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BOARD OF GOVERNORS
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FEDERAL RESERVE SYSTEM

Office Correspondence

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To Mr. Currie

Subject: National Pensions

From Alan R. Sweezy

A. R. S.

In a general way, the authors of this pamphlet appreciate the basic economic difficulty of the present time; that is, the difficulty of finding adequate investment outlets for the country's potential saving. This is indicated in such statements as the following:

> "We have already said that bank deposits or cash stop buying goods mainly because they are drained off as profits taken in cash but not in goods."

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> "We are told that prosperity would reign at home if only we could ship more goods abroad. Cotton--our No. 1 foreign-trade item--could all be used by Americans if those who raise it, and other low-wage groups, could buy and wear as much cotton clothing as do others. The cotton problem is a problem of purchasing-power, American purchasing-power or the lack of it. . . . It is distress at home that makes foreign trade seem so desirable, but we need to understand that the cause of the difficulty is . . . in our home affairs."

The analysis of this difficulty is, however, considerably oversimplified. Practically no account is taken of the actual need for a considerable amount of long-term investment. Investment is thought of entirely in terms of working capital and all long-term borrowing treated as sheer waste. For instance, the Social Security law is criticized as a "direct tax upon the earnings of the underpaid workers of the country. . . . This law has piled up a bookkeeping 'reserve' amounting to 1810 millions for the United States. . . . Instead of allowing it to be used to buy goods and promote trade, it (the law) 'invested' it in government bonds at 3% interest." This criticism is then generalized to cover all reserves regardless of what their investment counterpart may have been. "'Reserves' mean nothing of practical use unless they consist of tons of beans, canned meat, metals, textiles, and other tangible goods in warehouses." Here the working capital conception of investment is clearly evident. This same reasoning leads the authors to condemn all borrowing, which is not paid back within a few months, as inherently unsound.

In spite of the fact that the analysis is oversimplified and much too sweeping, it contains an important germ of truth. Since investment opportunities are deficient relative to the community's disposition to save, any measures that would increase consumption at the expense of saving would be in the right direction. The particular scheme proposed in this pamphlet has, however, three serious defects:

First: It proposes to pay pensions of $50 a month to every one over 50 years of age. This would involve annual payment of some $14 billions, which is a great deal more than is needed in the way of a direct stimulus to consumption. Two or three billion dollars net addition to purchasing power, through a pension scheme, would probably be enough to keep the national income at a reasonably high level (assuming that governmental bodies continued to spend a billion or so dollars a year net on public investment projects).

Second: The pension payments are to be financed by a combination of special income tax and borrowing through the issue of non-interest bearing obligations. The income tax is an indirect and cumbersome affair. Pensions are to be paid in a special type of money, "brown money" (comprises both deposits and currency) and all business done with this money is to be accounted for separately. Business concerns are to be allowed to deduct the costs of doing this "additional" business and to include in such costs salaries up to $10,000 a year (nothing is said about dividends and interest but presumably they would not be included as part of costs). Any profit on the additional business over the amount of deductible costs would be taxed 100 percent and used in financing pension payments for the next period. The administrative difficulties of determining what part of costs were properly allocable to the additional business would, of course, be considerable. Even more serious, the 100 percent tax would fall very unevenly on different categories of business. This would lead to further complications in the unwillingness of sellers to take "brown" money for their wares and the favoritism buyers--business concerns, that is--could exercise in distributing their "brown" as compared with their "white" purchases.

Third: The money to start pension payments would be raised in the following way: "The government will issue its bonds, in large denominations, for enough to cover the need. These bonds . . . will bear no interest . . . The pension bonds will be deposited in the

Federal Reserve banks for checking credit, and the Treasury will issue to each private bank and to each postal savings bank a check for the amount to be disbursed that month. The bank, in turn, will enter upon the ledger card of each registered pensioner a credit of $50 for the month." Apparently the idea is that the Federal Reserve banks would buy the non-interest bearing bonds, although no specific statement to that effect is made. The phrase "will be deposited in the Federal Reserve banks" is somewhat ambiguous as it stands.

The 100 percent recapture of profits on the business done with "brown" money is counted to eliminate savings of "brown" money by people in the higher income brackets. It will still be possible, however, for wage earners and other pensioners to save some of their "brown" money if they so desire. A sizable amount of such savings is, in fact, anticipated in the scheme as outlined. To offset such savings, additional money will be borrowed from the Federal Reserve banks at the beginning of the next period through the issue of additional non-interest bearing obligations.

A further twist is introduced in the proposal to have the "brown" money 100 percent reserve money. "This 100%-reserve 'brown' money will accumulate from year to year, augmenting the monetary capital resources of the nation. About 50 billions of 'white' deposits now serve inadequately. . . . There is therefore ample room on the books of the banks for the creation of a back-log of 100%-reserve 'brown' money . . ." It is estimated--though on very flimsy evidence--that 80 percent of the "brown" money paid out each year will be recaptured, leaving 20 percent of the $14 billions to be used in further purchases or savings. "If the entire balance of 20% were saved, the addition to 100% bank reserves would not exceed 3 billions a year. It would cost the nation nothing to create or maintain these funds." (Except for the service charge of two cents per check drawn and six cents per deposit entered, provided for earlier in the pamphlet.)

Thus it can be seen that, although this provision of the scheme might not be absolutely unworkable, it would be very cumbersome from a monetary point of view. There is no evidence that the present $50 billions of deposits is in any sense "inadequate". Addition of $3 billions a year in 100 percent reserve money would considerably complicate existing problems of monetary management.

A final objection that might be raised to this particular scheme is that the essential object could be accomplished much more simply and directly through the use of existing financial instruments.