BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

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To Chairman Eccles

Subject: N.A.M. report on "The American Individual Enterprise System"

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The general attitude towards fiscal policy expressed in this two-volume report is one of scepticism. It is not denied that variations in taxation or in government expenditure can, in principle, influence the level of business activity, but great emphasis is placed on the practical obstacles to the success of such a compensatory policy. The report is more favorably disposed towards monetary and credit controls, but argues that they should be used primarily to restrain a boom rather than to stimulate activity during depression.

Taxation. The sections on taxation are concerned mainly with the burden of supporting enlarged Federal activities, and especially with the effect of taxes on investment incentives. The present personal income tax is criticized as being too progressive--"this degree of progression penalizes risk taking and discourages individual initiative." (p. 753) Complete elimination of capital gains taxation and of the corporation income tax is proposed. The Federal government should abandon estate taxes, leaving them for the states "because the various states would strive competitively for lower rates in order to attract well-to-do persons." (p. 759)

All of these implied suggestions would have the effect of drastically reducing Federal revenues. Since no alternative tax sources are suggested, it is presumed that this is to be accompanied by a parallel cut in expenditures. On this point too, however, no concrete suggestions are offered.

Government expenditure. All public expenditures are condemned "unless at the same time it can be shown that such outlay has more usefulness to the public at large and to the individual citizens themselves than the income which they themselves must forego and pay to the government in taxes in order to finance the proposed expenditure." (p. 737) Government outlays should not be varied deliberately in order to offset fluctuations in private spending. Even the modest proposal of the President's Conference on Unemployment, in 1923, to postpone planned public works construction at the peak of a boom in order to carry it out during the subsequent depression, is condemned. "Elections are always just around the corner, and politicians cannot be expected to leave the spending for needed improvements in their districts to be exploited politically by their opponents." (p. 936) If this difficulty could be overcome, the backlog of public works would be too small in any case to have a significant effect on business activity, and the projects would not be located where additional spending was needed most.

Later, and larger, programs of public expenditure designed to combat unemployment are likewise condemned--partly on grounds of ineffectiveness and partly on grounds of waste, competition with private enterprise, and loss of freedom. The major arguments are (1) that government spending feeds on itself, politically, and cannot be held within bounds; (2) that it frightens investors and may therefore actually have a depressing effect on production; (3) that it leads to continual deficits, a growing national debt, and eventually to financial collapse; and (4) that it is inefficient and unproductive.

Monetary and credit controls. The report places considerable emphasis on expansion and contraction of credit as a cause of economic instability. The Federal Reserve System can combat this tendency mainly by curtailing credit creation during the boom. It is pointed out, however, that expenditure is not determined solely by the supply of money, but depends also on changes in the intentions of businessmen and consumers.

Explanation of the great depression. Although the report denies the effectiveness of fiscal policy in stabilizing the economy and places only limited hope in monetary and credit policy, it is not pessimistic about the future. This apparent contradiction is explained by the interpretation offered for developments after 1929. "Misdirected governmental action contributed extensively to the conditions leading to the 1929 debacle, just as it did to the depression of the nineties, of the seventies, etc." (p. 858) The chief mistake, it appears, was the failure of the Federal Reserve System to restrain excessive credit expansion during the twenties. A high tariff and unwise foreign lending, encouraged by government, contributed to the collapse.

The seriousness of the situation in 1932 is minimized in the report. "The economic system clearly was not in such a state of collapse that it must have an outside stimulant in order to get started on the uptrend again." (p. 937) It is pointed out that the Federal Reserve index of industrial production reached its lowest point in the middle of 1932 and had risen over 50 per cent by June, 1933. The fact that in March 1933 the index was only one point above the July 1932 low (54 as compared with 53) is not mentioned, and no connection is admitted between the rapid recovery from March to July 1933 and the inauguration of a new Administration in March. The course of economic events throughout the thirties is described as "politically induced stagnation." (p. 959)

Since the collapse of 1929 and the long subsequent depression are seen simply as the consequence of misguided government policy, it is not surprising that the N.A.M. "Program for America's Future" (Chapter XX, pp. 977 ff.) is largely negative.