reduction of wages) the benefits automatically accrue to the entire population. That is to say, price reduction not only adds to the purchasing power of the labor employee group but it increases the real income of the non-wage urban population and of the farm population. Thus the benefits are distributed throughout the entire economic system and a better balance is maintained between its different divisions.

In considering these alternative methods of disseminating
the benefits of progress, attention must also be directed to their bearing upon international competition. In so far as an increase in money wages is accompanied by increasing prices, the ability of American manufacturers to meet competition in foreign markets is obviously impaired. And even if prices should show no increase, the competitive power of the American manufacturer would be affected in a negative way. That is to say, he would not be in a position to reduce his selling price with a view to expanding foreign sales.

On the other hand, a progressive lowering of the prices of commodities strengthens a nation's competitive position in foreign markets. The greater the technical progress and the lower the consequent selling price the greater will be the chance of expanding foreign sales. Success in international competition will in the long run depend upon productive efficiency and not upon the level of money wages.

In short, the broad highway along which economic progress must be sought is the avenue of price reductions. When this road is followed the benefits of technological improvements are automatically conferred upon all divisions of the population. Maximum expansion of purchasing power is obtained and equilibrium is maintained.

Business Policy and Economic Progress

The problem thus briefly outlined is the fundamental issue confronting the business men of this and other countries. It is the business man's problem, for the simple reason that business policy is the determining factor in the making of prices. We are concerned here with a crucial question of economic organization under the capitalistic system. In order that there may be no failure to appreciate the vital significance of this problem from the standpoint of the functioning

* 18 *
of the economic system, let me briefly recall the fundamental principles upon which the capitalistic system depends for its successful operation. These principles have not only been long ago set forth in economic literature but have long been imbedded in the thinking of business and governmental leaders. They tend, however, to be forgotten in the everyday world of practical affairs.

The general theory underlying the system of capitalistic production and distribution clearly recognizes the necessity of an ever expanding mass purchasing power in order to absorb the expanding capacity of the productive establishment. Certain clearly defined principles were set forth which it was believed could be relied upon to bring automatically the desired results. Let me briefly summarize these principles.

First, it is pointed out that under a system operated for private profit each business manager naturally seeks to reduce costs by increasing the efficiency of production. He may accomplish this by the construction of a larger and more efficient plant, by the installation of improved equipment, by the introduction of superior internal management, by improved methods of marketing, by integrating various stages in the productive process, or by a combination of various methods.

Second, having reduced costs of production, he is in a position to increase his profits in one or another of two ways. He may continue to sell at the same price as before, enjoying the advantage of a wider margin between cost and selling price; or he may expand the volume of his business by means of price concessions. It was reasoned that since the increase in efficiency that is responsible for the reduction in costs commonly involves an expansion of productive capacity, and since the maximum economies can be obtained when operat-
ing at full capacity, the greatest profits will result if the output is expanded by means of a reduction of prices. The wise alternative is to expand sales by offering the products at a lower price.

In short, increased efficiency makes lower prices possible, while the profit incentive insures the actual reduction of prices. The greatest profit to the business enterpriser is thus derived through giving to the masses the most for their money. The interest of the profit-maker therefore coincides with the welfare of the community.

Third, the process naturally involves the continuous elimination of obsolescent or otherwise inefficient, high-cost, or marginal establishments. The fit, as gauged by ability to sell at a minimum price, alone survive. Moreover, the efficient of today promptly become the inefficient of tomorrow. A particular business man, firm, or corporation may indeed survive over a long period of years, but only if the production methods employed keep always abreast of changing times. Note that this theory of progress requires the maintenance of money wages—for if they are not maintained, the real purchasing power or income of the laboring class will not be expanded. The reduction of prices that is significant is the reduction that results from increased productive efficiency.

I submit that these fundamental requirements for progress under the capitalistic system have never been subjected to challenge. I submit that they cannot be refuted. As we increase productive efficiency we must, if our productive resources are to be fruitfully employed, match it with increased consumptive power among the masses.

I submit also that in the actual operation of the business system these principles have not always been adhered to. Certain prevailing practices have tended to nullify the bene-
INCOME DISTRIBUTION UNDER CAPITALISM

fits of technological improvements and to retard the rate of economic progress. First, the importance of maintaining the general level of wages as a part of the process has too often been forgotten. Indeed, the system itself has exerted a powerful pressure on business managers to reduce wages. When confronted with markets inadequate to absorb the full potential output of his factory, the individual business manager is naturally tempted to cut wages as a means of reducing costs; for with lower costs he can make price concessions and expand his sales. But if all business men cut wages as a means of reducing costs and selling prices they have not thereby expanded the purchasing power of the wage-earning population. The contention of labor leaders that labor is something more than a commodity is correct; labor is also a consumer. Fortunately this fact is becoming more and more widely recognized as the years pass.

In the second place, the primary mechanism upon which the system relies to distribute the benefits of technological progress has, to an increasing extent, not been permitted to operate. Instead of reducing prices as a means of expanding markets there has been a growing tendency to maintain prices and to let well enough alone.

Interferences with competitive price movements have occurred as a result of the development of at least three major types of business organization. The first is the unified monopoly or industrial combination under single management. The second, found chiefly in Europe, is the cartel or "collective monopoly," under which there is group control of production with a view to stabilizing prices in a given industry. The third is the trade association, which seeks, usually through informal cooperation, to stabilize certain conditions within particular industries without interfering with the con-

* 21 *
control of production. There are, of course, many different types of trade associations, and not all of them are able to exert an influence upon prices; but, by and large, trade associations consciously or unconsciously promote price stability. These associations, unlike consolidations, have generally been viewed with favor by the United States government as a means of stabilizing business.

Thus industrial policy, as it has evolved in this and other countries in recent times, has tended to impede the free functioning of the price system. Over an ever widening area the process of persistently expanding purchasing power by means of price reductions has been checked. We do not wish to imply that competition has entirely disappeared; for in broad sections of the industrial system prices are still reduced as productive efficiency increases. But as industry reaches a more mature stage of development, and as production becomes concentrated in larger units, the policy of maintaining prices to stabilize conditions and safeguard profits prevails increasingly.

The necessity of progressive price reductions as a means of expanding purchasing power and markets appears to have been forgotten alike by business managers and economic statesmen. Yet the conclusion is inescapable that, in so far as the effort to stabilize prices is effective, we are blocking the broad distribution of income and thereby throttling economic progress.

Effects of Price Stability

The results of these policies have been most clearly manifested in the decade of the twenties. This was a period of remarkable technological advancement. Both the amount of capital and the efficiency of its use increased in nearly all
INCOME DISTRIBUTION UNDER CAPITALISM

lines of production. But the benefits of this increasing efficiency were not automatically passed on to the masses of consumers, either through the medium of proportional wage increases or proportional price reductions. Wholesale prices of manufactured commodities declined a scant five per cent, and retail prices did not decline at all. In some lines of industry there were, to be sure, substantial decreases in prices. In other lines there was virtually no change, whereas in some there was a substantial increase.

Faced with productive capacity in excess of existing consumer demands, business men in the main sought a solution of the problem along the following lines: first, by stimulating consumptive desire through extensive advertising campaigns; second, by sales on the installment plan; and, third, by sales in foreign markets.

Competitive advertising could do little to increase the aggregate consumptive demands of the masses, since it did not increase their purchasing power and since the volume of their savings that might be diverted to consumption was of negligible significance. Installment selling could give a bulge to immediate purchases, but it could not increase aggregate purchasing power over a period of years. Exports could be expanded relative to imports only so long as foreign credits could be extended.

The remaining alternative, that of expanding markets for all the great necessities and conveniences of life through a reduction of prices, came largely to be ignored. Instead of endeavoring to put additional consumptive power back of each new addition to productive power, we sought, by and large, to maintain the price structure with a view to the stabilization of existing conditions. In thus attempting to stabilize existing conditions, not only was economic expan-
sion held in leash but the seeds were sowed for economic instability in the future.

The question will be raised, however, Is not price stability essential to the stability of business conditions? Does not price-cutting inevitably tear down the business structure and demoralize the markets and thus do vastly more harm than good?

In order to look at this issue in clear perspective, it is necessary to distinguish carefully between the situation that prevails in a period of acute depression and that which exists in times of prosperity. When in a period of business reaction prices in general are falling sharply, with each new decline intensifying business uncertainty, further general price reductions do not constitute a remedy for the existing demoralization. Stabilization, at some point, always has to be reached before recovery begins. It is our vivid experience with the destructive price warfare in disorganized periods of general deflation that makes men fearful of the effects of price reductions.

In a period of prosperity, on the other hand, a reduction of prices—made possible by improvements in productive efficiency—would have no demoralizing effects. In the nature of the case, such price reductions would be gradual in character, and since they would not be accompanied by either a restriction of output or a decrease in buying power, they would contribute to stability of an enduring character.

Industrial policy which rivets attention merely upon the maintenance of a favorable existing situation is shortsighted industrial policy. The maintenance of the status quo in prices is a barrier to progress. Unless wage increases or other offsetting factors intervene, economic growth is measured by the extent to which prices are reduced.

* 24 *
INCOME DISTRIBUTION UNDER CAPITALISM

PRICES AND PROFITS

The reduction of prices during a period of increasing technological improvement will not destroy profits for businesses which are increasing their efficiency. If the reduction in prices is matched by the increase in efficiency—which means a reduction in costs—the margin of profits is obviously not reduced. On the contrary, in so far as the reduction in prices expands purchasing power and permits a larger volume of sales, the unit cost of production is reduced and profits may be increased.

It is scarcely necessary to call to the attention of this audience the relation between volume of production, unit costs, and profits. But I must emphasize the danger of assuming that the cost of production is something that is rather definitely fixed by the existing costs of labor, materials, and so forth. In view of the overhead cost factor, unit costs decline with an increase in volume even though the direct expenses remain unchanged. Thus there are two means by which costs may be reduced: first, by increased efficiency in the productive process and, second, by reaping the advantages of capacity operation. If the latter type of gain is to be realized, the policy of price reductions must be an aggressive and not a lagging one.

In other words, price reductions should not be delayed until reductions in cost are clearly established. Focussing attention upon obtaining the largest possible return in a given year serves to prevent the making of larger returns in years to come. Excessive profits derived from high prices, moreover, invite over-expansion and lead to instability later. Even if price reductions resulted in a more moderate rate of profit, the policy would pay because of the long-run stability of earnings that it would bring about.

* 25 *
INCOME DISTRIBUTION UNDER CAPITALISM

Industrial history teaches that those industrial enterprises which rapidly install more efficient equipment and aggressively endeavor to expand the volume of business through lower prices need have no fear on the score of profits. It seems to me I recall that Andrew Carnegie once said in effect, "I know nothing about the making of profits; I only know about the making of steel." No doubt he was not unaware that the profits would in the long run take care of themselves.

Upon the way in which the business men of this country meet the challenge thus presented will, in my judgment, largely depend the future of private initiative in this country. If the private business system, as a result of shortsighted price policies, fails to provide that broad distribution of purchasing power upon which not only the welfare of the masses but the prosperity of the business system itself depends, then I am quite certain that we shall have increasing efforts on the part of the government to exercise control over the activities of private business.

It is no part of my purpose to set forth at this time any detailed program for accomplishing the objectives that have been outlined. Indeed, any single plan for bringing about a general and systematic reduction in prices would necessarily involve governmental regulation and control. The immediate need is for the business leaders of this country to face squarely the issues involved with a view to revamping basic price policies in their own businesses and in connection with voluntary codes or other forms of agreement.

There are difficulties, to be sure; but the greatest initial difficulty is psychological. So long as the disposition is to find all the reasons possible why prices cannot be reduced, not much may be expected. The first requirement is a basic
change of attitude about prices, and then systematic study of ways and means whereby all along the line prices may be gradually and cumulatively reduced. I say cumulatively because in an interrelated business structure reductions at one place facilitate the making of reductions at other stages in the productive process. Reductions in the price of basic materials that enter into later stages of manufacture are thus of especial importance.

In conclusion let me again emphasize that this analysis relates not so much to conditions of the moment as to longer-run possibilities. But even now it may well be possible in many lines to stimulate an increased volume of business through downward price adjustments. In any event, this is the great challenge presented to American business men in the months and years that lie ahead.
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