

Oct 1934
Edwin

ANSWERS TO OBJECTIONS TO A PUBLIC WORKS PROGRAM

Before going into the probable effects of a public works program upon the volume of production, the level of business activity and hence national income, it will be well to consider just what objections (1) are likely to be raised to such a program of Governmental spending. The more intelligent critics admit that at certain periods a public works program introduced in conjunction with a liberal central bank policy may prove of genuine value. However, if the capital market is weak, if the demand for bonds is highly inelastic, if the credit of the Government is uncertain then a Government issue of any considerable size may easily effect the bond market seriously and thus discourage the expansion of private enterprise and make profit ^{the} floatations almost impossible. Under these circumstances a program of public works would be highly dangerous and could have no other effect than to prolong and intensify the depression. The reason for this is that in a capitalistic economy we must assume that the fundamental work of production will be carried on by private enterprise and that therefore any sound revival of business must be predicated upon private enterprise entering the investment field. When the Government emits a

(1) The following discussion is largely based upon an analysis by Alvin H. Hansen and Herbert Tout. The reason for selecting this analysis is that it represents the thought of one of the leading American economists who has a rather high standing among the more enlightened group. I think it is therefore worthy of consideration, whereas the comments of financial editors and writers in the conservative journals are not, because they do not analyze the problem but simply dogmatically state the emotional reaction of the conservatives.

large issue of bonds it weakens confidence in the capital market and therefore postpones, delays and discourages private enterprise.

To the argument that public works would increase the demand for commodities thereby increasing business activity and raising the price level would save private business from being forced to make distress sales of securities, the reply is made that the unfavorable effects of a public works program to be financed by borrowing is immediately upon the bond market but that the favorable effect upon the commodity market takes some time to appear. Moreover, the favorable influence is felt only in certain sections of industry while the unfavorable one is not only earlier but more general throughout industry in its effect. It is further contended that although certain fields are stimulated by public works, thereby increasing the demand for certain raw materials and paying wages to certain workers, if the capital market is weak a damper may be placed upon private enterprise and hence operations elsewhere may be curtailed.

It must be admitted that these objections to a public works program are very real indeed at certain times provided the Government is not willing to proceed with a large enough public works program to take over the whole gap that would be left by private enterprise withdrawing from making new capital construction and hence restoring the rate of investment to a normal level. Therefore they cannot be neglected by the proponents of a government spending program.

However, I cannot believe that this line of objection to a public works program has any real validity under conditions as they exist at present. This view I realize is counter to the position of many lead-

ing economists, but I believe it can be supported with a good deal of evidence. It seems to me that the economists who hold otherwise have been taken in by surface indications rather than the underlying factors which are fundamental in the present depressed condition of the capital markets. They are too much impressed by the great volume of comment which appears in the financial journals to the effect that investors' confidence is at a very low ebb and therefore can only be revived by a return to the old tried and conservative policies which have been long hallowed by experience with an economic system which was fully utilized and where you were always pressing against the limits of the supply of capital, labor and natural resources.

They neglect it seems to me the fact that new investment by private enterprise depends not only upon the so-called "confidence" of investors but also depends upon the prospects of profits in the very near future and the existence of an increasing volume of business activity. The situation now is that there are small prospects of profits and therefore the demand for funds to be used in new capital construction is almost completely lacking. It is true that there is a continual wearing out of capital goods and that there have been long delays in necessary repairs and replacements, but certainly these will be put off as long as possible if there is no indication of increasing business activity. Moreover, there is evidence of a large amount of funds which would be available for investment provided the profitable operation of business was in prospect or that there were any need of increasing factory capacity to take care of future increases in production. This can be seen by the fact that banks are holding large amounts of excess re-

serves and individual depositors are holding large cash balances upon which they are obtaining little if any return.

To talk about the pessimism and loss of confidence which would be entailed if a large public works program and Government borrowing were promoted at the present time in contrast to the favorable psychology that would be enjoyed with an increase in new investment by private enterprise is beside the point. The so-called optimism which would be encouraged by the "boldness of some entrepreneurs who have the courage to act on the assumption that profits are in sight" when it is recognized that the large corporations of the country which control such a large part of our industrial production have large cash balances which they could use immediately for any new investment that offers them the prospect of profits without any recourse at all to further borrowing either from banks or from investors through the organized security markets. Moreover it is these corporations which could afford to be "bold" but why should they be when their facilities are only partially used. Certainly it appears to me that people who take the viewpoint that the Government action of further unbalancing budget by a prospective public works program of large volume definitely have the burden of proof upon them to show that there is an appreciable volume of applications for new capital funds which are simply held off the market waiting for a favorable time to be put out into the hands of investors and such issues would be adversely affected by the Government action. It seems to me that investors and banks would be willing to make commitments on long-term at low rates provided there were requests for such accommodation on the part of business enterprises of recognized financial standing.

While on this subject of confidence it seems to me that the other

side of the picture can be presented in a more convincing fashion than the presentation made by the conservatives and their spokesmen which usually proceeds along the following lines. To reestablish confidence of investors and thereby bring about an expansion in the private capital market the Government must end uncertainty as to the monetary policy and relax restrictions upon business enterprise, bringing about greater hope for business profits in the future and by balancing the budget through a contraction of Government expenditures. This type of attack goes upon the assumption that there is awaiting a large demand for new capital and that it is primarily the investors who are holding up the process of new investment. As I pointed out above a more reasonable view is that there is little hope of profits and little need for plant expansion and therefore little demand for new investment on the part of business enterprise. Thus any of these so-called "confidence creating" measures, while they might relieve the minds of a few of the orthodox and conservatives, would have little value in actually starting a flow of funds into capital formation. It is only after revival has started and business is receiving orders and the possibilities of a continued upward trend become plainly evident that business men regain confidence and therefore certain enterprises begin to feel a need for new working capital and hence make such requests to banks, and that large corporations which have idle cash balances begin to spend them for materials and labor. Later when production starts to press against the limits of existing production facilities we can expect the arising of a real need for new capital that would bring out a demand for long-term accommodations. So far as new industries are concerned it doesn't seem to

me that with a low level of consumer purchasing power which now exists there is any great prospect of expansion unless there exists an incentive to increase the volume of consumer indebtedness which has shrunken greatly in amount during the depression. Here again, however, it is only when these consumers see a prospect of increasing their individual incomes that they will be willing to incur new indebtedness to make purchases of more durable types of consumer goods.

As I view the situation the banking set-up is capable of meeting great increases in loans and investments with no fear at all of pressing against reserve requirements, and that the rediscount rates of the Federal Reserve are sufficiently low and money rates sufficiently easy. Anyway there is such a plethora of funds available that Federal Reserve rates are of little significance. What we must attempt to do is to increase the volume of funds in the hands of spenders and thus a movement through the system would increase national income. I cannot see that pushing Government securities out into the market would curtail in any way the investments which are being made by private enterprise and if the banks are willing to take Government securities on short-term there is created entirely new money which if used for a public works program can only have beneficial effects upon business activity and national income. Personally I believe that the so-called lack of confidence shows up almost entirely through the Government market and that this is where we should center our attention. The suggestions which were incorporated in the recent memorandum which we wrote to the Secretary if adopted would be very helpful in improving the banks' outlook towards investing in Government securities.

Oct 1934

166.