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FROM _____

REMARKS:

Apparently we have only one copy of the memo of 1/16/39 which was a draft of a reply to Byrd's letter -- it is filed with the Byrd controversy material in a book, hence I don't wish to remove it -- the 5/19/39 is taken from it, so should cover it.

GOVERNOR ECCLES' OFFICE

Material furnished from memo 1/16/39
only copy

May 19, 1939

Reynolds - pages 6-7

In his message to Congress in January, the President proposed an \$80-billion national income, at which level the budget would automatically be balanced from increased yields of existing taxes, as a desirable economic objective. There is nothing about this objective contrary to the principles laid down in the Democratic Platform of 1932. The whole idea of that platform was to bring about full recovery through the stimulation of private enterprise under democratic institutions. Nobody can say that we have anything like full recovery while there are still millions of unemployed--people who are able and willing to work--and while there are large quantities of idle capital as well as unlimited national resources.

The problem, therefore, is to put these different factors of production, these elements of real wealth to work. So far as possible, the job should be accomplished by private enterprise, the Government stepping in to employ idle men, idle resources, and idle capital itself only to the extent that it can do so not as a substitute for, but as a supplement and stimulant to, private activity. In supplementing private activity, the Government can effect the use of human and material resources that otherwise would go to waste to produce necessary, useful things, such as schools, roads, highways, bridges, slum clearance, conservation of forests and of soil, hospitalization, CCC camps, and numerous other things both desirable and useful to the

nation. These are things that private enterprise does not produce and cannot be expected to produce.

It is sometimes said that Government expenditures for these purposes do not create things that of themselves produce new wealth. But, certainly, no one who wants to preserve private capitalism would argue that Government should go into competition with American business and industry to create productive facilities. The whole point is that at such times as business and industry find themselves unable to use idle men, resources and capital, that is the very time, because it is a time of depression, when the Government can and should do these very things. To do them requires an increase in debt, just as business activity and production, and building of factories are invariably accompanied by an increase in private debt.

All of us individually dislike debt. Individually we admire the Poor Richard maxims, one of which is, "Neither a lender nor a borrower be". But if such maxims, however good for the individual, were applied to business or to our nation as a whole, we would have economic prostration. We would have to go back to a primitive system of barter. All of us favor savings, but unless savings are put to work, which usually results from somebody's borrowing them, they are idle and unproductive, yielding no return to the owners and producing no real wealth. The cardinal consideration is to maintain a flow of money in the economy. This is what the Government does when it borrows

idle money that business cannot or does not borrow, and puts it to work, giving employment and creating a demand for goods that otherwise would not be created.

We are all agreed that over a long period of time a balanced budget is essential to the credit and financial integrity of any government. We do not contemplate having deficits indefinitely. There is no real dispute as to the objective of attaining a balanced budget. The issue is merely, how do we get it? Some people appear to believe that we can get it by having the Government leave men, natural resources, and capital idle at the very time when business and industry are unable to utilize these things productively.

The Hoover Administration tried that for three long years after the crash of 1929 and the record speaks for itself. It is the most convincing demonstration of the fallacy of that idea. Wholly aside from social and humanitarian considerations and the fact that Government exists for the purpose of contributing to the welfare of all the people, it is economically unsound and indefensible.

Had the depression been cured by the Hoover Administration as its apologists tried to convince the American public in the campaign of 1932, it would have been possible to balance the budget and to reduce Government expenditures. But between the time that the drafters of the Democratic Platform adopted the general principles contained in that document and the time the Administration took office, the depression, instead of being over, continued to get worse.

It must be remembered that when this Administration took office, reopened the banks and turned nation-wide despair into new hope, it made a valiant effort to reduce Government expenditures and put through an economy program early in 1933. At this time the National Industrial Recovery Act, which originated with American business and industry and was ardently supported by them, was put into effect, heralded by its champions and proclaimed by its very title as a major means to recovery. We all know what happened. Undoubtedly it contributed a great psychological stimulus and it contributed temporarily a real stimulus because business in general rushed into activity, as was said later, "to beat the codes". In anticipation of higher prices, it stimulated a flush of purchasing which all too soon petered out. Why? Because underneath there was not a supporting bed-rock of a substantial and solid purchasing power among the masses of the American people.

It was soon apparent that this device was not sufficient to make any great dent upon the army of the unemployed or to make profitable business and industry that needed, most of all, customers with a sustained and rising income with which to purchase the products both of farm and factory.

It became apparent that the Government's first obligation in such an extreme economic situation was to revive and rehabilitate mass purchasing power. The principle here involved is fundamental in any true democracy. It will be remembered that Mr. Hoover stirred

up a tremendous battle over the alleged principle that the Government, while it might appropriate funds to feed starving mules, must not appropriate funds to feed starving human beings. That "great" principle was rejected and repudiated by the people of the United States.

Will Rogers once said, "We ought not to spend money that we haven't got for things we don't need". This is, of course, good common-sense. No one can deny that. It is an entirely different matter, however, to pretend, as some people have done, that it has any relevance to the present situation or to the policies pursued by the Administration since 1933. In the first place, as to the money: We have plenty of it. There is absolutely no shortage. On the contrary, one of the chief difficulties is the oversupply of money relative to the productive outlets for its use. We have so much money that insurance companies, savings banks and commercial banks are continually embarrassed to know what to do with the funds piling up in their hands. So tremendous is the supply relative to the uses for it that, as many of you undoubtedly know, savings banks not infrequently refuse to accept further deposits of more than a few hundred dollars.

On the other side, there can be no disagreement with the statement that we shouldn't spend money for things we don't need. There may, of course, be people who contend that we do not need schools, roads, slum clearance, and the even more vital necessities of life, such as food and clothing. If there are such, they are welcome to take that position and to try to defend it to the American people.

But unless they are willing to state explicitly that such objects of expenditure are not needed, they have no right to criticize the activities of the Government in the last six years on the basis of a lack of need for the things Government expenditures have provided.

Many competent business men and economists have recognized that the nation is capable of producing a national income of fully \$90 billions a year. The Brookings Institution, a distinguished and reputable group of economists, has stated in its publication, "Income and Economic Progress", page 83:

"If we are to achieve the goal of satisfactory standards of living for everyone, the first requirement is to increase progressively the total amount of the income to be divided. Only as the aggregate national income increases from 80 billions a year to 100 billions, to 150 billions, to 200 billions, will the goal of a high standard of living for everyone be attained.

"The distribution of income from year to year is of primary significance not for its momentary effects upon the well-being of the masses, but for its possible cumulative effects in promoting a fuller utilization of our productive facilities and a consequent progressive increase in the aggregate income to be available for distribution. We are not interested in maintaining a static situation in which the total income, even if equally distributed, would be altogether inadequate; we are interested rather in producing a dynamic situation in which increasing quantities of newly created goods and services would become available for everyone."

Critics of the Administration's policies in this country are fond of denouncing the British economist, Dr. John Maynard Keynes, as an alleged inspirer of these policies and as a "prophet without honor in his own country", who is given to the propagation of "seductive

schemes" and "fantastic fallacies". These critics would do well to read Mr. Keynes' "Economic Consequences of the Peace" and then to say whether this prophet--whether he is honored or not in his own country--has been proved wrong in his forecast of what the peace treaty would do in undermining the foundations of economic order. They would also do well to familiarize themselves with the subsequent writings and analyses of this same economist in the light of events of the last ten years.

In recent months we have heard a lot about the difference between British and American recovery, with the implication that the relatively greater recovery achieved by the British can be attributed to the fact that they maintained a balanced budget up until the last year. Before an intelligent comparison of the course of the recovery in the two countries can be made, certain striking differences in the relative situation before and during the depression must be noted. In the first place, the English national income did not fall nearly as far as ours did. Our national income dropped from \$80 billions in 1929 to around \$40 billions in 1932, a decline of 50 percent. The British national income in the same period fell from \$21.9 billions to \$19.3 billions, a drop of only a little more than 10 percent. Moreover, the public debt in Great Britain was far higher, relative to national income, than in this country. For the national government alone, the British debt in 1932 amounted to \$37 billions, as compared with a Federal debt in this country of only slightly more than \$19 billions. On a per capita basis the British debt was over five times as big as the American. If we consider all governmental

units, State and local as well as national, public debt in Great Britain was approximately \$45 billions, compared with about \$37 billions here.

People see that the British balanced their budget, but they neglect to point out that their public debt and their taxes--especially their taxes on income and wealth--all along have been relatively far greater than ours. Would they perhaps have us apply the remedy of increased taxation--especially on incomes and estates--in order to balance the budget at this time? Business is loudly complaining that taxation is a deterrent to an expansion of activity. No one is advocating currently that taxes be raised. Thus, if they insist on a cessation of borrowing, they are forced to the only other alternative; that is, a reduction in Government expenditure.

If it were not such a hazard to the preservation of the country, if it were not so inhumane, it would be interesting to put the retrenchment program into effect so that we could have another visual demonstration of the economic setback that would inevitably result, but even that would not convince people who have not understood the lessons of recent economic history, which should be convincing, without need for further demonstration, that this is not the road to recovery and thus to a balanced budget.

Doubtless some progress could be made by Congress both in the field of taxation and of expenditure so that the gap between what the Government takes in and what it pays out would be narrower than

it is now. Such a course would be wholly desirable so long as it was carefully charted so that the Government's contribution to purchasing power would not be withdrawn too sharply at the wrong time and before we have had a fuller measure of industrial and private recovery.

A prominent critic of the Administration's fiscal policies recently scored what he called the fallacious theory of "purchasing" prosperity on borrowed money. In contrast, he stated his own position as based on the proposition "that genuine prosperity must come from the productive industry of the citizens of our Republic". This clearly reflects misconception of our present problem and of the way our economic system works.

The effect of the Government's borrowing is, first, to take idle, unused funds in the hands of individuals and corporations and put those funds to work. That does not reduce or add to the existing supply of money. It merely puts it to work or gives it velocity. The money, after it is expended, again becomes bank deposits. Thus, this process neither adds to nor subtracts from the existing volume of deposits. Nor does this take away from private industry and business any funds that they need for their activity in giving employment and producing goods. If the Government's taking this idle money and putting it to work did take it away from business and if otherwise business would use this money productively if Government did not, there would be some basis for the alarm about it. Such is not the case. If it were, interest rates would reflect the competitive demand for these idle funds.

Secondly, by selling its securities to the commercial banks, the Government has created new money. Due to deflation and liquidation of bank loans and thus of deposits, this all-important part of our money supply shrank by one-third between 1929 and 1932. The effect of the Government's sale of its securities to the commercial banks was to replenish this supply of funds by the creation of new deposits or new money. It is not as if we had a fixed supply of money. Money expands and contracts in accordance with the demand for it, whether by Government or by business, or both. In an international gold standard world, automatic and arbitrary limits could be put upon the supply of money, but that is not the case today.

As for the contention that genuine prosperity must come from the productive industry of the country, that is--or should be--self-evident. That is the only place it can come from and the only justification for the Government's contribution to purchasing power is to help bring about exactly that result.

A recent study of the Twentieth Century Fund contains the statement that "our economic system would be far more healthy if debt financing were used less frequently" and that "measures should be taken to reduce its extent". It would be a mistake to interpret this statement as advocating an immediate attempt to reduce Government or private debt. The idea of the authors is rather that in the future it would be desirable in the sphere of private business if there could be greater reliance on the issue of common and preferred stocks, rather

than of bonds, mortgages and other forms of debt. In other words, the authors are concerned in this part of their study, not primarily with the question of the Government debt, but rather with the broader question of the desirability of having a larger proportion of financing done through the issuance of equity rather than of debt obligations.

That is one reason why the Administration has recommended the abolition of tax-exempt securities both by the Government and by States and municipalities, because, among other things, the tax-exempt feature puts a premium upon such securities and tends to induce private capital to invest in these forms of debt instead of in equities that might be issued by business and industry.

A number of authorities have called attention to the fact that the laws which have grown up over the years have required banks, insurance companies and many other institutions to invest only in high-grade bonds; that is to say, in debt forms. Thus, there is great competition for such debt forms. These authorities point out that if other means of financing, particularly preferred stocks, were eligible for purchase, it would reduce the unduly heavy competition for debt forms on the one hand, and it would reduce, on the other, the relative volume of debt, substituting therefor shares or equities in industry and business generally.

In recent discussions of the debt and the problems raised by it, a point has been established that public and private debt, taken together, in the United States is no greater today than it was in 1929.

In spite of this fact many commentators still insist that there is cause for alarm in the size of the present debt total. The question inevitably arises, would they be equally alarmed if the private business had incurred a larger proportion of the debt and the Government a smaller proportion? Do they think we can have reasonably full employment and production unless somebody is willing to increase debt? Why have British business men not been alarmed for the last twenty years when their debt has been and still is relatively so much greater than ours? Aren't people perhaps alarmed at the wrong things?

There would be danger in this great volume of debt, both public and private, if our country were destined to stagnation or retrogression. But debts are relative things. They are great or small relative to income. When our national income had shrunk to less than \$40 billions a year in 1932 and our national debt was approximately \$20 billions, the debt load and the debt burden were relatively far greater than was the case in 1937 when, although our national debt had increased to about \$37 billions, our national income had risen to \$70 billions.

The critics see the debt, but they appear to fail to see its relationship to national income, and thus miss the point which the President made in his annual message to Congress. When they say or imply that the Administration regards the Federal debt as a national blessing, that is sheer misrepresentation. Nobody has contended that it is a blessing, but merely an unavoidable means to the larger objec-

tive of full recovery and restoration of national income. Viewed in this proper light, it can hardly be considered the frightful blight that the critics' alarm about it would indicate.

It is an expedient, a necessity, just as in the case of the increase in our national debt during the World War, when our debt increased by \$25 billions in the period of approximately two years. Nobody has contended that that increase in debt was a blessing. It was a necessity to fight the war, just as the present increase in debt has been a necessity to fight the depression.

People frequently fall into the error of saying that the present generation has placed a mortgage on future generations and that we are handing down to our children staggering indebtedness which they did not incur but will be required to pay. The fallacy here springs from the notion that we have, and will have for all eternity, a fixed national income out of which to service and pay debts. There is, of course, no reason to think that this will be the case. With the far larger national income that should be possible in their time, our children and our grandchildren will find the burden of debt no greater than we do today.

This is not only a common but also an ancient fallacy. In his "History of England", Lord Macaulay called attention to it a long time ago. Recounting how the British debt rapidly mounted and how "shallow politicians were repeating that the energies of the people were borne down by the weight of the public burden", yet how England's wealth

grew notwithstanding the alarm over the size of the public debt, he wrote:

"It can hardly be doubted that there must have been some great fallacy in the notions of those who uttered and of those who believed that long succession of confident predictions, so signally falsified by a long succession of indisputable facts. To point out that fallacy is the office rather of the political economist than of the historian. Here it is sufficient to say that the prophets of evil were under a double delusion. They erroneously imagined that there was an exact analogy between the case of an individual who is in debt to another individual and the case of a society which is in debt to a part of itself; and this analogy led them into endless mistakes about the effect of the system of funding. They were under an error not less serious touching the resources of the country. They made no allowance for the effect produced by the incessant progress of every experimental science, and by the incessant efforts of every man to get on in life. They saw that the debt grew; and they forgot that other things grew as well as the debt.

"A long experience justifies us in believing that England may, in the twentieth century, be better able to bear a debt of sixteen hundred millions than she is at the present time to bear her present load. But be this as it may, those who so confidently predicted that she must sink, first under a debt of fifty millions, then under a debt of eighty millions, then under a debt of a hundred and forty millions, then under a debt of two hundred and forty millions, and lastly under a debt of eight hundred millions, were beyond all doubt under a twofold mistake. They greatly overrated the pressure of the burden; they greatly underrated the strength by which the burden was to be borne."

You will note that the "monstrous" British debt which existed in Macaulay's day was 800,000,000 pounds. Today it is 7,797,000,000 pounds and the British people are still not ruined nor have the children or grandchildren of the alarmed false prophets, referred to by Macaulay, been in chains, borne down hopelessly by the debt saddled upon them by reckless ancestors.

Taxes, to be sure, are high in Great Britain--so high that if we had the same rates in this country, our budget would be balanced today. Yet, as is frequently pointed out, Great Britain is relatively more prosperous than we are. Obviously there must be something wrong in the theory that a large debt and high taxes would necessarily prove so pressing a burden as to destroy enterprise and impoverish a country.

If taxes fall on the mass of the consumers, thereby draining away their purchasing power, and if the proceeds are used predominantly to pay interest to holders of the debt, the effects undoubtedly would be very serious. This has not been, however, the course which the British have pursued. The interest on the debt is more than covered by taxes on incomes and wealth; that is, taxes paid by the same class of people who hold the debt and receive the benefit of interest payments on it. In fact, the British tax system is so arranged that, combined with the well developed social security services they enjoy, a net balance of purchasing power is transferred from the wealthier members of the community to the great mass of consumers. In this way consumption is stimulated and stabilized. There can be little doubt but that this factor has accounted to a considerable extent for the remarkable record of the British economy in the depression and the subsequent recovery.

That the interest on the debt is received in large part by the same group who pay the taxes to finance it was recognized in the report of the Colwyn Committee:

"A large amount of the Income Tax and Super-tax paid by persons with incomes exceeding £2,000 comes back to themselves as a class in the form of War Loan interest. It is clear that this internal transfer does not diminish the aggregate real income of the class. It increases the income of the

debt holder exactly as it decreases the income of the taxpayer. In relation to real income, therefore, the tax so applied is not onerous. So far as the debt interest of the Super-tax paying class is provided from the Income Tax paid by other classes, there is an actual increase of their income."

Advocates of a balanced budget as a means to recovery are somewhat weak on their recent economic history. In 1929, we had a balanced budget, an automatic gold standard, and we were free of the regulative and so-called restrictive laws about which there is so much complaint today. We continued to enjoy all these blessings in 1930, 1931 and 1932. To be sure, the budget did not remain in balance throughout this period, but the Hoover Administration tried strenuously to bring it into balance and was only defeated by the steady fall in national income, with a consequent precipitate drop in revenues.

Notwithstanding the unbalanced budget and notwithstanding the other acts of the present Administration, of which there is so much complaint, we had a very large degree of recovery in 1935 and 1936, and, in fact, right up to the middle of 1937. In these years business profits were very large; private business activity was going at a reasonably high rate; tax collections increased; and for a period of nine months in 1937, with the social security levies added in, the Treasury collected more than it spent. On a cash basis of income and outgo, we not only had a balanced budget, but a surplus of approximately \$100 millions. That cash balance was achieved, not by slashing Government expenditure to any considerable extent, nor by imposing rates of taxation on incomes and inheritances comparable to those of the British, but rather because of the increase of the annual income

of the country by some \$30 billions since 1932. The balance was undoubtedly brought about too quickly, especially in view of the fact that the new social security taxes and the reduced WPA expenditures caused a sharp squeeze on consumers' purchasing power at the critical period in the development of the recovery. In general, however, the program of increasing revenues and working toward a balanced budget by increasing the national income had proved itself to be sound.

Critics of the Administration are fond of harkening back more than a century to Thomas Jefferson and Andrew Jackson, both great statesmen of our pioneer days, when the country was just beginning the most spectacular growth in the history of the world. The economics suitable for these pioneer days can hardly be applied without scrutiny and adaptation to the entirely different economic environment of today.

Outlets for investment today for the profitable employment of our savings are far more restricted than was the case when we were a fast growing nation with an ever-widening frontier, when our supply of capital was limited, when we had more outlets and opportunities for investment than we had capital to supply the demand. Business not only borrowed savings and put them to work as rapidly as savings accumulated, but borrowed heavily from abroad, and all this vast stream of money went into the building of America.

Today we have no such rapidly expanding frontiers. We have the phenomenon of more savings, more capital, than can find productive

outlet in new enterprise. That is the dominant reason why the owners of capital today put their money into Government securities notwithstanding the low yields, instead of putting their money into the building of new plants and to produce goods.

In addition, we have witnessed since 1932 the most extraordinary inflow of foreign capital in our history, seeking refuge and seeking outlet here because since this Administration took office America has been all along, notwithstanding the prophets of evil, a better haven than any other in the world today. Thus we have been glutted with foreign funds.

Why have these accumulations of domestic and foreign capital failed to go into new production, as was the case through much of our history? The explanation cannot lie in the existence of an unbalanced budget for the money which the Government has borrowed from these individual and corporate owners of the capital was only taken over because it was idle, because the owners of these funds could find no profitable place to put them. The Government's spending of this money created business that otherwise would not have been done. It resulted in profits that otherwise would not have accrued. And it flowed right back again into bank balances, largely held by corporations and still seeking outlet. Although there seems to be a feeling that money thus borrowed and put to work by the Government is somehow contaminated, whereas, if private business put it to work it would be sanctified, it does not appear that

the merchant or little storekeeper sees any difference between the dollar spent in his store, for example, by a WPA worker and a dollar spent in his store by an American citizen fortunate enough to have a job in private industry.

Why, it may be asked, were we able to recover from the depression of 1921 without an increase in Federal expenditures? The school of thought which has assumed all along that recovery would come from so-called "natural forces" if Government would only get out of the way, should look a little more closely at the history of that post-war recovery. It came at a time when the nation turned from war to peace, when industrial Europe was still prostrate, when there was one of the most severe housing shortages in our history, when the productive plant of the country needed to undergo a rapid conversion from a wartime to a peacetime basis, when we were still making huge foreign loans, many of which have since proved uncollectible. Many experts have pointed out the housing revival as the leader of that recovery, but there was also a tremendous expansion in the capital and durable goods industries, especially in automobiles and public utilities among others. However, the 1921-22 period was characterized by a drastic fall in prices after the high prices of war days. This price decline was precipitated by what at that time was called the "buyers' strike". We have not had since 1929 either the foreign markets, the latent domestic purchasing power, or by comparison, the urgent unfulfilled needs, nor have we at

the moment the prospect for expansion of new industries that existed then.

We discovered in the late Twenties that savings accumulated faster than outlets for their productive use. They went into bidding up the stock market and other equities, and into building huge apartment houses and office buildings that have never been able to justify the investment. They did not flow into new production, and the basic reason is that relatively the purchasing power of the markets have not existed since 1929 for new goods that prevailed immediately after the war ended and in the early Twenties. It is for this reason that the Administration, recognizing that the old diagnosis no longer fitted the case, undertook to revive purchasing power at home after the Hoover Administration had waited for more than three years for natural forces to come to the rescue.

On the question of paying off the public debt, no responsible students of the problem maintain that debt repayment would never under any circumstances be desirable or possible. That is an entirely unfounded misapprehension. The point is that as private debt expands, public debt may be paid off, but that to pay off public debt while private business is still short of reasonably full recovery, would have a devastating deflationary influence under present-day conditions.

This point is also dealt with by the Twentieth Century Fund in their study, "Debts and Recovery". Under the heading, "The Mythology

of Debt Maturities", they said (page 14):

"Not only do few debtors intend to get out of debt when their obligations mature, but the economic system is so made up that any sudden and general attempt to get out of debt would be a great calamity. If the banks tried successfully to pay off their debts, for instance, they would deprive us of most of what serves as money in this country, and we should have a catastrophic fall of prices. If merchants all paid off their debts in a short time, they would either have to go out of business or to press their debtors unmercifully. Everyone who had a charge account, for instance, would have to pay it off and make all future purchases for cash, which would disrupt markets for such things as clothing and furniture.

"Similar objections would apply to the paying off of any important class of debts."

Thus, the point is the timing of the paying off of public debt, just as the same vital consideration applies to the timing of Government expenditure. This question of timing and the effect of a too sudden withdrawal of the Government's contribution to buying power in 1937, as compared with 1936, has been explained by Dr. Alvin H. Hansen, Professor of Political Economy at Harvard University. Speaking before the Academy of Political Science in November 1937, before the Administration launched its program in the spring of 1938, he said:

"We are currently witnessing a rapid shift in income-creating expenditures both public and private. The props which have been lifting the level of consumption are being withdrawn. The automobile boom has tapered off. We are moving toward a saturation point in installment sales. The government stimulus to consumption is in process of being completely withdrawn in a dramatic reversal from a plus of three billion dollars to a minus of four hundred million dollars within a single year. The full force of this sudden change upon our recovery has perhaps not been adequately appraised. One explanation for this is probably

that the public has fixed its eyes on the formal balancing of the budget. And since this is not yet balanced, the impression is abroad that the government is still lavishly spending more than it is taking from the public in tax receipts. But this is looking at the form and not the substance. From the standpoint of consumption stimulation, the 'economic budget', so to speak, in contradistinction to the formal fiscal budget, will already in the current year, according to the President's estimates, be more than balanced. In other words, when we take account of the social security taxes, including both old-age and unemployment insurance, it is found that the government in this fiscal year is actually exerting a deflationary pressure on the volume of consumption.

"I do not draw the conclusion that there is inevitably impending a major recession. But I do say that if we are to avoid some considerable recession, either consumption must be pushed forward or else investment must be pried loose from the narrow limits imposed by the immediate requirements of the existing volume of consumption.

"We cannot lightly assume that consumption, unaided by government spending, will of itself continue to rise."

His perception was right. The too sharp withdrawal of Government stimulation was an important factor in the sharp recession, which was not reversed until the Government again stepped up its activities.

As to the dilemma presented by this problem of an abundance of capital with relatively meager outlets in new production, Professor Hansen, in the course of the same address, had this to say:

"The all-important desiderata are total income and employment. Had governmental expenditures been combined with a planned program of cost reduction, there might have followed an expansion of income and employment not only via a stimulation of consumption, but also via a stimulation of new investment. This program we have not adequately achieved, and now that the consumption stimulus is being withdrawn, the forbiddingly high level of costs renders it difficult for investment to hold back the re-

ceding tide. Thus we are left without the necessary volume of total expenditures, whether for consumption or investment, to carry us on toward full recovery.

"This is the fatal error we have made. But I must not overstate the case. For there is one other consideration that troubles me and raises uneasy doubts whether, though we had managed our affairs ever so wisely, we should even so have been safely and securely on the road to full and sustained recovery. I refer to certain technological and other conditions which in part determine the volume of investment outlets. For it is not true, as is sometimes alleged, that technological conditions have been uniformly and at all times equally favorable for new investment outlets. Not every period can be characterized as a kind of new industrial revolution. The introduction of power-driven machinery was followed by a prolonged period of difficult readjustment. In a later age, as the curve of railway construction eventually flattened out, it was discovered that there was no adequate ground for the easy optimism that plenty of promising investment possibilities would surely appear to fill the gap. In point of fact they did not appear in adequate volume, and so there ensued toward the close of the last century a prolonged period of secular stagnation. It is true that in the course of time technology gave birth to the electrical and automobile age and with it a new era of highway construction. Altogether these developments swallowed up vast sums of capital; but it is not difficult to see that this latter episode is nearing completion and, as has happened before, nothing else of equal magnitude has so far appeared above the horizon. Add to this the wholly new fact of a rapidly approaching cessation of population growth. Let the perennial optimist reflect on the enormous masses of capital that found investment outlets during the nineteenth century for no other reason than that the population of England quadrupled, that of Europe trebled, while that of the United States increased fifteen-fold. For these and other reasons we shall do well to ponder deeply the problem of the long-waves, or, if you prefer, the problem of secular stagnation, the magnitude of which may well, in the period which lies before us, quite overshadow that of the business cycle. Viewed against this background, governmental expenditures take on a new significance."

As for inflation dangers, everyone will agree that we cannot go on indefinitely creating debts and piling up deficits. However, inflation results when we create too much money relative to real wealth. We must remember that more than 90 percent of what we use for money is bank credit. In addition, we have our supplies of currency, including gold and silver. Bank credit normally expands and contracts in accordance with the needs of business. When we create too much debt, too great a volume of bank deposits which are a form of debt, or, in other words, when we create too much money and too little production of real wealth, then money becomes cheap relative to real wealth. That is monetary inflation.

We should look upon money as a means to an end, and we must consider its creation and extinguishment in relation to the creation of real wealth, of which it is but a symbol and a shadow. So long as idle facilities and idle man power are being used to create real wealth, and are not at the same time being taken away from private industry, it cannot be said that inflation is taking place.

What critics of the Administration undoubtedly fail to understand is the necessity for a more flexible governmental functioning. Very simply stated, it means that in depressed times, instead of trying to offset shrinking Government revenue with higher taxes or reduced expenditure, that the Government frankly accept deficits temporarily, not permanently, so that the Government's net contribution to the spending stream may tend to prevent deflationary forces from continuing downward and in order to stimulate an upturn. Then, at the other swing

of the cycle, as business recovery progresses, the Government shall taper off its contribution as private contributions to the spending stream are made so that the deficits may be eliminated, the budget balanced, and the debt reduced.

The same general considerations apply to taxation, namely, that instead of trying to increase tax rates in a depression when business and individuals are least able to stand the added rates, it would be better to reduce taxation temporarily at least, even though it increased the deficit, so that the remission of taxes would tend to stimulate revival. Conversely, in boom times, instead of reducing taxes as we have done in the past, it would be a wiser procedure to increase the rates both as a means of restraining unhealthy speculative developments and as a means of making up for the deficits incurred on the other side of the cycle.

Surely this is not an approach lacking in economic soundness or inconsistent with our system. In fact, it is the only logical alternative to avoid the impossible policy of Government inaction and non-intervention in depression--a policy which the Hoover Administration vainly tried--or, at the other extreme, to avoid regimentation and dictatorship. It is entirely a practical approach to an admittedly difficult situation that did not arise in pioneer days or when Government was not compelled to intervene on the large scale made necessary by present-day problems and by changed conditions throughout the world.

There are manifest difficulties of administration. Certainly, once the objective is fully understood, even though the timing and direction of expenditures were far from perfect, it would be preferable to what has clearly been in the past a failure adequately to appreciate the unbalancing influence of wrongly timed expenditures and taxes.

In their illuminating volume, "Toward Full Employment", the authors devote a good deal of attention to how the problem might be organized on a practical basis. These authors are practical men. They are, Henry S. Dennison, President of the Dennison Manufacturing Company; Lincoln Filene, President of William Filene's Sons Company; Ralph E. Flanders, President of Jones and Lamson Machine Company; and Morris E. Leeds, President of Leeds and Northrop Company.

In advocating exactly the general approach adopted by the Administration and in their discussion of the principles of a flexible budget, which they strongly advocate, they reach the conclusion that this is the most practicable and the soundest approach to the problem. These business men cannot be dismissed as "crackpots".

It is, of course, not merely a question of the admittedly limited amount which the Government can contribute to the spending stream, but equally vital is how the contribution is made. If it is made with a view to stimulating private business recovery, that is one thing. If it is made in a way that discourages private business recovery, it defeats the fundamental objective of the whole program.

Timing is also important, as we witnessed from the experience of 1936 and 1937. Thus, even if the Government had no debt whatever and if we were in a period of full employment and speculative excess, to have the Government contribute more to the spending stream at that time would be unsound. In other words, it is not simply a question of whether we do or do not have any public debt. Manifestly, with no debt, the wrong timing would be bad, just as if the debt were insupportable it would be unwise to embark upon deficit-financing. This is evident from the British situation where the debt was already so large that it was considered important not to increase it and better, therefore, to balance the budget, not by a sharp reduction of Government expenditures, but by increased taxation.

That many people fail to comprehend the basic principles involved is evident from the fact that they ask why, with the \$3 billions deficit incurred by the Hoover Administration, we did not have a recovery. But this is to miss the whole point. The Hoover Administration unbalanced the budget. Indeed, it had no choice because the budget unbalanced itself due to the fact that instead of adopting this very program on a scale adequate to halt the deflation, they did virtually nothing until late in the depression when money was rushed into banks, insurance companies, and other business and financial institutions in the attempt to prop them up while the credit structure continued to crumble. They failed completely to put a bottom under purchasing power, which is at the very basis of a program of this character.

We hear over and over again the statement that prosperity can be restored by restoring confidence, by "eliminating needless frictions and restraints, and by freeing the enterprise of a great people who want jobs, not charity; work, not taxes". Surely no fair-minded man would take exception to any of these noble phrases. Everybody is for all of that. The practical point is, however, how can confidence be restored?

After the crash of 1929 we did not have these things, these Administration policies, of which the people complain, and there was no confidence. Business grew steadily worse. In 1935 and 1936 we did have innumerable things of which people complained, and, yet, we had a very large recovery of business. Indeed, it might be said that there was too much confidence of the wrong kind. Certainly business profits were very large, comparing favorably with the late Twenties.

Many people seem to think that confidence is something abstract that can be conjured into being by some form of incantation such as Mr. Hoover practiced so assiduously, but unsuccessfully, when he was assuring the nation that prosperity was just around the corner. Confidence is based upon something far more tangible; namely, the prospect for making a profit. The prospect for making a profit arises when business sees an opportunity to build plants or to use existing ones to produce goods to sell to customers. That means that customers must have some money with which to purchase the goods.

Critics of the Administration's policies are still mystified as to what produced the recovery beginning in 1934. According to their view, it could not, of course, be even remotely connected with stimulation of purchasing power provided by the Government. Likewise, the downturn in 1937, of course, had nothing whatever to do with the withdrawal of the Government's stimulus to purchasing power. It was all in some mysterious fashion produced by "natural forces".