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National Resources Committee
Interior Building
Washington

January 6, 1938

MEMORANDUM to: Mr. Frederic A. Delano

From: Gardiner C. Means

Subject: Prof. Copland's Cable and Incentives to Capital Creation

While agreeing with most of the points in Prof. Copland's memorandum there is one point of very great importance on which there might be misinterpretation. This has to do with techniques for stimulating new investment.

There is general agreement that new capital creation is essential. Prof. Copland seems to think that the main approach should be through (1) keeping costs low, and (2) improving the psychological milieu of the business man. He seems to think that undue emphasis has been given to the providing of increased buying power in the hands of consumers by higher wages and relief payments.

There seems to me grave danger that the major importance of increased buying by consumers as a factor in stimulating capital creation might be lost sight of.

So far as capital creation by manufacturing and mining enterprises is concerned, it seems likely that the volume of orders is a more important incentive to capital expenditure than any other single factor. When an enterprise is only operating part of its capacity and no great increase in orders is expected in the immediate future (next 6 to 8 months) there is little inducement to build new facilities no matter how satisfactory the relations between government and industry and no matter how low the level of construction may be. (The two significant exceptions to this statement arise where new techniques have been developed which promise very considerable reductions in operating costs, or where construction costs are likely to rise in the near future.) On the other hand, when orders are flowing in and production is at a higher level, there is a real inducement to build new capital even though the relations between government and business are unsatisfactory and even though construction costs are as high as they have been from 1932 to 1937.

This thesis is supported by the estimates of capital outlays by manufacturing and mining enterprises from 1923 to 1937, made by Dr. Terborgh of the Federal Reserve and plotted in the attached chart. Capital outlays by manufacturing and mining enterprises have increased greatly since 1932-33 and by 1937 appears to have reached a level as high as the average from 1926 to 1928, though not as high as 1929. Correlation analysis indicates that manufacturing and mining capital outlays fluctuate fairly closely with the fluctuation of production in the current and the preceding year taken together. The magnitude of fluctuation is, of course, greater for capital outlays, the indications being

that capital outlays would cease altogether if the index of industrial production based on 1923-25 = 100 were to average much below 50 for two successive years. There is not a close correlation between capital outlays and industrial production for the current year. This is to be expected since capital outlays are as a rule decided upon many months before the actual outlays. An index of capital outlays authorized would probably show a close relation to current production.

In making the correlation analysis only the data from 1923 to 1932 were used. The formula obtained was used to calculate what the capital outlays in each year from 1933 to 1937 would have been if the relation between capital outlays and the production in the current and preceding years continued to hold good after 1932. The calculated figures correspond fairly closely to the capital outlay actually made, as can be seen in the chart.

This closeness of fit between actual and calculated would appear to support the thesis that capital outlays in manufacturing and mining are closely related to the volume of production in the current and preceding years. This conclusion certainly lends color to the thesis stated above that capital creation for manufacturing and mining is largely dominated by orders (closely related to production) and is little impeded by unsatisfactory relations between government and business or recent costs of construction. Certainly there is no direct evidence of a capital strike on the part of mining and manufacturing enterprises.

It is possible that on a priori grounds one would expect capital outlays to be greater in relation to production in the current recovery period than in earlier years because of the low level of equipment replacement during the depression. To the extent that capital outlays should have been greater and were not a case could be made either for the impeding influence of costs and the poor relations between government and business or for the claim of a capital strike. Actually I doubt if a significantly greater capital outlay could have been expected.

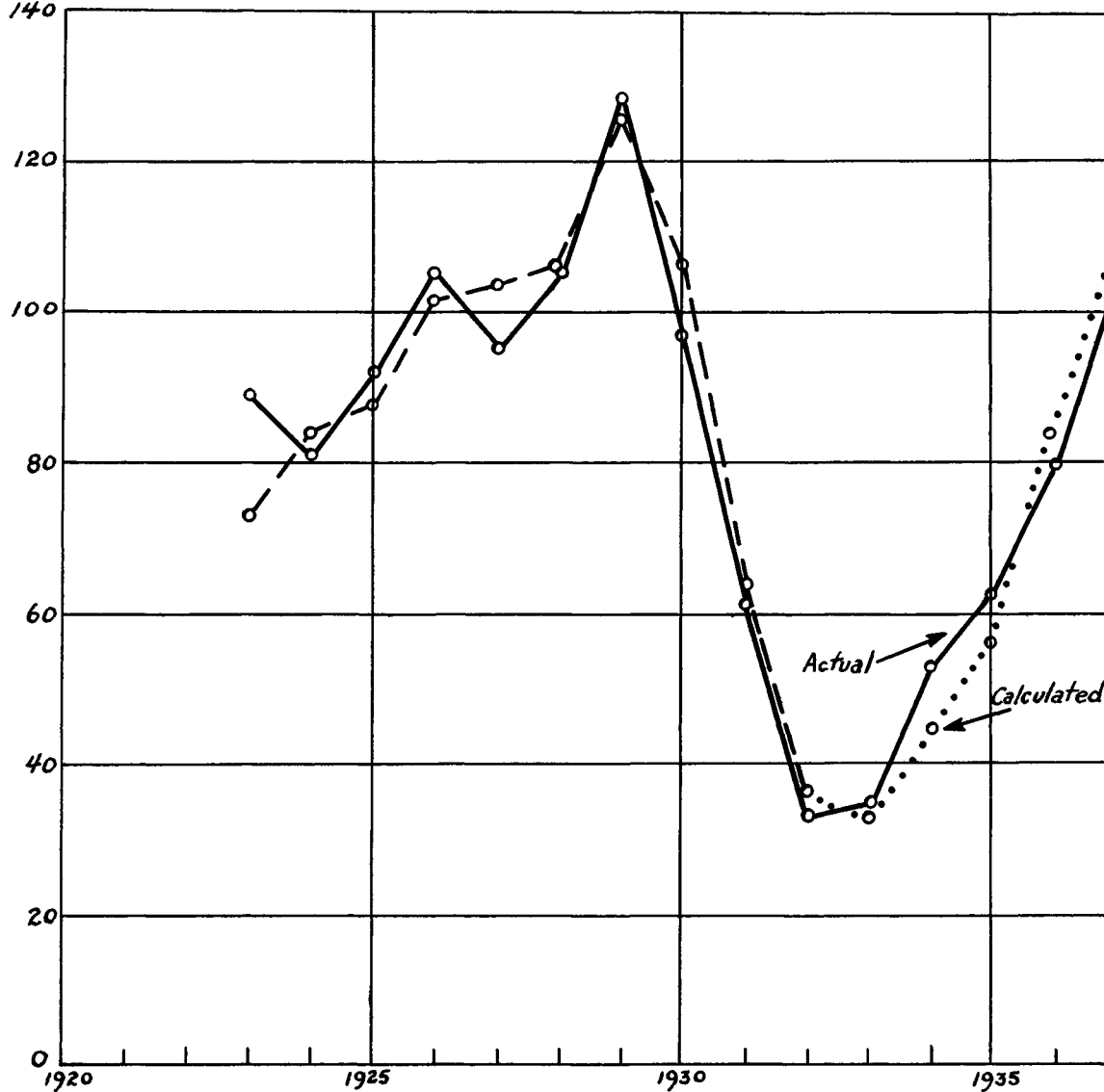
It seems likely that capital outlays by wholesale and retail enterprises and in the service industries would show a similar relation to output. Railroad and utility capital outlays may follow quite a different pattern. Certainly new housing and government construction follow patterns different from that of manufacturing and mining capital outlay.

The conclusion from my analysis is that so far as mining and manufacturing are concerned, and probably trade and services, the problem of inducing new capital creation must be met by inducing increased purchase of the products of industry. Of course, lower construction costs and other steps suggested by Prof. Copland would be beneficial if they are not taken at the expense of consumer buying power.

Additional copies of this memorandum are attached in case you wish to send them to the other members of the Advisory Committee.

**ACTUAL AND CALCULATED CAPITAL OUTLAYS
BY MINING AND MANUFACTURING ENTERPRISES**

*Index of
Capital Outlays
(1923-29 = 100)*



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COPY OF CABLE SENT

PROFESSOR COPLAND
MELBOURNE UNIVERSITY
MELBOURNE (Australia)

I would very much appreciate memorandum by cable of your views and recommendations on a possible economic policy in the United States stop If you are willing we would like to submit your memorandum to the President stop Regards

HEINEMANN

COPY OF CABLE RECEIVED

Thanks invitation responding with some misgivings because distance dims impressions of changing situation stop Subject to political cross currents unknown to me suggest following stop Understand objective President is controlled capitalism on lines enlightened Western democracies stop American individualism persisted twenty years too long but impossible make transition swiftly stop Advisable to adjust tempo of reform to temper of business without deserting ultimate objective stop Immediate need is capital construction in housing public utilities and factory extension and this demands cooperation Government and business stop Business unduly sullen and suspicious Government policy but onus on President break down resistance by magnanimous statesmanship stop Too much emphasis upon evils speculation and too rigid application controls through high margins high compulsory bank reserve ratios and gold sterilization stop Essence successful control is reasonable adjustment to changing conditions stop My view Government should announce first relaxation all controls established past twelve months against boom developments, second, stability of currency at present gold value, third, exemption from undistributed profit tax of reserves used for capital construction, fourth, economic advisory council consisting representatives of Government advisers and business to work out plans for restoration private investment, fifth, necessity for keeping costs low to stimulate investment stop Death duties less damaging to enterprise and disturbing to markets than heavy capital gains taxes stop Suggest modification latter in favor higher death duties stop Undue emphasis in American recovery on doctrine of increased spending power based upon higher wages and relief payments to consumers stop Higher consumers income will come after recovery established as in Australia where real wages now above 1928 level though money wages reduced substantially in depression stop Real national income in Australia now higher per head than before depression and this due mainly to active investment not higher export prices stop Recovery impossible in America without active investment and President's alternatives are to come to terms with business and thus restore investment or to take over investment in housing and utilities at once or to let position drift as in recent months stop Though my sympathies wholly

with Presidents objective of controlling economic system in common interest and I agree in general with his legislation I put agreement with business first because ultimate objective impossible without cooperation with business and consequences of continued industrial stagnation in America appalling stop Compromise now merely postpones reform measures and gives background of prosperity in which reform can be resumed later stop Government should alter budgetary practice to get rid of myth that budget deficit incurred when Government borrows for public works stop On this standard no Australian budget balanced in this century stop Alternative to cessation borrowing by Federal Government is resumption borrowing by States or municipal authorities stop Business critics of budget condemn in their own country what they condone and admire in Great Britain and Australia as important contributory factor to recovery stop Government borrowing or its equivalent can be reduced as private investment expands but cannot be abandoned stop Every new million investment would probably increase national income ultimately by two and half through repercussions and thus raise volume of employment in all industries stop Fear of rising prices an illusion stop Best indication of recovery is rising prices and these necessary to adjust debt burdens stop Important distinguish between rising prices for raw materials and finished products stop Former highly desirable but impossible without increased demand from industry based upon investment which remains key to position stop No objection you pass this message to President provided explain sent at your request and you know known to me as sympathetic to Presidents policy stop Would appreciate message on developments

COPLAND