Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 2, 1939

To Chairman Eccles

Subject:

From Emile Despres

Attached is a memorandum prepared at Mr. Currie's request, by Mr. Sherrard of this Section. The memorandum reviews and criticizes an article in the Atlantic Monthly for November by Sumner H. Slichter. I have taken steps to obtain a copy of Slichter's article, and will send it to you when it arrives. The article was forwarded to Currie for criticism by an official of the T.N.E.C., who, in turn, had received it from Mr. W. S. Farish, President of the Standard Oil Company (New Jersey). Mr. Farish had expressed strong approval of the views put forward by Slichter, and I suspect that this article, like Slichter's early articles on inadequate profits, will be warmly praised by many business executives.

ED

November 20, 1939

"Business Looks Ahead"

Professor Slichter points out ("Business Looks Ahead", in The Atlantic Monthly for ~~October~~ November) that the United States could use a great deal of new capital equipment. "Never, not even in 1929, has the national output per man, woman, and child reached $700 a year." One way to increase per capita output is, of course, to provide more productive equipment; that is, to use more capital. The amount of capital per worker has tripled since 1880 and may be expected to increase further; this should offset the fact that the number of new workers to be provided with "working places, equipment, and tools" will be only about 500,000 a year in the immediate future, as compared with over 700,000 in the Twenties. Furthermore, income per capita rose 32 percent between 1920 and 1929, while it rose only 12 percent in the first decade of the century. Expenditures on industrial research are now seven times as large as in 1920. Technological advance may be expected to continue at an accelerated rate in the future. "This," the Professor concludes, "does not look like stagnation."

Professor Slichter is quite right. This does not look like stagnation. It does not look like unemployment either. No responsible economist has ever denied—since it would be absurd to deny--that the United States is potentially wealthier now than at any time in the past. Nor would anyone deny that the national income per capita was still pitifully meager even during the Twenties. Indeed, Professor Slichter proves too much. If investment opportunities existed whenever there was a need for more goods, we should always have full employment. The need for goods is particularly pressing during a depression, yet somehow investment declines. How can this be explained? Any business man could readily give the answer: Investment opportunities exist only when need is coupled with ability to pay and with the desire to purchase. The problem is to find profitable outlets for capital expenditure; useful outlets are always abundant. But the existence of profitable capital outlets depends, in the long run, upon the development of adequate volumes of consumer expenditure. This is the only ultimate source of business income.

It is for this reason that the decreasing rate of population growth is important. As population increases, it becomes profitable to build houses. Families must have shelter of some sort and will spend all of their incomes if necessary, or even go into debt or appeal to charity, in order to provide it. With a stationary population, construction profits would be less assured. Replacement building would continue, and geographical shifts of population would require some new construction. In addition, there would be a potential demand for better or more fashionable housing, but this would be an unstable, unpredictable element--representing postponable expenditure. Not only this, but every transfer of families from old to new quarters (as opposed to the demand for new quarters that arises from population increase) results in vacancies somewhere. These unoccupied dwellings are likely to depress the general housing market. Since it is impossible to foresee accurately the trends of population movement or of taste, building becomes an increasingly speculative business. Already houses are being designed for their sales appeal, with emphasis on shiny gadgets and advertiseable refinements. Professor Slichter hails the prospective increase in the relative importance of luxuries in our economy: "Since tastes for luxuries change, there will be a perpetual demand for new plants to make these goods." He forgets that business men are no fools and can usually recognize an ephemeral demand when they see one. The increased risk of obsolescence will discourage purchase of costly equipment to supply an unpredictable luxury market, even though a similar volume of demand for staple goods might have called forth heavy capital expenditure. Once again he has confused usefulness with profitability.

Professor Slichter's claim that "slowing population growth is likely to stimulate rather than diminish the demand for housing, the largest single outlet for savings, because only when families are small can they afford to live in houses which they own" seems to assume the very point at issue. It would be plausible only if the decreased average size of family increased per capita income. (Even then there would be several qualifications, as we shall see.)

If the declining rate of population growth increases unemployment, the assumption of a resulting increase in per capita income becomes unreasonable. Putting the same point differently, any employed worker is in a better financial position the smaller his family--assuming that wages remain unchanged--but if the demand for his output falls off as a result of decreases in other people's families, he may find himself without a job.

Furthermore, the fact that families live in "houses which they own," as opposed to rented houses, is of little significance with respect to employment opportunities. The construction of new housing, whether intended for occupancy by the owner or by tenants, creates jobs; the purchase of already existing properties does not.

Professor Slichter has been unnecessarily ingenious in searching out a cause for the recent British housing boom. It has, he says, "been based in part upon the fact that families are smaller." To be sure, families are smaller and there has been a housing boom; but it seems oversubtle, in view of the fairly well recognized explanations of the construction activity, to find a causal connection between them. In the first place, Great Britain had no construction boom comparable to ours in the Twenties. Thus part of the World War housing shortage remained as a backlog into the Thirties. Secondly, from 1929 onward the cost of living fell more rapidly than wage rates--largely because of the importance of imported agricultural products, the prices of which fell sharply. At the same time an increasing proportion of the national income was absorbed by taxation and expended by the Government on services for the lower income groups. Thus the real income of employed workers was increased from two sides. This fact, taken together with the perfected system of building and loan societies, provided the necessary background for the construction boom. Finally, the great migration from north and west to south and east served as a stimulus to bring the other forces into play. (This migration was itself based on a development of the consumer goods industries and the service trades, which was in turn due indirectly to Government policy and the decline in import prices.) The southern cities, particularly London and its suburbs, became crowded while those of the heavy industrial areas were relieved of pressure. With the revival of activity in the latter areas in 1936 and 1937, largely as a result of armament orders, construction continued as an aspect of general prosperity.

The Professor draws another lesson from British experience, stating that "there has been a spectacular drop in the volume of saving during the last generation." Assuming this to be true (and information on savings in Great Britain is so meager that it can be no more than an assumption), the tendency is one that should be encouraged. Professor Slichter points out that it "is partly due to stiff increases in taxes", although he had previously stated, with reference to the United States, that "plainly, the prospect of solving the problem of oversaving by taxing away savings is not bright." The Englishman, it appears, has many virtues not vouchsafed to Americans: he can start a housing boom because the size of his family has decreased, and responds to taxation as a gentleman should.

The other part of Professor Slichter's explanation of the (assumed) behavior of savings is that "people preferred to spend a larger part of their incomes on durable consumers' goods (automobiles, radios, household appliances), recreation, vacations, education, and medical care." This is true and important. It indicates, in fact, the direction that future development must take if an insufficiency of investment outlets is to be avoided. Business men will not make capital expenditures unless there is a reasonable expectation that their products can be sold to consumers at a profit. Goods cannot be sold to consumers at a profit unless the consumers are willing and able to buy. There is no presumption, however, that a sufficient volume of consumer expenditure will appear unless it is fostered by conscious policy. It is not sufficient that people merely "prefer" to buy services and durable goods; they must also have incomes sufficient to implement the preference. Thus decreased corporate income taxes, as suggested by Professor Slichter, would be no solution.

The Professor tells us that money "will not continue to circulate if the outlook for business is poor." Exactly: and the outlook for business, in the long run, depends upon the ability and willingness of consumers to absorb its products.

To believe that full employment of our resources depends upon the stimulation of consumer purchases is not to accept "a gloomy picture of the outlook for industry in America." The problem is to adjust our economic structure to the standards of living made possible by technological progress and capital accumulation. We can now afford a level of consumption that would have appeared fantastic even fifty years ago. We can afford decent housing, good health, old-age protection, higher wages, and more consumer spending. In fact, our productive equipment cannot be fully utilized unless we do have these things. Without them there will be unemployment and low profits--depression affecting business men and wage earners together. But the prospect of rising standards of living and increased consumer spending is not a gloomy one. Quite the contrary; if the challenge of transition is accepted, the future should be one of increasing harmony and prosperity for all classes in the community.